Office of
The City Attorney
City of San Diego

MEMORANDUM
MS 59

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DATE: February 22, 2016

TO: Honorable Mayor and City Council

FROM: City Attorney

SUBJECT: Rebuild San Diego Initiative

This Memorandum is in response to questions from Councilmember David Alvarez related to a proposed San Diego Charter (Charter) amendment, entitled "Rebuild San Diego" (Proposal). The San Diego City Council (Council) is contemplating placement of the Proposal on the June 2016 ballot for consideration by City of San Diego (City) voters.

The Proposal involves amending the Charter to add provisions that create an Infrastructure Fund (Fund), into which dedicated sources of revenue will be deposited. The proposed Fund, if approved by voters, will be used exclusively for the acquisition, construction, reconstruction, rehabilitation, repair, and maintenance of City infrastructure. Under the Proposal, the Council must comply with the requirements of the Charter amendment when adopting the City's annual budget. The Fund may be used for all costs associated with infrastructure projects, except new convention center or professional sports venues. The Fund may be used to cover personnel costs for City employees involved in infrastructure projects, but not operations.

At the January 26, 2016 Council meeting, Councilmember Alvarez asked this Office to respond to three questions related to the Proposal. This Memorandum addresses the questions.

QUESTIONS PRESENTED

1. Are there meet-and-confer requirements that must be met before placement of the Proposal on the ballot?

2. Is there any outstanding litigation that could affect pension-related savings available for use on infrastructure projects?

3. Is the use of pension savings as part of the Proposal legal, and are there are any issues the Council should consider?

SHORT ANSWERS

1. The Proposal does not directly affect a matter within the scope of bargaining, which is defined as wages, hours, and other terms and conditions of employment. The Proposal involves a fundamental policy decision, setting spending priorities for future revenue. The City would only have an obligation to meet and confer prior to making a fundamental policy decision if the policy decision has a significant and adverse effect on wages, hours, or working conditions, and a reviewing court found that the City's need for "unencumbered decisionmaking" in managing its operations is outweighed by the benefits to employer-employee relations of bargaining the matter. Because the Proposal's impact on future wages or benefits of the City's represented employees is speculative and the right of the legislative body to set spending priorities is absolute, it is unlikely that a reviewing court would mandate bargaining on the Proposal.

2. There are three cases currently in litigation that involve pension benefits. They are discussed below.

3. The use of pension savings is legal, but the City must ensure that there are sufficient funds in the future to pay City employees the retirement benefits that they have been promised by approved agreements.

DISCUSSION

I. THE PROPOSAL INVOLVES FUNDAMENTAL POLICY DECISIONS THAT SHOULD NOT REQUIRE MEET AND CONFER PRIOR TO PLACEMENT ON THE BALLOT.

The Meyers-Milias-Brown Act (MMBA), the state law controlling labor relations for public agency employers and their represented employees, provides that public agencies, like this City, must give employee organizations "reasonable written notice" of any proposed "ordinance, rule, resolution, or regulation directly relating to matters within the scope of representation." Cal. Gov't Code § 3504.5(a). Under the MMBA, as a general rule, conditions of employment require bargaining, and management prerogatives are exempted from bargaining. *City of Fresno v. People ex rel. Fresno Firefighters, IAFF Local 753*, 71 Cal. App. 4th 82, 91-92 (1999).

Before a public agency employer makes a decision that involves a matter within the scope of representation or bargaining, it must complete the bargaining process to agreement or through completion of mandated impasse resolution procedures. Cal. Gov't Code §§ 3504.5, 3505.

The city council of a charter city must comply with the meet-and-confer requirements of the MMBA before it proposes an amendment to a city charter concerning the terms and conditions of public employment. *People ex rel. Seal Beach Police Officers Assn. v. City of Seal Beach*, 36 Cal. 3d 591, 594 (1984).

The California Supreme Court (Supreme Court) has concluded that, although a charter city has a constitutional right to amend its charter through the initiative process, it is required to meet and confer in good faith under the MMBA *before* placing a measure on the ballot that affects matters within the scope of bargaining. *Id*. at 602. The question we must answer is whether the Proposal is within the scope of bargaining.

California Government Code (Government Code) section 3504 defines the scope of bargaining or representation, as follows:

> The scope of representation shall include all matters relating to employment conditions and employer-employee relations, including, but not limited to, wages, hours, and other terms and conditions of employment, except, however, that the scope of representation shall not include consideration of the merits, necessity, or organization of any service or activity provided by law or executive order.

Cal. Gov't Code § 3504.

The "scope of representation" has been the subject of interpretation by the Supreme Court and appellate courts over a series of cases. The Supreme Court has recognized that Government Code section 3504 has "arguably vague, overlapping provisions." *Building Material & Constr. Teamsters' Union v. Farrell*, 41 Cal. 3d 651, 658 (1986) (*Farrell)*.

The Supreme Court has concluded that a public agency employer is required to bargain when a proposed action *directly relates to and has a significant and adverse effect* on the wages, hours, and other terms and conditions of employment of represented employees. *Id*. at 658-59. *See also Fire Fighters Union v. City of Vallejo*, 12 Cal. 3d 608, 616 (1974) (*Vallejo*).

The Supreme Court distinguishes between decisions that directly relate to and significantly and adversely affect conditions of employment, and those that involve fundamental policy considerations. *Claremont Police Officers Ass'n v. City of Claremont*, 39 Cal. 4th 623, 632 (2006) (*Claremont*). The distinction, however, is not absolute. *Farrell*, 41 Cal. 3d at 660. Government Code section 3504 "codifies the unavoidable overlap between an employer's policymaking discretion and an employer's action impacting employees' wages, hours, and working conditions." *Claremont*, 39 Cal. 4th at 635.

The Supreme Court has explained that the California Legislature included the "limiting language" in Government Code section 3504 "not to restrict bargaining on matters directly affecting employees' legitimate interests in wages, hours and working conditions but rather to forestall any expansion of the language of 'wages, hours and working conditions' to include more general managerial policy decisions." *Vallejo,* 12 Cal. 3d at 616. "To require public officials to meet and confer with their employees regarding fundamental policy decisions . . . would place an intolerable burden upon fair and efficient administration of state and local government." *Berkeley Police Ass'n v. City of Berkeley*, 76 Cal. App. 3d 931, 937 (1977).

When a matter involves an employer's "policymaking discretion," it must be negotiated "only if the employer's need for unencumbered decisionmaking in managing its operations is outweighed by the benefit to employer-employee relations of bargaining about the action in question." *Farrell*, 41 Cal. 3d at 660.

The Supreme Court recently relied on federal precedent under the National Labor Relations Act, the private sector collective bargaining provisions, to summarize the three categories of management decisions: (1) decisions that "have only an indirect and attenuated impact on the employment relationship" and thus are not mandatory subjects of bargaining, such as "choice of advertising and promotion, product type and design, and financing arrangements"; (2) decisions directly defining the employment relationship, such as wages, workplace rules, and the order of succession of layoffs and recalls, which are always mandatory subjects of bargaining; and (3) management decisions that directly affect employment, such as eliminating jobs, but nonetheless may not be mandatory subjects of bargaining because they involve "a change in the scope and direction of the enterprise" or, in other words, the employer's "retained freedom to manage its affairs unrelated to employment." *International Ass'n of Fire Fighters, Local 188, AFL-CIO v. Public Employment Relations Bd.*, 51 Cal. 4th 259, 272-73 (2011) (citations omitted). Bargaining is not required for decisions in the third category if they do not raise an issue that is "amenable to resolution through the bargaining process," although the employer is normally required to bargain about the results or effects of such decisions. *Id*. at 273 (citations omitted).

The Supreme Court has developed a three-part inquiry to determine whether a matter requires bargaining under the MMBA. *Claremont*, 39 Cal. 4th at 638. *See also Santa Clara Cty. Corr. Peace Officers' Ass'n, Inc. v. County of Santa Clara*, 224 Cal. App. 4th 1016, 1029 (2014), *review denied* (Jul. 9, 2014). We will apply this three-part inquiry to the Proposal.

First, we ask whether the proposed management action has "a significant and adverse effect on the wages, hours, or working conditions of the bargaining unit employees." *Id*. (citing *Farrell*, 41 Cal. 3d at 660). If not, then there is no duty to meet and confer. *Id*.

Here, the Proposal does not clearly have a significant and adverse effect on the wages, hours, or terms and conditions of employment, thus mandating bargaining. The Proposal seeks to limit the Council's discretion by requiring a percentage of General Fund revenue growth, including sales tax increment above a baseline and pension cost reduction to be dedicated to infrastructure programs and projects. As the Office of the Independent Budget Analyst (IBA) explained in IBA Report Number 16-02, restricting future revenue to infrastructure needs could impact funding for other priorities, such as staffing and operating costs. IBA Report No. 16-02 (Jan. 15, 2016), at 12-13. This means there may be less money for general salary increases or other employee benefits, which arguably may be an impact or effect of the Proposal. However, this is speculative, especially because the Proposal allows for funding of City employees who work on infrastructure projects. Therefore, it is reasonable to stop the inquiry here and conclude that the City does not have a duty to meet and confer on the Proposal.

But, because it could be argued that the Proposal may have a significant and adverse effect on the ability of the City to negotiate wage increases or increases to benefits in the future because it limits the expenditure of a portion of future City revenue, we will proceed with the inquiry.

Second, we ask whether the significant and adverse effect on terms and conditions of employment arises from "the implementation of a fundamental managerial or policy decision." *Claremont*, 39 Cal. 4th at 638. If not, then the meet-and-confer requirement applies. *Id*.

Here, there is precedent to conclude that the Proposal involves implementation of "a fundamental managerial or policy decision." Budgetary decisions are "inherently within fundamental managerial policy and prerogative, even without an explicit reservation of managerial rights." *Santa Clara Cty. Corr. Peace Officers' Ass'n, Inc.*, 224 Cal. App. 4th at 1041 (concluding that deciding to accomplish a budget target by layoffs or other means is within management prerogative). The Proposal involves budgetary matters in that it is intended to restrict expenditure of a portion of future City revenue.

Further, the City's Employee-Employer Relations Policy, which is a negotiated policy under the MMBA, sets forth the "exclusive City rights with respect to matters of general legislative or managerial policy." Council Policy 300-06 (adopted by San Diego Resolution R-301042 (Nov. 14, 2005)). The City's management rights include:

> The exclusive right to determine the mission of its constituent departments, commissions and boards; set standards of service; . . . maintain the efficiency of governmental operations; determine the methods, means and personnel by which government operations are to be conducted; . . . and complete control and discretion over its organization and the technology of performing its work.

Id. at ¶ I.A.

Determining the methods and means by which governmental operations are to be conducted includes determining service levels and City expenditures. The Council, as the City's legislative body, has nondelegable legislative authority to adopt legislation that determines how the City spends public money. San Diego Charter § 11.1. Further, the Council has constitutional power to propose Charter amendments. *See* Cal. Const. art. XI, § 3(b).

In addition, a determination of the work to be performed by a public agency employer is a managerial right outside of the scope of bargaining. *Davis Joint Unified School Dist*., PERB Dec. No. 393 (1984); *City & County of San Francisco*, PERB Dec. No. 1608-M (2004). The level of service to be provided is also a managerial decision. *Los Angeles Superior Court*, PERB Dec. No. 2112-I (2010); *Mt. Diablo Unified School Dist*., PERB Dec. No. 373 (1983); *Arcohe Union School District*, PERB Dec. No. 360 (1983).

Under these legal authorities, a reviewing court will find that the restriction of future revenue for infrastructure projects by Charter amendment is a fundamental policy decision. California courts have concluded that "[a] decision of such fundamental importance as to the basic direction of the corporate enterprise is not included within the area of mandatory collective bargaining." *San Jose Peace Officer's Assn. v. City of San Jose*, 78 Cal. App. 3d 935, 948 (1978). The Supreme Court has stated that a managerial decision with an "indirect and uncertain impact" on working conditions may be sufficient to conclude that the decision is not subject to bargaining. *Claremont*, 39 Cal. 4th at 634 (citation omitted).

However, to complete the inquiry and because it could be argued that restricting a portion of future revenue may impact the ability of the City to negotiate wages in the future, we will proceed to the final question.

Third, if an action taken to implement a fundamental managerial or policy decision has a significant and adverse effect on the wages, hours, or working conditions of the employees, we apply a balancing test. *Claremont*, 39 Cal. 4th at 638 (citing *Farrell*, at 660). "The action is within the scope of representation *only if* the employer's need for unencumbered decisionmaking in managing its operations *is outweighed by* the benefit to employer-employee relations of bargaining about the action in question." *Id*. (emphasis added). In applying this balancing test, a court may consider whether the "transactional cost of the bargaining process outweighs its value." *Id*.

Applying the balancing test of the third inquiry, a reviewing court would likely find that the Council's need for "unencumbered decisionmaking" in proposing a Charter amendment that prioritizes infrastructure spending is *not* outweighed by the benefit to employer-employee relations of bargaining the Proposal, because the Proposal's impact on employee's future wages is speculative and unclear and legislative authority over public spending is fundamental. Further, there is nothing in the Proposal prohibiting the use of funds to pay employees' salaries in the future. Employees represented by both the San Diego Municipal Employees' Association and AFSCME, Local 127 work on infrastructure projects. Employees in the Deputy City Attorneys Association give legal advice on City infrastructure projects.

If the Proposal directly impacted wages, then the analysis would be different, and the Proposal would fall within the City's meet-and-confer duties. If it is approved by City voters, the City's recognized employee organizations may request to bargain over the impacts to terms and condition of employment, if any. Further, the Proposal contemplates an implementing ordinance, which may require bargaining.

A public agency employer's fundamental policy decisions may require bargaining on the implementation and effects of those decisions. *International Ass'n of Fire Fighters*, 51 Cal. 4th at 272-73. *See also Claremont*, 39 Cal. 4th at 632. For example, while a decision to lay off employees for financial necessity is not subject to bargaining, a public agency employee must give its employees an opportunity to bargain over the implementation of the layoff decision, including the number of employees to be laid off, and the timing of the layoffs, as well as the effects of the layoffs on the workload and safety of the remaining employees. *Santa Clara Cty.*

Corr. Peace Officers' Ass'n, Inc., 224 Cal. App. 4th at 1028. The Public Employment Relations Board (PERB), the state administrative agency that enforces the MMBA, has explained the requirement to bargain the effects of a decision:

> Upon reaching a firm decision and before implementing a non-negotiable decision, an employer must give notice and bargain upon request over the reasonably foreseeable effects of that decision. The employer must provide notice sufficiently in advance of implementation to permit the union a reasonable amount of time to consider demanding to bargain and to negotiate over the effects.

Rio Hondo Community College District, PERB Dec. No. 2313 (2013) (citations omitted).

Under "effects bargaining," the impacted employee organization must demand to bargain on a subject within the scope of representation. If the employer and the employee organization disagree on whether an impact is within the scope of representation, then the parties must meet to clarify their respective positions:

> Upon receiving such a demand, the duty to bargain obliges the employer either to bargain, or to seek clarification of the union's negotiability rationale. If the employer seeks such clarification, and it thereafter refuses to bargain, it may defend this refusal on the ground that the union's bargaining demand, as clarified, failed to address an impact that was both reasonably foreseeable and within the scope of representation. If the employer refuses to bargain without seeking clarification of the union's negotiability rationale, it fails to meet and negotiate in good faith.

Id. *See also Healdsburg Union High School Dist. & Healdsburg Union School Dist./San Mateo City School Dist*., PERB Dec. No. 375 (1984) (stating that the failure to seek clarification is, in itself, a violation of the duty to negotiate in good faith).

Note, that, on February 5, 2016, the City's Labor Relations Office provided notice to all of the City's recognized employee organizations that the Rebuild San Diego measure is being considered by the Council. The notice stated that it is the City's position that the measure is a management right that does not require bargaining prior to placement on the ballot. The City has received responses from at least one of its recognized employee organizations and the Labor Relations Office is addressing those issues.

If any of the employee organizations disagrees about the scope of bargaining issues, then the City has a duty to meet to try to clarify the disagreement. This Office is evaluating the responses, and further analysis may be required to ensure the City is complying with its bargaining obligations.

II. THERE ARE THREE PENDING CASES THAT MAY IMPACT FUTURE PENSION COSTS.

There are three cases that broadly involve pension benefits. The first case involves PERB's recent decision in *San Diego Municipal Employees' Association v. City of San Diego.* The second case is *Ganley v. City of San Diego.* In *Ganley,* the pension benefit at issue is the surviving spouse benefit. The third case is *Abbe v. City of San Diego. Abbe* involves voluntary purchases of pension service credits by certain employees when the price of the service credits was priced too low in the future. At this time, it is not known if any of these cases will have any effect on the City's pension costs.

III. THE PROPOSAL'S USE OF PENSION SAVINGS IS LEGAL, BUT THE CITY MUST ENSURE THERE ARE SUFFICIENT FUNDS IN THE FUTURE TO PAY FOR ALL VESTED PENSION BENEFITS.

On January 21, 2010, this Office issued a comprehensive legal opinion entitled "Pension Benefits and Other Post-Employment Benefits," in which we explained the legal principles involved with modifying and funding the City's pension benefits. 2010 Op. City Att'y 2 (LO-2010-1; Jan. 21, 2010). To summarize, public employment gives rise to certain obligations that are protected by the contract clauses of the federal and state constitutions, including the right to payment of compensation that has been earned. *Kern v. City of Long Beach*, 29 Cal. 2d 848, 852-53 (1947). We explained that a public employee's pension constitutes deferred compensation for services performed. *See Betts v. Board of Administration*, 21 Cal. 3d 859, 863 (1978). The right to pension benefits is contractual. *See, e.g., In re Marriage of Brown*, 15 Cal. 3d 838, 845 (1976). In the legal opinion, we analyzed the nature of various benefits, explaining which had constitutional protection.

In restricting a portion of future revenue for infrastructure projects, the City must ensure that there are sufficient funds for the City's required contributions to City employees' defined benefit pension plans and defined contribution retirement plans. The defined benefit pension plan is administered by the San Diego City Employees' Retirement System (SDCERS or Retirement System). The City must pay its annual contribution, as required by Charter section 143. The defined contribution plans are administered by the City's Risk Management Department. The defined contribution plans that require City contributions are the City's Supplemental Pension Savings Plan (SPSP) and Supplemental Pension Savings Plan-Hourly (SPSP-H) and the 2009 401(a) plan for people hired between July 1, 2009 and July 19, 2012. The SPSP-H plan covers certain hourly employees, including employees hired before July 20, 2012, the effective date of Proposition B. The SPSP-H Plan also covers benefitted employees hired on or after July 20, 2012, the effective date of Proposition B, which closed the City's Retirement System to all employees hired after its effective date except sworn police officers. San Diego Charter §§ 140, 150. The Proposal's definition of "Pension Cost" does not include all retirement benefits for all City employees that the City must fund.

Councilmember Alvarez asked a specific question about the "Waterfall." The "Waterfall" was the concept of "Surplus Undistributed Earnings" in the defined benefit pension plan, which was implemented in 1980. San Diego Ordinance O-15353 (Oct. 6, 1980). At that time, the Council requested that the Retirement System study the problem faced by retired employees as a result of extreme inflationary conditions. *Id.* The Council implemented a proposal to distribute a percentage of investment earnings, known as "Surplus Undistributed Earnings" or "Surplus Earnings," to retirees for enhanced benefits under specific conditions. *Id*. *See also* Report of the Audit Committee of the City of San Diego, Kroll (presented at Council on Aug. 8, 2006) (*see* San Diego Resolution R-301857 (Sept. 29, 2006)) (Kroll Report). Rather than enacting an enhanced retirement benefit paid through the City's annual contribution to SDCERS, the Council adopted an ordinance defining all investment earnings in excess of a certain percentage as Surplus Earnings and directed that a portion of these Surplus Earnings be used to pay for enhanced benefits. San Diego Ordinance O-15353 (Oct. 6, 1980).

As the Kroll Report explained, "[t]he 1980 legislation, and the SDCERS compliance with it, involved a significant conceptual error." Kroll Report, at 32. Excess investment earnings above expected earnings are not, in fact, "surplus," and are needed to offset returns in years when the earnings are below expected. *Id*. Using these funds to pay current obligations reduces the Retirement System's actuarial value of assets and increases the unfunded actuarial accrued liability.[1] *Id*. In reality, the City had not found a pool of surplus money from which to fund increased benefits. "This flow of Surplus Earnings to a succession of otherwise unfunded benefits came to be known as the 'Waterfall.'" Kroll Report, at 33-34. It left SDCERS "poorly positioned to weather inevitable financial hard times." *Id.* at 34.

The elimination of the concept of the Surplus Undistributed Earnings or the "Waterfall" was part of the reforms to the City's Retirement System. *See* San Diego Ordinance O-19781 (Sept. 11, 2008). San Diego Municipal Code section 24.1501 states that the concept of Surplus Earnings is eliminated and that payments previously made from surplus earnings must be made from plan assets. *Id*.

The concept of Surplus Earnings is not present in the Proposal. The Proposal creates the concept of "Pension Cost," which is defined as the General Fund share of contributions the City must make to SDCERS for the defined benefit plan, plus the City's contributions to the defined contribution plan for employees hired on or after July 20, 2012, the effective date of Proposition B. "Pension Cost" in the Proposal does not include the City's required contributions to the SPSP, SPSP-H, and the 2009 401(a) plans. The Proposal also creates the concept of "Pension Cost Reduction," which means the amount by which the General Fund Pension Cost in a proposed budget for each fiscal year is lower than the Pension Cost in a base year. In developing these definitions, the Council must ensure that it is providing sufficient funding to cover all required payments to the City's defined benefit and defined contribution plans. The

[1] The unfunded liability is the difference between the City's "estimated future obligations reduced to present value, and the value of assets on hand to pay these future obligations." Kroll Report, at 33.

Council may want to consider clarifying that "Pension Cost" as defined for purposes of this proposed Charter section is not intended to define, limit, or otherwise modify the City's obligation to fund any vested retirement benefit for any City employee.

This Office is available to answer any further questions, as requested.

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By *__/s/ Joan F. Dawson__*
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