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MEMORANDUM OF LAW

DATE: August 5, 2005

TO: The Honorable Deputy Mayor and City Councilmembers

FROM: City Attorney

SUBJECT: Authority to Remove Members of the Retirement Board of SDCERS

INTRODUCTION

Next week, the City Council is scheduled to consider the removal of the Chair of the Retirement Board of the San Diego City Employees' Retirement System [SDCERS]. The Chair was appointed by the City Council under the newly revised Board composition requirements set forth in Charter section 144. Since then, questions have been raised about whether the Chair has complied with his fiduciary duties to ensure that accurate and complete financial statements are issued and audited on an annual basis. This memorandum addresses whether the City Council may remove an appointee to the Retirement Board for cause.

QUESTIONS PRESENTED

May the City Council remove a member of the Retirement Board that has failed to comply with his or her fiduciary duties to the SDCERS?

SHORT ANSWERS

Yes. The City Council may remove a member of the SDCERS Board for cause. Cause may be established by the failure of a SDCERS Board member to abide by the fiduciary obligations imposed on him or her by the provisions of article xvi, section 17 of the California Constitution. Because section 17 requires that the members of the SDCERS Board properly administer the retirement system, and the failure to ensure that accurate and complete financial statements are issued on an annual basis threatens the future ability of the City to make contributions to SDCERS, the City Council has cause to remove any member of the SDCERS Board who acts to prevent, or fails to act to achieve, the requirements of section 17.

BACKGROUND AND ANALYSIS

The issue of removal of SDCERS Board members was addressed in a June 27, 2005 memorandum from the City Attorney to Councilmember Jim Madaffer, a copy of which is attached for reference. One of the issues addressed in the memorandum was whether the City Council may remove a member of the Board for failing to waive the attorney-client privilege when such waiver is necessary to allow the completion of financial audits and achieve proper administration of the system. The memorandum concludes that such circumstances give rise to removal of a Board member for cause.

Each member of the Board of SDCERS is required to perform their responsibilities as fiduciaries. Central to the performance of these duties is the obligations to ensure accurate financial statements are issued and audited on an annual basis. In that regard, the California Constitution states, in relevant part that:

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.

Cal. Const. art. xvi, § 17.

Peter Preovolos, as the Chair of the retirement board, has failed to meet the fiduciary duty to ensure that accurate and complete financial statements are issued and audited on an annual basis in that Mr. Preovolos has specifically refused to order or permit an AU section 317 illegal acts investigation for the 2003 and 2004 SDCERS financial statements. Mr. Preovolos has been informed through public reports by the City Attorney, letters from the City's outside auditor KPMG, other public reports, and by the existence of U.S. Attorney investigations and District Attorney prosecutions, of the existence of possible illegal acts by prior SDCERS Board members, and despite this knowledge and requests by the City Council, City Attorney, the City's Audit Committee, retirees, and union leaders, Mr. Preovolos has refused to order or permit an illegal acts investigation.

Under the mandate of section 17, the SDCERS Board has an obligation to protect the system's assets. This obligation requires the Board to ensure that the system is operating legally in all respects. Refusing to order or permit an illegal acts investigation for the 2003 and 2004 financial statements is contrary to a Board member's fiduciary duty to the system. Rather than protecting the system, the failure to take all necessary steps to provide accurate and complete financial records harms the participants and results in the SDCERS members violating the requirements of article xvi, section 17.

This failure has put the pension system into further financial crisis, does not minimize contributions by the City as required by article xvi, section 17 of the California Constitution, and threatens the financial welfare and future ability of the City to make contributions to SDCERS. Accordingly, it is appropriate and proper to remove Mr. Prevolos from the appointment as a member of the SDCERS retirement board.

CONCLUSION

The City Council has the authority to remove Retirement Board members for cause. Such cause may be demonstrated by a failure to perform their responsibilities as fiduciaries. The failure of the Chair to order or permit an illegal acts investigation, in light of the ongoing investigations and prosecutions of former Board members for possible illegal activity, is sufficient cause to justify removal of a Retirement Board member.

Respectfully Submitted

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City Attorney

MJA:jb
Attachment
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