

DATE ISSUED: July 7, 2004

REPORT NO. 04-148

ATTENTION: Honorable Mayor and City Council
Docket of July 13, 2004

SUBJECT: Approval of Settlement Agreement in Gleason v. SDCERS, et al.

SUMMARY

Issues –

1. Should the City Council approve the global settlement agreement of three lawsuits related to the San Diego City Employees' Retirement System (SDCERS) which have been consolidated and are now known as *Gleason v. San Diego City Employees' Retirement System, et al?*

Manager's Recommendation –

1. Approve the global settlement agreement of three lawsuits related to the San Diego City Employees' Retirement System (SDCERS) which have been consolidated and are now known as *Gleason v. San Diego City Employees' Retirement System, et al.*

Other Recommendations – None

Fiscal Impact – The Settlement Agreement provides that the City make full actuarially calculated contributions to SDCERS in accordance with the San Diego City Charter beginning in Fiscal Year 2006. Beginning with the June 30, 2004 Annual Actuarial Valuation, the amortization period for the unfunded Actuarial Accrued Liability will be reset to a new 30-year fixed amortization period. The Fiscal Year 2005 contribution will be a fixed amount of \$130 million, which is less than the full actuarial amount but \$45 million more than the Fiscal Year 2004 contribution amount. The City's contribution amount for Fiscal Years 2006,

2007, and 2008 will be based on the reset amortization period. After Fiscal Year 2008, the City will remain obligated pursuant to the Charter to contribute to SDCERS an amount derived from the rates calculated by the SDCERS actuary in its annual valuation and approved by the SDCERS Board of Administration. The amortization schedules selected by SDCERS after Fiscal Year 2008 may be shorter than 30 years, in which case there would be a substantial increase in the City's contribution amount. The City's payments will be approved each year as part of the annual budget process.

BACKGROUND

A class action complaint was filed against the City of San Diego on January 16, 2003 alleging that the City violated the City Charter and San Diego Municipal Code from Fiscal Year 1997 to the present by failing to contribute an annual amount to the San Diego City Employees' Retirement System (SDCERS) as calculated by the SDCERS actuary. The plaintiffs in this action, known as *Gleason*, are James F. Gleason and David W. Wood individually and on behalf of all persons who were as of April 6, 2004 no longer employed by the City and are entitled to receive benefits from SDCERS.

In September 2003, the court ordered the consolidation of *Gleason* with two other cases, both of which were filed against SDCERS. In *Gleason II*, the plaintiff alleged that certain members of the SDCERS Board improperly voted to approve the November 18, 2002 contract between the City and SDCERS concerning the City's annual contribution rates because those Board members allegedly had a conflict of interest under the provision of the California Political Reform Act and Government Code section 1090. In *Wiseman*, the plaintiff sought a judicial declaration that ex officio members of SDCERS Board, the City Manager and the City Auditor, have improperly delegated their duty to serve on the Board to senior members of their staffs. Each of the latter two cases was filed against SDCERS and the City is not a party to the actions.

Gleason, *Gleason II*, and *Wiseman* have been consolidated per court order. While the City and SDCERS have disputed and denied the allegations in each action, settlement terms were reached during mediation for the consolidated actions now known as *Gleason v. San Diego City Employees' Retirement System, et al.*

DISCUSSION

The parties to the consolidated actions have agreed to settle the actions and have negotiated the details of a global Settlement Agreement, which is attached. The Plaintiffs and the SDCERS Board have reviewed and approved the Settlement Agreement; however SDCERS' execution of the Agreement will occur after its counsel have approved of the title reports for several additional properties being used as collateral (a process that is occurring as of this writing). The Settlement Agreement was approved by the Court on July 7, 2004, conditional only on final approval and sign-off by the City and SDCERS.

While the agreement contains a number of provisions, all of which should be read closely, those that are most substantive are explained below.

1) Full Actuarial Rates

As part of the Settlement Agreement, the City agrees to abandon the agreements between the City and SDCERS known as Manager's Proposal I (1997) and Manager's Proposal II (2002), under which the City had been making annual contributions to SDCERS. Those agreements allowed the City to pay less than the full actuarial rate calculated by the SDCERS actuary each year, and instead pay a lower rate to SDCERS. Under the settlement, the City abandons its practice of paying less than the full actuary rate, and abandons its interpretation of the Charter which allowed less to be paid. The City will begin paying the full actuarially calculated rate in Fiscal Year 2006 and beyond using a new 30-year fixed amortization schedule that will be in place for four years between 2005 and 2008. In Fiscal Year 2005 only, the City has paid a fixed amount of \$130 million (which is less than the full actuarially calculated rate) largely because of state budget takeaways and other fiscal pressures. The \$130 million payment has been made and was an increase of \$45 million over the 2004 payment.

2) Past Alleged Underpayments by the City

Through the settlement, the City will not be required to directly pay any part of the past alleged under-funding of SDCERS, even though the plaintiffs sought this. However, the alleged under-funding does affect the Unfunded Accrued Actuarial Liability (UAAL). Thus, the City's contributions in the future will be calculated by SDCERS in part by applying the prevailing UAAL, and to that extent, the City's rates in the future may be higher in light of the past funding levels.

3) New Amortization Schedule

The new 30-year fixed amortization schedule SDCERS will be adopted as part of the settlement will only be in place for four years. After Fiscal Year 2008, SDCERS is free to adopt any amortization schedule it and its actuary select, including a shorter 15-year schedule, for example. Doing so may substantially increase the City's required payments to SDCERS in the future since the City is agreeing to pay the full actuarially calculated rate without regard to the amortization schedule chosen by SDCERS. Paying less than the full actuarially calculated rate in the future would require an amendment to the City Charter.

4) Collateral to Secure the City's Payments

In addition to the other agreed to terms, the Settlement Agreement commits the City to provide collateral to SDCERS to secure payment of the annual contribution obligation through Fiscal Year 2008, but not beyond. The City will provide SDCERS with trust deeds securing City property valued at approximately \$375 million. There will be three separate trust deeds encumbering City-owned property valued at approximately \$125

million for each of the fiscal years 2006, 2007, and 2008. The City makes its annual contribution to SDCERS on or about July 1 of each year. As it does so, the collateral securing that year's contribution will be promptly released to the City through a reconveyance. Thus, for example, when the City makes its 2006 contribution on July 1, 2005, SDCERS will release \$125 million in collateral back to the City.

The City is not selling or giving the property used as collateral to SDCERS and would not have to do so unless the City were to default on any of the three remaining annual payments and SDCERS foreclosed on the collateral. The City will continue to collect rents on each of the encumbered properties, and SDCERS will have no rights with regard to the properties including collection of rents unless the City defaults on the annual payments.

The City and SDCERS have spent considerable time negotiating the terms related to the collateral, the appraisal process used to determine the value of the collateral, and selecting the specific properties the City will use in each of the three remaining years. The City's proposed schedule of properties allows the City to pursue its own agenda/development schedule for the properties. The City Manager will distribute a copy of the executed Settlement Agreement and Release with a description of the collateral properties later this week.

Summary

It is recommended by the City Manager, the City Attorney, and the City's outside counsel that this negotiated Settlement Agreement be approved by the City Council. The agreement is scheduled to be approved by the Court on July 7, 2004. All parties have agreed to use their best efforts to obtain Court approval of the Settlement. Within 120 days of the Court's entry of a final order approving the agreement, the City shall repeal those portions of San Diego Municipal Code Section 24.0801 enacted November 18, 2002 which specify that rates the City pays are as agreed to in the governing Memorandum of Understanding between the City and SDCERS. Staff will return to City Council with an ordinance to make that change within the time frame specified.

Respectfully submitted,

Bruce Herring
Deputy City Manager

Note: The attachment is not available in electronic format. A copy is available for review in the Office of the City Clerk.

Attachment: Settlement Agreement and General Release