

OPINION NUMBER 92-2

DATE: December 17, 1992

SUBJECT: Council Approval of Consultant Contracts and
Custodial Bank Contracts

REQUESTED BY: Larry Grissom, Retirement Administrator

PREPARED BY: Richard A. Duvernay, Deputy City Attorney

QUESTIONS PRESENTED

In the normal operation of the Retirement System, issues periodically arise which inevitably lead to questions about the authority and role of the Board of Administration ("Board") as contrasted with the authority and role of the City Council ("Council"). You recently brought two of these issues to the attention of this office when you posed the following questions:

1. Must the Board obtain Council authorization to contract for consulting services or to contract with a bank to serve as custodian of the Retirement Fund?
2. Must the Board follow Council Policies and Administrative Regulations in selecting a consultant or custodial bank?

ANSWER

The Board is vested with exclusive power under the Charter of The City of San Diego ("Charter") to manage the Retirement System, to administer and invest the Retirement Fund and to appropriate payments from the Retirement Fund. Council is vested with the exclusive power to establish the Retirement System, to enact general ordinances defining the conditions under which persons may be admitted to benefits and to define certain permissible investment categories. Council may enact any ordinance and may create any policy or administrative regulation affecting the Retirement System, provided the legislative mandate does not usurp power exclusively vested with the Board by the Charter or by Section 17 of Article XVI of the California Constitution.

In our opinion, the Board is not required to obtain Council's approval before contracting with a bank to serve as custodian of the Retirement Fund because such a requirement would usurp power exclusively vested with the Board by the Charter and

the California Constitution.

Depending upon the nature of the services desired, the Board may be required to obtain Council's approval to contract with a consultant and may be required to follow City Council Policy 300-7 and Administrative Regulation 25.70 with respect to the selection process used to retain the consultant. If the consultant services relate to analysis of conditions of admission into the Retirement System or conditions upon which persons receive benefits, Council's consultant selection policies must be followed. However, if the services relate to administration or investment of the Retirement Fund, Council's consultant selection policies need not be followed.

BACKGROUND

This office has been called upon in the past to render opinions regarding the role of the Board and the role of the Council in the Retirement System. See, for example, 1 Op. City Att'y 1 (1985); 2 Memorandum of Law, 568 (1986); Op. City Att'y 15 (1982).

More importantly, in the last fifty years, three court opinions have been published involving our Retirement System where the court has addressed and contrasted the role of Council and the Board. See *Bianchi v. City of San Diego*, 214 Cal. App. 3d 563 (1989); *Grimm v. City of San Diego*, 94 Cal. App. 3d 33 (1979); *Montgomery v. Board of Admin., Etc.*, 34 Cal. App. 2d 514 (1939).

In addition, in the November 3, 1992 general election, a ballot initiative known as The California Pension Protection Act of 1992 ("Act") was approved by the voters of this state. The Act amends Section 17 of Article XVI of the California Constitution and impacts the role of the Council and the Board in our Retirement System. These laws and opinions form the basis for this analysis.

ANALYSIS

The City of San Diego is established under a charter. The Charter is the supreme law of the City, subject only to conflicting provisions in the United States and California Constitutions. *Grimm v. City of San Diego*, 94 Cal. App. 3d at 37. The Charter, in establishing boundaries, acts as a limitation on the powers of municipal officers. *Id.* at 38. The duties and powers designated in the Charter to the Mayor and Council, or to any particular department of our municipality, are considered in the nature of public trusts and cannot be delegated, surrendered or otherwise exercised by any other officers or departments. 2 McQuillin, *The Law of Municipal Corporations* 1136 Section 10.42 (3d ed. rev. 1988).

For example, in *Montgomery v. Board of Admin., Etc.*, the

issue concerned a conflict between Charter section 141, which requires ten years of continuous service for benefit eligibility, and a then existing San Diego Municipal Code ("SDMC") section which permitted the totaling of intermittent periods of employment to satisfy the ten year vesting requirement.

In 1938 the Board suspended payments to pensioners whose eligibility had been calculated by the method of totaling intermittent periods of employment. Following that action, W.S. Montgomery filed a lawsuit asking the court to determine and declare his rights and the rights of all other pensioners under the Charter and the SDMC.

The court identified the conflict between the Charter and the SDMC, elaborated upon the supremacy of the Charter, then ruled that "in so far as the SDMC ordinances attempted to substitute intermittent service for continuous service as a basis for retirement, their provisions are void as contrary to the charter and as an attempt to amend the charter in an unauthorized manner." *Id.* at 520.

Charter section 141 was subsequently amended by a vote of the people in 1945, but the lessons taught by Montgomery are timelessly topical. In the legislative web of laws affecting the Retirement System, Charter provisions reign supreme over ordinances. More importantly, a clear understanding of the allocation of powers granted and limited by the Charter is necessary in order to avert the potential of having a Board action or Council action later declared void by the courts. What follows here is a review of Charter and constitutionally allocated powers which must be necessarily exercised by the Board or, the Council for the continued operation of the Retirement System.

I. General Legislative Power

Section 11 of the Charter sets forth the general legislative power of the Council and reads as follows: "All legislative powers of the City shall be vested, subject to the terms of this Charter and of the Constitution of the State of California, in the Council, except such legislative powers as are reserved to the people by the Charter and the Constitution of the State."

A cardinal rule of Charter interpretation is that a particular enumeration of power necessarily implies the exclusion or limitation of all others. 2 McQuillin, *The Law of Municipal Corporations* 1064 Section 10.23 (3d ed. rev. 1988). The Council's otherwise plenary legislative power can only be qualified by an express limitation of the Council's legislative power found in the Charter or California Constitution, or by an implied limitation of power by virtue of a Charter or

constitutional grant of power to an entity other than Council.

II. Charter Sections Expressly Granting Powers to Council

Charter sections 141, 144 and 146 confer express grants of legislative power to the Council on issues related to the Retirement System.

Section 141

Section 141 states that "The Council of the City is hereby authorized and empowered by ordinance to establish a retirement system" This provision has never been challenged in court and is of no practical importance now that our system has been established.

Section 144

Section 144 grants three important and distinct powers to the Council which will each be addressed below.

A. Powers Related to Composition of the Board

Section 144 grants the power to the Council to appoint four citizen members to the Board, with the qualification that one of those citizen appointees must be an officer of a local bank.

The Council's power to appoint members to the Board has never been directly challenged. However, in *Grimm v. City of San Diego*, the court did significantly elaborate upon the Charter mandated composition of the Board. In 1977 the Council passed an ordinance establishing a nine member quorum requirement for the Board. Charles Grimm, along with other interested affected parties, sued the City challenging the Council action. Recognizing that the Council is empowered under Charter section 146 to enact general ordinances affecting the Retirement System which are consistent with the Charter (see analysis below), the court concluded that in order to decide whether the quorum requirement ordinance was consistent with the Charter, it was first necessary to discern the meaning of the Charter provisions mandating the composition of the Board.

Significantly, the court stated that "the evident purpose of . . . the Charter section mandating Board composition is to secure a board as objective, fair and competent as possible through the representation of all those interests necessarily involved within a public service retirement system." *Grimm v. City of San Diego*, 94 Cal. App. 3d at 39. The court further stated that "the necessarily implied intent of the composition requirement is to have this 'representative' Board benefitted by the perspectives, opinions and values of its varied membership and thus their vote representative of such diverse interests." *Id.* at 40. The court went on to hold that the quorum requirement ordinance was a valid exercise of Council power within the meaning of Charter section 146 because the ordinance was consistent with and furthered the intent of the Charter section

provision which mandates the composition of the Board.

B. 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. This grant of power to the Council, although never directly challenged was recognized by the court in *Grimm v. City of San Diego*, 94 Cal. App. 3d at 39. There, the court acknowledged the reasoning expressed by another court in *Lyons v. Hoover*, 41 Cal. 2d 145 (1953), where identical charter language in Sacramento's charter was challenged.

In *Lyons*, Sacramento's controller, A.O. Hoover, refused to draw warrants to pay for benefits owed to Margaret Lyons after being directed to do so by the retirement board. The controller refused to draw the warrants in the manner calculated by the board because it would be contrary to a resolution adopted by the city council fixing the manner of payment differently.

Margaret Lyons sued the city's controller and the court was required to interpret a provision of the Sacramento City Charter identical to ours which granted the council power to enact "general ordinances" defining benefits. The court voided the action by the council and declared that the resolution was not binding on the retirement board. *Lyons*, 41 Cal. 2d at 148. Interpreting the charter, the court concluded that "while the city council may control the board's activities by general ordinances, with respect to benefits, it is the function of the board to act in individual cases." *Id.*

C. Power to Define Certain Investment Categories by Type or Class

Section 144 grants the Council the power to define for the Board "by investment type or class" certain authorized investment categories which are in addition to the investment categories which the Board has the exclusive power to define. This power, however, is qualified. The Council is specifically precluded, and the Board is exclusively empowered, to define investment categories which fall within the general category of "bonds or securities which are authorized by General Law for savings banks."

Although this particular grant of power has never been challenged in a court case, in 1985 it was the subject of much discussion when the Rules Committee of the Council asked the City Attorney for an opinion interpreting and clarifying this section of the Charter. 1 Op. City Att'y 1 (1985) (attached) extensively discussed the allocation of power in the Charter between the Board and Council with respect to investment responsibilities.

Without repeating substance from the aforementioned Opinion,
it is worth noting that the conclusions drawn there by the City Attorney remarkably parallel the instant analysis of Charter allocation of power with respect to benefits. From this, a pattern to the Charter emerges. The Council is granted power to exercise discretion in defining conditions upon which benefits will be awarded and to exercise discretion in defining certain permissible investment categories. The Board is granted power to exercise discretion in deciding whether a particular benefit should be granted and the power to exercise discretion in deciding how the Retirement Fund should be invested within the particular investment categories the Board chooses and those additional investment categories authorized by the Council.

Section 146

Section 146 empowers the Council to enact any and all ordinances necessary to carry into effect the provisions of Charter sections 141 et seq. This general proclamation of Council power is consistent with the general legislative power conferred by Charter section 11 to the Council, as analyzed above. However, it does not authorize the Council to enact any SDMC section which conflicts with a charter provision. *Grimm v. City of San Diego*, 94 Cal. App. 3d at 39.

III. Charter Sections Limiting Council's Power

Charter sections 141, 143.1, 144 and 145 limit the Council's legislative power to affect the Retirement System.

Section 141

As discussed above, the Council is empowered to define by general ordinances the conditions upon which benefits will be awarded. However, this power is not unbounded. The Council's power to define benefits is limited by, and must be consistent with, the requirements set forth in Charter section 141. Charter section 141 reads in pertinent part as follows:

No employee shall be retired before
reaching the age of sixty-two years
and before completing ten years of
continuous service, except such
employees may be given the option to
retire at the age of fifty-five years
after twenty years of continuous
service with a proportionately
reduced allowance. Policemen,
firemen and full time lifeguards,
however, who have had ten years of
continuous service may be retired at
the age of fifty-five years, except

such policemen, firemen and full time lifeguards may be given the option to retire at the age of fifty years after twenty years of continuous service with a proportionately reduced allowance.

The Council may also in said ordinance provide:

(a) For the retirement with benefits of an employee who has become physically or mentally disabled by reason of bodily injuries received in or by reason of sickness caused by the discharge of duty or as a result thereof to such an extent as to render necessary retirement from active service.

(b) Death benefits for dependents of employees who are killed in the line of duty or who die as a result of injuries suffered in the performance of duty.

(c) Retirement with benefits of an employee who, after ten years of service, has become disabled to the extent of not being capable of performing assigned duties, or who is separated from City service without fault or delinquency.

Section 143.1

Section 143.1 is a relatively straightforward limitation prohibiting the Council from enacting any ordinance affecting the vested benefits of any employee or retiree without the approval of a majority vote of the affected members.

Section 144

Charter section 144 states that the Retirement System shall be managed exclusively by the Board and that the Board shall have exclusive control over the administration and investment of the Retirement Fund. To "manage" means to engage in the act or art of managing. Management is defined as: "The executive function of planning, organizing, coordinating, directing, controlling, and supervising any industrial or business project or activity with responsibility for results." Webster's Third New International Dictionary 1372 (1976).

A conflict over "management" of our System has never found its way into the courts. The Council is presumably precluded by this provision of the Charter from taking any action affecting

staffing requirements, organizational structure or operation policies of the Retirement System.

The issue of Council versus Board control of the Retirement Fund is not repeated here as it was fully discussed above in the section of this memorandum describing powers expressly granted to Council under Charter section 144.

Section 145

Section 145 prohibits the Council from authorizing any payment from the Retirement Fund. Payments may only be made from an order issued by the Board.

IV. The California Pension Protection Act of 1992

On November 3, 1992, a majority of the voters in the state approved Proposition 162, a ballot initiative titled The California Pension Protection Act of 1992 ("Act"). The Act amends Section 17 of Article XVI of the California Constitution to read in pertinent part as follows:

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 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 retirement 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 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.

(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.

At this point in time, it would not be prudent to boldly critique the impact the Act will have on our System. In the coming months, the Act will be the subject of much commentary, it will undoubtedly be challenged in court, and ultimately its precise meaning will be decided by the courts. At present, the best we can do is hazard a prediction with respect to how the Act will legally impact our System.

The Act is a legal milestone because it elevates the specific subject matter contained within it from a matter previously considered purely a "municipal affair" under the "home rule doctrine," to a subject matter of statewide concern.

Under Article XI, Section 5 of the California Constitution, City Charters may provide that cities "may make and enforce all ordinances and regulations in respect to municipal affairs, subject only to restrictions and limitations provided in their several charters and in respect to other matters they shall be subject to general laws." Section 5 also grants plenary authority for chartered cities to provide for the compensation of municipal officers and employees. Prior to the passage of Proposition 162, courts have held that all "provisions for pensions relate to compensation and are municipal affairs within

the meaning of the Constitution." *Grimm v. City of San Diego*, 94 Cal. App. 3d at 37. However, Section 4 of the Act, which begins "notwithstanding any other provisions of law or this Constitution to the contrary," appears to carve out a narrow exception to the "home rule" provision in Article XI, Section 5, in the case where a charter city has established a retirement system for City employees. The exception is strictly limited to the subject matters addressed in the Act. See, *In re Redevelopment Plan for Bunker Hill*, 61 Cal. 2d 21, 74 (1964). Matters not addressed in the Act but related to the administration of a public pension system, such as control over benefit definition and distribution, will continue to be municipal affairs insulated from potential state legislation.

The practical implication which will follow from passage of the Act is that the Board, Council and the courts will be required to harmonize any interpretation of our Charter with the more elaborate and comprehensive language contained in the Act, including the findings and declarations contained in Section 2 of the Act and the declaration of purpose and intent contained in Section 3 of the Act.

One of the more important findings is contained in Section 2, paragraph (g) of the Act which states: "The integrity of our public pension systems demands that safeguards be instituted to prevent political 'packing' of retirement boards, and encroachment upon the sole and exclusive fiduciary powers or infringement upon the actuarial duties of those retirement boards."

One of the more important declarations of purpose and intent is contained in Section 3, paragraph (e) of the Act which provides that the Act is intended:

To 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.

The Act should have little or no practical impact on the way our Retirement System currently operates because it practically duplicates our Charter scheme. To the City's credit, when the Charter was amended in 1925 to create a general member

retirement system for City employees, our people had the foresight to act upon the same public policy considerations which were reduced to writing sixty-seven years later by the drafters of the Act.

In our view, the word "Legislature" as used in sections (f) and (g) of the Act means the California Legislature, consisting of the Senate and Assembly. (See generally California Constitution, Article IV.) Since the California Legislature has never before attempted to dictate the composition of the elected members of the Board or the manner in which the Board invests the Fund, these provisions have no impact on our System, and likely never will. Ultimately, the interpretation of this provision of the Act, as with the balance of it, is a matter for the courts to decide and our System will be bound by those determinations.

CUSTODIAL BANK CONTRACT

Individually and collectively, Board members are trustees of the Retirement Fund charged with the delicate fiduciary responsibility of obtaining the maximum degree of investment return for Retirement System members, while at the same time prudently safeguarding and protecting the trust property. *Purdy v. Bank of America*, 2 Cal. 2d 298 (1935); 1 Op. City Att'y 1 (1985).

Obviously, the process of selecting a bank to serve as custodian of the Retirement Fund is one of the Board's most important fiduciary responsibilities associated with administration and investment of the trust. As previously discussed, Charter section 144 specifically prohibits Council, or anyone else, from infringing upon the Board's exclusive responsibility for administering the Retirement Fund. The Act also confers "plenary authority and fiduciary responsibility for investment of moneys" with the Board.

Hence, the Council cannot legislatively require the Board to seek its approval before contracting with a custodial bank. Likewise, the Council cannot interfere with the Board's selection process by dictating to the Board by resolution or ordinance how it should or must go about discharging its fiduciary responsibility in selecting the custodial bank. The Board is, of course, legally accountable for this financial decision and official behavior under the laws governing the standard of care required of all trustees. Probate Code Section 16002 et seq.; 76 Am. Jur. 2d Section 409 et seq. (1992).

Based on the Charter, the Act and the reasoning cited above, it is our opinion that the Board, utilizing a selection process it deems prudent, may contract with the bank of its choice to serve as custodian of the Retirement Fund.

CONSULTANT CONTRACTS

As a general rule applicable Citywide, professional consultant contracts are not subject to the competitive bidding requirements of Charter section 28 or 94 and not subject to Civil Service Commission authorization. See Op. City Att'y 28 (1974) and Memorandum of Law 201 (1974).

Consultants who are hired under the authority of the City Manager are subject to the provisions of SDMC section 22.0226, which requires the Manager to seek Council approval if the cost of the consultant agreement exceeds \$25,000. However, the SDMC is silent with respect to the hiring of consultants by City departments not under the control of the City Manager, like the Retirement System. City Council Policy 300-7 and related administrative regulation 25.70 both address Citywide policies with respect to selection of outside consultants applicable to both managerial and nonmanagerial departments.

Must the Retirement System adhere to Council Policy 300-7 and related administrative regulations in the hiring of consultants? We think the answer depends upon the nature of the services provided by the consultant. If the services relate to a project or subject matter within the purview of power granted by the Charter to Council, then yes, Council Policy must be followed. On the other hand, if the services relate to a project or subject matter within the scope of power granted by the Charter or the Act to the Board, the Board is not required to follow Council policies in selecting a consultant.

A decision should be made on a case by case basis as to the nature of the consulting services desired by the Board. If the services relate directly to either "management" of the Retirement System or "administration and investment of the Retirement Fund," then adherence to Council Policy 300-7 and Administrative Regulation 25.70 is not required. However, if the services relate to analysis of the conditions under which persons should be admitted into the System, or conditions under which they may receive benefits (matters of responsibility delegated to the Council by the Charter and not elevated to statewide concern by the Act), then Council Policy 300-7 and the related administrative regulation must be followed.

CONCLUSION

The relationship between the Board and the Council is a complex symbiosis. The Board is not completely independent of the Council, but neither is it completely under the thumb of the Council. This unusual relationship is probably best described in the following passage from the court's opinion in *Bianchi v. City of San Diego*, 214 Cal. App. 3d 571 (1989):

These same factors

demonstrate that the Retirement Board here is not in privity with the City. The retirement system is established as an independent entity; all funds for the system are required to be segregated from city funds, placed in a separate trust fund under the exclusive control of the Retirement Board, and may only be used for retirement system purposes. The Retirement Board acts as an independent administrator empowered to conduct actuarial studies to determine conclusively the amounts of contributions required of the City and participating employees. The board has the sole authority to determine the rights to benefits from the system, and to control the administration of and investments for the fund. The Retirement Board has twelve members, the majority of whom are not City officers: three represent active members of the retirement system, one represents retired members of the system, one is an officer of a local bank, and three are independent citizens of the City.

Most significantly, the retirement system is a contributory system, based on actuarial tables established by the Retirement Board, with contributions to fund the system paid equally by the City and its participating employees. Indeed, the system also encompasses noncity entities and employees. The San Diego Unified Port District, a special entity separate and distinct from the City, and its employees participate in and contribute to the system on an actuarial basis (emphasis in original) (citations omitted).

If the Council is the patriarchal body of the City, then the Board is the proverbial stepchild. And just as the familial

allegiance of a stepchild is often balanced and compromised between two families competing for attention - the same holds true with the Board. The Charter and the Act require the Board to honor certain responsibilities, obligations and allegiances to the City and Council on one hand, and its retired members, contributing members of the Port District and non-contributing members who are no longer employees of the City, on the other hand.

As long as the Retirement System operates efficiently, the legal nuances of Charter power allocation between the Board and the Council may seem inconsequential. Nothing could be further from the truth. The Retirement Fund is presently valued at close to 1.2 billion dollars and millions of dollars are paid into and out of the Fund each year. As illustrated by the cases cited throughout this memorandum, a seemingly innocuous action by the Board or the Council can be transformed into a problem of enormous magnitude with disastrous results.

Respectfully submitted,

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Attachment

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APPROVED:

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