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DATE: January 21, 2010

SUBJECT: Pension Benefits and Other Post-Employment Benefits

REQUESTED BY: Honorable Mayor and City Councilmembers

PREPARED BY: City Attorney

INTRODUCTION

This Opinion provides an overview of the general legal principles related to whether City of San Diego [City] pension benefits and other postemployment benefits [OPEB][1] can be changed, and, if so, what needs to be done to change a benefit.

In this Opinion, the terms "retirement benefits" and "pension benefits" are used synonymously. The San Diego Charter [Charter] uses the term "retirement benefits." The San Diego Municipal Code [SDMC] uses the terms "retirement compensation" and "retirement benefits" interchangeably. However, there is a distinction between "retirement benefits" and "retirement system benefits." A "retirement system benefit" is a benefit which is paid out of the San Diego City Employees' Retirement System [SDCERS] trust fund. The City also offers "retirement benefits," such as the Supplemental Pension Savings Plan [SPSP] for eligible

[1] OPEB is a term used by the Governmental Accounting Standards Board [GASB]. As defined by GASB, OPEB is a benefit or benefits that employees will receive at the start of retirement that is provided in addition to pensions as part of the total compensation offered to employees. OPEB does not include pension benefits paid to the retired employee. OPEB may include life insurance premiums, health care premiums and deferred-compensation arrangements that are provided separately from the pension plan. *See* Summary of Statement No. 43 (issued 4/04) and Summary of Statement No. 45 (issued 6/04), Governmental Accounting Standards Board (http://www.gasb.org).

employees and a 401(k) Plan, and OPEB, specifically the retiree health benefit, that provide income or compensation in retirement, but are not benefits under the City's retirement system. [2]

This Opinion uses the term "employment benefits" to refer to those benefits that are subject to modification through appropriate procedures, including state collective bargaining procedures. Examples of "employment benefits" include salary and holiday or vacation pay.

This Opinion is not intended to serve as an admission of or limitation on any position the City may take in any pending or future litigation or as a waiver of any position the City may take in any litigation or other legal matter. Specifically, the City has sought to void certain benefits allegedly granted on the grounds of illegality or inconsistency with the Charter. The analysis in this Opinion does not address those litigation issues. This Opinion is for advisory purposes and assumes that the benefits discussed here were properly granted.

QUESTION PRESENTED

Can pension benefits and OPEB be modified or eliminated? If so, what is required to change a benefit?

SHORT ANSWER

As a general rule, a retirement or pension benefit that is deemed a vested benefit cannot be modified or eliminated without the City, as a public agency employer, demonstrating that the change is reasonable and necessary to keep the retirement system flexible to permit adjustments to changing conditions and to maintain the integrity of the retirement system. Further, when a change to a vested benefit results in a disadvantage to employees, the City must provide the disadvantaged employees with "comparable new advantages," meaning an offsetting improvement that relates generally to the benefit that has been diminished. Vested benefits are protected by federal and state constitutional provisions prohibiting impairment of contracts. Benefits that are not vested may be modified or eliminated, subject to the procedural requirements of the Meyers-Milias-Brown Act where appropriate, and any applicable City civil service provision.

When the City seeks to change a benefit under the City's retirement system, as defined by the Charter, there is an additional procedural requirement set forth in Charter section 143.1 that

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[2] For financial reporting purposes, the City's "pension plans" include defined benefit plan authorized by Article IX of the Charter and administered by the SDCERS, which includes the Deferred Retirement Option Program [DROP], Purchase of Service Credits, Corbett Settlement Benefits and Retirement Factors, and Preservation of Benefit Arrangement. *See City of San Diego, Comprehensive Annual Financial Report* [CAFR]. For reporting purposes, the City's "pension plans" also include the defined contribution plans, which are the City's Supplemental Pension Savings Plan [SPSP] and the 401(k) Plan. For reporting purposes, the City's OPEB are the postemployment health care benefits for qualifying General, Safety, and Legislative Members.

mandates approval of a proposed change by an election or elections of active employees, retirees, or the electorate, depending on the proposed modification.

ANALYSIS

I. LEGAL AUTHORITY TO ESTABLISH SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM

A. The Charter authorizes the establishment of SDCERS, and empowers the City Council to provide for retirement benefits, by ordinance.

As a charter city, San Diego has the authority under article XI, section 5(b) of the California Constitution to provide for the compensation, including pension benefits, of City employees. *Grimm v. City of San Diego,* 94 Cal. App. 3d 33, 37 (1979). Provisions for pensions relate to compensation and are municipal affairs within the meaning of the Constitution. *Id.* (citing *City of Downey v. Board of Administration*, 47 Cal. App. 3d 621, 629 (1975)).

The Charter, at article IX, sections 141 through 149, authorizes the City Council, by ordinance, to establish a retirement system for compensated public officers and employees. Charter section 141 provides the requirements for employees to receive retirement benefits.[3] Charter section 141 also authorizes the City Council to provide for industrial disability retirements, disability retirements, and death benefits for dependents of employees killed in the performance of duty, and health insurance benefits for retired employees. San Diego Charter § 141. The retirement system is to be managed by a Board of Administration. San Diego Charter §§ 142, 144.

Consistent with article XVI, section 17 of the California Constitution, the Board of Administration has "plenary authority and fiduciary responsibility for investment of moneys and administration of the system." San Diego Charter §143. The Charter mandates that the Board of Administration "shall be the sole authority and judge under such general ordinances as may be adopted by the Council as to the conditions under which persons may be admitted to benefits of any sort under the retirement system; and shall have exclusive control of the administration and investment of such fund or funds as may be established . . . ." San Diego Charter § 144.

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[3] " 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, except such employees may be given the option to retire at the age of fifty-five years after twenty years of service for which payment has been made with a proportionately reduced allowance. Policemen, firemen and full time lifeguards, however, who have had ten years of service for which payment has been made 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 service for which payment has been made with a proportionately reduced allowance." San Diego Charter § 141.

The City Council's legislative role, as it pertains to the retirement system, does not cease once benefits are established by the Council, but instead continues for the purpose of maintaining and, if necessary, modifying the framework for the retirement system. *Grimm*, 94 Cal. App. 3d at 33; *see also* San Diego Charter § 146.[4]

The City's present retirement system was created by ordinance adopted by the City Council in November 1926. San Diego Ordinance O-10792 (Nov. 29, 1926). The City's retirement system provisions are presently set forth in article 4 of the SDMC. *See* SDMC § 24.0101.[5] "Retirement System" is defined in the Municipal Code as "the City Employees' Retirement System as created by [article 4]." SDMC § 24.0103. "Retirement Fund" is defined as "the trust fund created by the Charter in Article IX." SDMC § 24.0103.

In 1976, the City Council added a statement regarding the purpose of article 4 of the SDMC, which sets forth the retirement benefits. The City Council stated that retirement compensation is intended to be deferred compensation.

> The purpose of this article is to recognize a public obligation to City employees for their long service in public employment by making provision for retirement compensation and death benefits as additional elements of compensation for future services and to provide a means by which City employees who become disabled may be replaced without inflicting hardship on the employees removed.

SDMC § 24.0100 (added by San Diego Ordinance O-11964 (Dec. 8, 1976)).

Membership in the retirement system is compulsory and "a condition of employment for all members of the classified and unclassified service." SDMC § 24.0104. Full-time employees are required to join the retirement system on the date of their employment. SDMC § 24.0104.

Not all retirement benefits or OPEB are benefits under the retirement system as defined by article IX of the Charter and the SDMC. For example, the City offers SPSP, a supplemental pension plan for certain employees that is not established under the retirement system or

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[4] Charter section 146 provides additional authority to the City Council to implement the Charter provisions regarding a retirement system. "The Council is hereby fully empowered by a majority vote of the members to enact any and all ordinances necessary, in addition to the ordinance authorized in Section 141 of this Article, to carry into effect the provisions of this Article; and any and all ordinances so enacted shall have equal force and effect with this Article and shall be construed to be a part hereof as fully as if drawn herein." San Diego Charter § 146.

[5] "The City Employees' Retirement System created and established by the terms and provisions of Ordinance No. 10792, adopted by the Common Council of The City of San Diego on November 29, 1926, be, and the same is hereby continued in existence, except as hereafter changed and modified." SDMC § 24.0101.

administered by SDCERS. *See* San Diego Resolution R-255609 (Jan. 8, 1982). Similarly, the City offers a defined contribution retirement savings plan, established under Internal Revenue Code section 401(k), not under the retirement system. *See* San Diego Resolution R-263371 (June 10, 1985). The City also offers a retiree health benefit for certain employees. This benefit is not presently a benefit under the retirement system as defined by the Charter.[6]

B. The Charter mandates that the retirement system be contributory in nature, with the City and its employees contributing jointly.

The retirement system is conducted as a defined benefit, contributory plan, and both the City, as the employer, and City employees are mandated to make contributions. San Diego Charter § 143.[7]

All moneys contributed by employees and appropriated by the City Council under the terms of article IX of the Charter "shall be placed in a special fund in the City Treasury to be known as the City Employees' Retirement Fund." San Diego Charter § 145. This fund is a trust fund to be held and used only for the purpose of carrying out the retirement system, under article IX of the Charter. "No payments shall be made therefrom except upon the order of the Board of Administration." San Diego Charter § 145.[8]

The "contributory" requirement was part of the 1931 Charter, in which section 143 had the requirement that "[t]he retirement system herein provided for shall be conducted on the contributory plan – the City contributing jointly with the employees affected thereunder." San Diego Charter § 143 (1931). Originally, City employees paid an amount not to exceed a percentage of their salaries, and the City contributed "an equal amount" for a "normal retirement allowance." *Id.* On June 8, 1954, San Diego voters approved Proposition H, which amended the contribution requirements to the present language, which states that the contributions of the City and the employees be "substantially equal."

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[6] "The retiree health benefit described in [division 12 of the SDMC] will be paid by the City, directly, from any source available to it other than the Plan." SDMC§ 24.1204.

[7] "Contributory" generally means "one who contributes or who has a duty to contribute." Black's Law Dictionary (8th ed. 2004).

[8] It is the duty of the Board of Administration of SDCERS to "secure from a competent actuary a report of the cost of establishing a general retirement system for all employees." San Diego Charter § 142. It is the actuary's duty to determine the contributions to be paid by employees and the City: "The mortality, service, experience or other table calculated by the actuary and the valuation determined by him and approved by the board shall be conclusive and final, and any retirement system established under this article shall be based thereon." San Diego Charter § 143.

The Charter sets forth the employees' obligation to fund their retirement benefits as follows:

> Employees shall contribute according to the actuarial tables adopted by the Board of Administration for normal retirement allowances, except that employees shall, with the approval of the Board, have the option to contribute more than required for normal allowances, and thereby be entitled to receive the proportionate amount of increased allowances paid for by such additional contributions.

San Diego Charter § 143.

Both General and Safety Members of SDCERS are required to make bi-weekly retirement contribution payments, which are deducted by the City Auditor and Comptroller from employee paychecks, and transferred to SDCERS for crediting to each individual member's account. SDMC §§ 24.0204, 24.0304. It is the duty of the Board of Administration to "adopt by Rule the mortality, service and other tables and interest rates it deems proper" and to "revise by Rule the Members' contribution rates as it deems necessary, to provide the benefits of the Plan." SDMC § 24.0902.[9] *See also International Ass'n of Firefighters v. City of San Diego*, 34 Cal. 3d 292, 300 (1983) (upholding an increase in employee contributions to San Diego pension because the increase "merely makes City's contribution more 'substantially equal' to that of the members, as City's retirement system requires")

The Charter sets forth the City's obligation to fund employees' retirement benefits as follows:

> The City shall contribute annually an amount substantially equal to that required of the employees for normal retirement allowances, as certified by the actuary, but shall not be required to contribute in excess of that amount, except in the case of financial liabilities accruing under any new retirement plan or revised retirement plan because of past service of the employees.

San Diego Charter § 143.

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[9] The SDCERS annual financial report for 2009 provides: "Members are required to contribute a percentage of their annual salary to each plan in the Group Trust. Contributions vary according to the member's age at the time of enrollment and member's group (e.g., safety, general and elected officers). *See* SDCERS Comprehensive Annual Financial Report 2009, at p. 39-40 (<http://www.sdcers.org>).

Based upon the advice of SDCERS' actuary, the Board of Administration separately determines and adopts the City's employer contributions for General Members, Safety Members, and Elected Officers. SDMC § 24.0801. The City's actuarially determined contribution is known as the Annual Required Contribution [ARC]. *SDCERS Comprehensive Annual Financial Report 2009*, at p. 18 (<http://www.sdcers.org>). The ARC also includes an amortization payment on the unfunded actuarial liability. *Id.* at p. 18. An unfunded actuarial liability results when the retirement system's Actuarial Value of Assets [AVA] is less than the Actuarial Accrued Liabilities [AAL]. *Id.* at p. 14.

A component of the present unfunded accrued actuarial liability [UAAL], which is also known as the unfunded actuarial liability [UAL], resulted from agreements between the City and SDCERS, known as City Manager Proposal I [MPI] and City Manager Proposal II [MPII]. *See* "Agreement regarding Employer Contributions between the City of San Diego and the San Diego City Employees' Retirement System," City Clerk Document No. RR-297336 (Nov. 18, 2002). To prevent future underpayment of the ARC, San Diego voters approved Proposition G on November 2, 2004, which amended the Charter section on contributions, as follows:

> Funding obligations of the City shall be determined by the Board on an annual basis and in no circumstances, except for court approved settlement agreements, shall the City and the Board enter into multi-year contracts or agreements delaying full funding of City obligations to the system.

San Diego Charter § 143.

The term "normal retirement allowances" as used in Charter section 143 is not defined, nor is there a definition in the SDMC. However given the historical context in, which the term "normal retirement allowances" was used in the 1931 Charter and subsequent amendments, it is reasonable to conclude that the term "normal retirement allowances" means that retirement benefit afforded employees who do not elect to contribute more into the system for enhanced

benefits, under SDMC sections 24.0205 (General Members) and 24.0305 (Safety Members).[10] "Normal retirement allowances" should also include benefits afforded an employee pursuant to a disability retirement as authorized by Charter section 141. San Diego Charter §§ 141, 143.

When analyzing the City's obligation to make contributions for employees' retirement, the language in Charter section 143, "shall not be required to contribute in excess of that amount," may be interpreted to mean that the City shall not contribute any more than a "substantially equal" amount to what employees contribute for a normal retirement allowance. The argument is that no person or entity, including the City Council by ordinance, can "require" the City to contribute more than what the employees are contributing.

The language may also be interpreted to mean that there is no mandate for the City to contribute more than a substantially equal amount; however, there is no express prohibition against the City contributing more. A "pickup" is a payment by the City of a portion of the employees' retirement contribution. The City has a practice of "picking up" a portion of the employees' share of retirement contributions. The pickup is often negotiated through the collective bargaining process in lieu of providing employees with salary increases or other compensation. The practice is permissible under section 414(h)(2) of the Internal Revenue Code, and any negotiated pickups are included in the annual salary ordinance. As a result of the City's negotiations with its recognized employee organizations for Fiscal Year 2010, the pickup for the majority of employees has been eliminated.

A third interpretation, and the most likely given the history of the language, is that the City is not mandated to contribute more than a substantially equal amount to the employees' contributions for a normal retirement allowance when an employee elects to contribute more.

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[10] The SDMC uses the term, "Unmodified Service Retirement Allowance," which is "the monthly allowance paid to a Member based on a formula using the Member's age at retirement, the Member's Final Compensation, and the Retirement Calculation Factor selected by the Member for the calculation of the Member's Base Retirement Benefit, in accordance with [SDMC] Sections 24.0402 and 24.0403." SDMC § 24.0103. The Unmodified Service Retirement Allowance is composed of two elements: (1) a service retirement annuity, which is the actuarial equivalent of the member's accumulated normal contributions at the time of the member's retirement, and (2) a creditable service pension, which is the pension derived from the contributions of the City. SDMC §§ 24.0402, 24.0403. "Actuarial equivalent" means a benefit of equal value when computed upon the basis of the mortality, interest, and other tables adopted by the Board of Administration. SDMC § 24.0103. "Annuity" means payment for life derived from contributions made by a member. *Id.* When added together, the creditable service pension, derived from the City's contributions, and the member's service retirement annuity, are intended to be sufficient to equal the "Unmodified Service Retirement Allowance." SDMC § 24.0103, 24.0402(d), 24.0403(d). The Unmodified Service Retirement Allowance is capped at 90 percent of final compensation, with some exception, as set forth in sections 24.0402(g) and 24.0402(e).

See SDMC §§ 24.0205 (additional contributions for General Members), 24.0305 (additional contributions for Safety Members). This argument is supported by the ballot question presented to voters.

> Proposition H. Amend section 143 of Article IX of the Charter of The City of San Diego. This amendment provides that any retirement system authorized by the Council shall be based upon a contributory plan, with the City contributing equally with the employees for normal retirement allowances, and authorizes the employees to receive additional benefits at higher rates of contribution; except in the case of financial liabilities accruing under a new or revised retirement plan because of past service of the employees, the City is not obligated to contribute more than that necessary for normal allowances.

Ballot Materials, San Diego City Election (June 8, 1954); *see also* San Diego Ordinance O-6043 (April 6, 1954).[11]

The City and SDCERS should ensure, through a proper accounting, that the "substantially equal" requirement is being met for "normal retirement allowances." The "substantially equal" requirement should also apply to employees who retire with a disability retirement. San Diego Charter §§ 141, 143. Therefore, the accounting should include review of disability retirement contributions and any amortization of unfunded liability being paid by the City, such as any unfunded liability as a result of recent stock market losses, to determine that contributions that are not "substantially equal" properly fit into the exception to the requirement as "financial liabilities accruing under any new retirement plan or revised retirement plan because of past service of employees." San Diego Charter § 143.

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[11] When the language regarding the "substantially equal" requirement and its exception was added in 1954, the City was intending to and did implement a general overhaul of the retirement system. "City Employe[e] Pension Plans On Primary Ballot Explained," *Evening Tribune*, June 5, 1954. The proposed modifications to the retirement system put to San Diego voters involved enhanced benefits. According to Shelley Higgins, the assistant city attorney working on the revision, "Proposition H provides that the initial cost of implementing the revised system can be paid by the City. After that the City and employe[e]s share equally in contributions." *Id.* Higgins told the newspaper: "If [Proposition H] fails at the polls, each employe[e] now covered who wanted to join the new system would have to pay a lump sum sufficient to cover the period he would have to serve before retirement to make up for the higher benefits. And that lump sum would probably be so high, says Higgins, that most employe[e]s couldn't afford to join." *Id.*

C. The Charter requires approval by certain classes of individuals to modify a benefit under the City's retirement system.

Charter section 143.1 places a procedural requirement on the City prior to introduction and adoption of an ordinance to modify a retirement system benefit. Depending on the proposed modification, Charter section 143.1(a) requires approvals by vote of (1) employees, (2) San Diego voters, and/or (3) retirees. The voting requirements are set forth as follows:

> No ordinance amending the retirement system which affects the *benefits of any employee under such retirement system* shall be adopted without the approval of a majority vote of the members of said system. No ordinance amending the retirement system which increases the benefits of any employee, legislative officer or elected official under such retirement system, with the exception of Cost of Living Adjustments, shall be adopted without the approval of a majority of those qualified electors voting on the matter. No ordinance amending the retirement system which affects the vested defined benefits of any retiree of such retirement system shall be adopted without the approval of a majority vote of the affected retirees of said retirement system.

San Diego Charter § 143.1 (italics added).

The phrase, "benefits of any employee under such retirement system," as used in Charter section 143.1, is not specifically defined. When a term is not defined in a statute or charter provision, a court will give the term the effect of its usual, ordinary meaning. *California Teachers Ass'n v. San Diego Community College District*, 28 Cal. 3d 692, 698 (1981). "Benefit" generally means "advantage; privilege" or "profit or gain." Black's Law Dictionary (8th ed. 2004). "Under," in this context, means "within the group or classification of" or "subject to the authority, rule, or control of." Webster's II, New College Dictionary (3rd ed. 2005).

The term "retirement system" as contemplated in section 143.1 refers to the retirement system established pursuant to the authority of Charter section 141. *See Domar Electric, Inc. v. City of Los Angeles*, 9 Cal. 4th 161, 171 (1994) (stating that charter provisions are construed in the same manner as statutory provisions); *Dyna-Med, Inc. v. Fair Employment & Housing Commission*, 43 Cal. 3d 1379, 1387 (1987) (stating that the words of statutory sections relating to the same subject must be harmonized, both internally and with each other to the extent possible). Charter sections 142 and 144 discuss that the retirement system is to be established and administered by the Board of Administration. "Retirement system" has also been defined by ordinance as "the City Employees' Retirement System as created by [article 4]." SDMC § 24.0103.

The term "members" has been defined, by ordinance, to mean "any person employed by the City of San Diego who actively participates in and contributes to the Retirement System, and who will be entitled, when eligible, to receive benefits from the Retirement System. There are three classes of Member: General, Safety, and Elected Officer." SDMC § 24.0103.

Before the City Council adopts an ordinance amending the retirement system, which affects the benefits of any employee "under the retirement system," the City must obtain approval of a majority vote of the members of the retirement system. San Diego Charter § 143.1(a). We interpret "majority vote of the members of said system" to mean that a majority of the members of the retirement system, who are by definition City employees, must affirmatively vote for the benefit change. City Att'y MOL No. 2009-5 (June 1, 2009). It is our opinion that the voting requirement is not satisfied if the affirmative vote is solely a majority of the affected members or a majority of those voting. *Id.* The Fourth District Court of Appeal has stated that the voting requirement does not apply when the ordinance amending the retirement system "does not affect in any manner either the substantive benefits or the vested rights of any member of the retirement system." *Grimm*, 94 Cal. App. 3d at 41, fn. 4.

If the City Council intends to increase the benefit of any employee, legislative officer, or elected official under the retirement system, with the exception of cost of living adjustments, the City must obtain "the approval of a majority of those qualified electors voting on the matter." San Diego Charter § 143.1(a). This provision was added by San Diego voters with approval of Proposition B in November 2006. *See* San Diego Resolution R-302222 (Dec. 5, 2006) Additional requirements to approve an enhanced benefit are set forth in subsections (b) and (c) of San Diego Charter section 143.1. The requirement for voter approval of retirement system benefit increases sunsets fifteen years from January 1, 2007. San Diego Charter § 143.1(d).

If the City Council intends to amend the retirement system in a way that "affects the vested defined benefits of any retiree," the City must obtain "the approval of a majority vote of the affected retirees of said retirement system." San Diego Charter § 143.1(a). Therefore, any proposed ordinance seeking to amend a benefit under the retirement system must be analyzed to determine whether employees, retirees, or the San Diego electorate must approve the modification prior to ordinance introduction and adoption.

II. DISTINCTION BETWEEN NON-VESTED EMPLOYMENT BENEFITS AND VESTED RETIREMENT BENEFITS OR OPEB

A. Employment benefits may generally be modified subject to applicable procedural requirements.

As a general rule, the terms and conditions of public employment are governed by statute or ordinance rather than by contract, and employment benefits, including compensation, may be modified or reduced as long as the City complies with any applicable procedural requirements. *Miller v. State of California*, 18 Cal. 3d 808, 813 (1977). *See also Butterworth v. Boyd*, 12

Cal. 2d 140, 150 (1938); *San Bernardino Public Employees Ass'n v. City of Fontana*, 67 Cal. App. 4th 1215, 1221 (1998) (citing *California League of City Employee Ass'ns v. Palos Verdes Library Dist.*, 87 Cal. App. 3d 135, 139 (1978)). California courts distinguish between "employment benefits" and "pension rights."

> [P]ublic employment and the rights, duties, and conditions thereof are creatures of statute, not contract, and unless and until vested rights to retirement ripen into vested contractual rights, the Legislature may modify conditions of employment without violating vested pension rights which have become protected under the contract clauses of the Constitution.

Vielehr v. State of California, 104 Cal. App. 3d 392, 396 (1980).

In *Vielehr*, the appellate court distinguished employment benefits and retirement rights, and held that only retirement rights are entitled to contract clause protections. The court ruled that a statute reducing the amount of interest paid to public employees who withdrew their pension fund contributions upon leaving public service before retirement diminished a right of employment, not a right of retirement. *Id.* at 395-396. *See also Miller*, 18 Cal. 3d at 815-817 (holding that employee has no vested contractual right to remain in public employment beyond the age of retirement established by the Legislature); *Tirapelle v. Davis*, 20 Cal. App. 4th 1317, 1332-1333 (1993) ("It is well established that public employees have no vested rights to particular levels of compensation and salaries may be modified or reduced by the proper statutory authority.").

B. Principles of vesting and estoppel may limit the ability to modify certain benefits.

While public employment benefits may generally be modified so long as the City complies with any applicable procedural requirements, there is an exception. Public employment also "gives rise to certain obligations that are protected by the contract clause of the state and federal constitutions, including the right to payment of salary that has been earned." *Kern v. City of Long Beach*, 29 Cal. 2d 848, 852-853 (1947). A public employee's pension constitutes deferred compensation, meaning the right to a pension allowance paid in retirement is earned while an employee is working *See Betts v. Board of Administration*, 21 Cal. 3d 859, 863 (1978).

Under the United States Constitution, "No state shall . . . pass any . . . law impairing the obligations of contracts . . . " U.S. Const. art. I, § 10, cl. 1. Similarly, under the California Constitution, a "law impairing the obligations of contracts may not be passed." Cal. Const. art. I, § 9.

Vested pension benefits are obligations protected by the federal and state contracts clauses.[12] They cannot be abolished or impaired by repeal or changes in the law. *Kern*, 29 Cal. 2d at 853 (quoting *Dryden v. Board. of Pension Commissioners*, 6 Cal. 2d 535, 579 (1936) ("A pension right is an 'integral portion of contemplated compensation,' [and] cannot be destroyed, once it has vested, without impairing a contractual obligation.")); *see also* R.D. Hursh, Annotation, Vested Rights of Pensioner to Pension, 52 A.L.R. 2d 437 (1957).

The right to pension benefits vests upon the first day of employment, even though the right to payment of a full pension may not mature until certain conditions are met. *Miller*, 18 Cal. 3d at 815; *Betts*, 21 Cal. 3d at 863. An employee does not earn the right to a full pension until he has completed the prescribed period of service, but actually earns some pension rights as soon as he has performed substantial services for his employer. *Kern*, 29 Cal. 2d at 855. *See also California League*, 87 Cal. App. 3d at 139 ("[A]n employee begins earning pension rights from the day he starts employment."). The California Supreme Court has held:

> While payment of [pension] benefits is deferred, and is subject to the condition that the employee continue to serve for the period required by the statute, the mere fact that performance is in whole or in part dependent upon certain contingencies does not prevent a contract from arising, and the employing governmental body may not deny or impair the contingent liability any more than it can refuse to make the salary payments which are immediately due.

Kern, 29 Cal. 2d at 855 (concluding that city's action was unconstitutional when it denied a pension to a city employee who had worked for close to twenty years, on the basis that the city repealed the retirement provisions 32 days before the employee would have become eligible for the benefit). Outright destruction of pension rights for current employees is an unconstitutional impairment of contract. *Id.*

However, in *Kern*, the Court also stated that a "vested contractual right to a pension . . . is not rigidly fixed by the specific terms of the legislation in effect during any particular period in which [the employee] serves." *Id.* at 855.

> The statutory language is subject to the implied qualification that the governing body may make modifications and changes in the system. The employee does not have a right to any fixed or definite benefits, but only to a substantial or reasonable pension.

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[12] "Vested" means "having become a completed, consummated right for present or future enjoyment; not contingent; unconditional; absolute." Black's Law Dictionary (9th ed. 2009).

> There is no inconsistency therefore in holding that he has a vested right to a pension but that the amount, terms and conditions of the benefits may be altered.

Id.

Vested benefits are not limited to those in effect at the beginning of employment. Benefits promised or provided during the course of employment may also be or become vested benefits. *See Betts*, 21 Cal. 3d at 866; *Phillis v. City of Santa Barbara*, 229 Cal. App. 2d 45, 66 (1964); *Pasadena Police Officers Ass'n v. City of Pasadena*, 147 Cal. App. 3d 695, 703 (1983); *United Firefighters of Los Angeles v. City of Los Angeles*, 210 Cal. App. 3d 1095, 1107-08 (1989). "An employee's contractual pension expectations are measured by benefits which are in effect not only when employment commences, but which are thereafter conferred during the employee's subsequent tenure." *Betts*, 21 Cal. 3d at 866; *see also Carman v. Alvord*, 31 Cal. 3d 318, 325 (1982).

The *Betts* case is an example of an unconstitutional attempt by the employer, the State of California, to modify a vested retirement benefit after an employee left State service, but before the employee actually retired. In *Betts*, the California Supreme Court reviewed whether the petitioner, a former Treasurer for the State of California, was entitled to the retirement benefit computed by the formula in place when he left office or by a modified formula that was changed after the petitioner left office, but before his retirement and application for benefits. The Legislature changed the benefit computation method from a "fluctuating" system to a "fixed" system. *Betts*, 21 Cal. 3d at 862-863. The "fluctuating" system allowed for a retired member's monthly allowance to be adjusted periodically throughout the term of the pension to reflect changes to the salary of the current state Treasurer; the allowance under the "fixed" system was based on an annual amount equal to 5 percent of the highest compensation received by the officer while serving in the office, multiplied by the number of years of service credit. *Id.* [13]

When petitioner applied for retirement, he was told his allowance would be computed based on the modified "fixed" formula. *Id.* at 863. Following an administrative hearing and appeal, petitioner filed a writ of mandate directing the Public Employees' Retirement System to compute his retirement benefit on the basis of the salary payable to the present Treasurer ("fluctuating" system) rather than on the basis of the highest salary received by petitioner during his term of office ("fixed" system). *Id.* Petitioner contended that application of the modified, "fixed" benefit to him interfered with his vested contractual right to an earned pension. *Id.* The

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[13] Presumably, the change to a "fixed" system of compensation could result in a reduced or diminished benefit for the petitioner because the allowance was not tied to the salary of the current state Treasurer, which had increased after the petitioner left office. *See Allen v. City of Long Beach*, 45 Cal. 2d 128, 132 (1955) (explaining that replacing a "fluctuating" system of benefit computation with a "fixed" system of benefit computation constituted a disadvantage to affected employees because the retirement benefit freezes the benefit at a salary level preceding retirement and does not take into account future economic conditions including inflationary economic cycles).

California Supreme Court agreed, relying upon a long line of California decisions, including *Kern v. City of Long Beach*, 29 Cal. 2d 848, 852-853 (1947); *Wallace v. City of Fresno*, 42 Cal. 2d 180, 183 (1954); and *Allen v. City of Long Beach*, 45 Cal. 2d 128 (1955).

Another limitation on modification of an employment benefit is where an employee asserts a right to a benefit based on the legal theory of promissory estoppel. *See Van Hook v. Southern California Waiters Alliance*, 158 Cal. App. 2d 556, 570 (1958). The elements of a promissory estoppel claim are: (1) a clear and unambiguous promise must be made, (2) the party to whom the promise is made must actually rely on that promise, (3) the reliance must be reasonable and foreseeable, and (4) the reliance must result in injury. *Van Hook,* 158 Cal. App. 2d at 570. Analysis of a proposed modification to a retirement benefit should include consideration of any estoppel arguments that may be made. However, it is important to note that estoppel and other equitable theories may not be invoked against a governmental body where doing so would operate to defeat a policy designed to protect the public. *City of Long Beach v. Mansell*, 3 Cal. 3d 462, 493 (1970); *County of San Diego v. California Water & Tel. Co.*, 30 Cal. 2d 817, 826 (1947); *Emma Corp. v. Inglewood USD*, 114 Cal. App. 4th 1018, 1030 (2004); *Medina v. Board of Retirement*, 112 Cal. App. 4th 864, 869 (2003).

C. Modifications of vested benefits are limited to those changes reasonable and necessary to keep a retirement system flexible to permit adjustments in accord with changing conditions and to maintain the integrity of the retirement system, and modifications must be accompanied by comparable new advantages.

The California Supreme Court, in a series of cases, has held that a government employer is strictly limited in modifying or changing vested benefits. This rule, abbreviated in this Opinion as the *Kern/Allen/Betts* rule, says:

> The employee does not obtain, prior to retirement, any absolute right to fixed or specific benefits, but only to a "substantial or reasonable pension." Moreover, the employee's eligibility for benefits can, of course, be defeated "upon the occurrence of a condition subsequent." However, there is a strict limitation on the conditions which may modify the pension system in effect during employment.

Betts, 21 Cal. 3d at 863 (citing and quoting *Wallace v. City of Fresno*, 42 Cal. 2d 180, 183 (1954) and *Kern*, 29 Cal. 2d at 853).

Reasonable modifications to a pension benefit may be made prior to an employee's retirement for the purpose of (1) keeping a retirement system flexible to permit adjustments in accord with changing conditions and (2) to maintain the integrity of the system. *Allen*, 45 Cal. 2d at 131; *Abbott v. City of Los Angeles*, 50 Cal. 2d 438, 449-453 (1958). However, to be

sustained as reasonable, a modification to a pension must "bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages." *Allen,* 45 Cal. 3d at 131; *Maffei v. Sacramento County Employees' Retirement System*, 103 Cal. App. 4th 993 (2002). It is for a reviewing court to determine what is a permissible modification. *Betts,* 21 Cal. 3d at 864 (citing and quoting *Allen,* 45 Cal. 2d at 131; *Miller*, 18 Cal. 3d at 816).

When making modifications to a retirement system, the requirement of providing "comparable new advantages" to disadvantaged employees "must focus on the particular employee whose own vested pension rights are involved." *Betts*, 21 Cal. 3d at 864. An offsetting improvement must "relate generally to the benefit that has been diminished." *Betts*, 21 Cal. 3d at 864-865 (quoting *Frank v. Board of Administration*, 56 Cal. App. 3d 236, 245 (1976)).

Stated differently, to determine whether a modification to a pension plan is permissible, a court will measure the "advantage or disadvantage to the particular employees whose own contractual pension rights, already earned, are involved." *Abbott,* 50 Cal. 2d at 449, 454 (concluding that "the substitution of a fixed for a fluctuating pension is not permissible unless accompanied by commensurate benefits").

D. To determine whether a benefit is vested or not, a court will look to the actual language used by the legislative body to establish the benefit and the circumstances of its adoption.

To determine whether a benefit becomes a vested right which a public employer cannot abrogate without providing a comparable new advantage, a court will look at the language of the pension provisions as well as judicial construction of similar legislation at the time the contractual relationship was established. *Kern*, 29 Cal. 2d at 850; *San Bernardino Public Employees Ass'n v. City of Fontana*, 67 Cal. App. 4th 1215, 1223 (1998) (citing *Valdes v. Cory*, 139 Cal. App. 3d 773, 786 (1983)).

The analysis of whether a benefit is vested or not is fact-specific. It involves an inquiry into the legislative body's intent to create a protected contractual right and a factual analysis of how the benefits have been and are treated.

> A statute will be treated as a contract with binding obligations when the statutory language and circumstances accompanying its passage clearly . . . "evince a legislative intent to create private rights of a contractual nature enforceable against the State."

San Bernardino Public Employees Ass'n, 67 Cal. App. 4th at 1223 (quoting *Valdes v Cory*, 139 Cal. App. 3d 773, 786 (1983)). [14]

In determining whether a benefit is vested and only subject to modification under limited circumstances as set forth in *Kern/Allen/Betts*, a reviewing court will also analyze and interpret the contract at issue using established rules of analysis for contracts. *Sappington v. Orange Unified School District*, 119 Cal. App. 4th 949, 954 (2004). A court will look first at the actual descriptive language of the benefit and how specific or unspecific it is. *Id.* A court may also consider extrinsic evidence that is not in conflict with the specific language of the contract, such as collective bargaining history and legislative history of the benefit, any statutory or other authority that supports the benefit, and relevant facts concerning the employer's and employees' course of conduct in implementing a benefit over the years. *Id.* at 953. The *Sappington* court emphasized that a fact that employees or retirees "accepted" a benefit does not mean they understood that they were contractually entitled to the benefit. *Id.* at 954-955. "Generous benefits that exceed what is promised in a contract are just that: generous. They reflect a magnanimous spirit, not a contractual mandate." *Id.* at 955.

In *Sappington*, the retired employees argued that they had a vested right to free preferred provider organization [PPO] coverage because the school district employer had a long-standing policy that provided that the district "shall underwrite the cost of the District's Medical and Hospital Insurance Program for all employees who retire . . . . " *Id.* at 951, 953. Historically, the district paid the entire subscription cost for whichever health plan a retiree chose among those offered that year. *Id.* However, in 1998, as a result of the spiraling costs of health insurance and the district's dire financial condition, the district instituted a "buy-up charge" for participation in the PPO plan, but continued to offer the HMO at no cost. *Id.* at 951-952. The Fourth District of Court of Appeal affirmed the trial court's ruling that the district did not impair a vested contractual right. *Id.* at 951. The court focused on the nature of the benefit.

> The [trial] court construed the language of the policy in light of extrinsic evidence of the parties' course of conduct during the 20 years that preceded the District's purported breach. Specifically, the court took note of the regular changes in the mix of HMOs,

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[14] Note, "[n]o contractual obligation may be enforced against a public agency unless it appears the agency was authorized by the constitution or statute to incur the obligation; a contract entered into by a governmental entity without the requisite constitutional or statutory authority is void and unenforceable." *Air Quality Products, Inc., v. State of California*, 96 Cal. App. 3d 340, 349 (1979).

> indemnity plans, and PPOs offered, with attendant wide fluctuations in the retirees' costs for copayments, deductibles, and prescription drugs. The court also specifically noted the fact the District had offered free coverage under at least one HMO and one PPO/indemnity plan each year.
>
> The court concluded the policy does not obligate the District to offer free PPO coverage. In essence, the court construed the policy as a promise to offer at least *one* health insurance plan for which retirees pay no monthly premiums ("a District underwritten medical insurance plan"), and the court found the District's offer of free HMO coverage satisfies this contractual obligation.

Id. at 952-953.

The *Sappington* court held that retired school district employees had no vested interest in the PPO retiree benefit plan because they had no reasonable expectation that the district would always provide free PPO coverage as part of the medical insurance program. *Id.*

Core pension benefits, such as the formula used to compute pension, have been held to be vested. *Betts*, 21 Cal. 3d at 863. In a case involving the City's retirement system, the Fourth District Court of Appeal held that the pension provisions of the Charter "are an indispensable part of the contract of employment between a city and its employees, creating a right to pension benefits as an integral part of compensation payable under such contract, which vests upon acceptance of employment." *Abbott v. City of San Diego,* 165 Cal. App. 2d 511, 517 (1958).

Further, California courts have extended the principle of vesting to benefits other than core pension benefits. However, there is a split of authority within California's appellate courts regarding the standard that should be considered in the analysis.

In *California League of City Employee Ass'ns v. Palos Verdes Library District*, 87 Cal. App. 3d 135 (1978), the Second District Court of Appeal affirmed a trial court decision that a library district did not have the ability to unilaterally eliminate a longevity salary increase, a fifth week of vacation after ten years of continuous service, and a four-month fully paid sabbatical for librarians at the end of each six years of full-time service. The library district negotiated with the city's employee organization, but was unable to reach agreement. The district then exercised its authority under state collective bargaining provisions to unilaterally eliminate the benefits after exhaustion of required impasse procedures. *Id.* at 137. The employee organization petitioned the trial court for a writ of mandamus. The trial court found for the employee organization and ordered the library district to reinstate the benefits for the long-term employees. *Id.* at 137-138. The appellate court affirmed. *Id.* at 141.

The *California League* court stated that the key to determining the nature of the benefit was an evaluation of "the effect of [the benefit] in human terms and the importance of it to the individual in the life situation." *Id.* at 139-140 (citing and quoting *Bixby v. Pierno*, 4 Cal. 3d 130, 144 (1971)). The court said: "We think the trial court was correct in the circumstances of this case in concluding that the benefits were important to the employees, had been an inducement to remain employed with the district, and were a form of compensation which had been earned by remaining in employment." *Id.* at 140.

The court also found that a unilateral salary increase did not adequately offset the elimination of the benefits, under the principles of *Allen v. City of Long Beach*, 45 Cal. 2d 128 (1955), because the salary increase and the eliminated benefits constituted entirely different types of compensation and the salary increase fell unequally on different classes of employees. *Id.* at 140-141. Further, there was no evidence that the financial integrity of the district was at stake. *Id.*

The court emphasized that the library district had implemented the benefits as a matter of practice over a long period of time. *Id.* at 137. The benefits were set forth in the district's official policies pertaining to employment and they were seen as "significant incentives" and "inducements to the employees to remain in the service" of the district. Further, the longevity merit salary raises were awarded automatically and without any attendant labor negotiations. *Id.* at 138. "Because the raise is implemented only on the condition that the employee serve a stipulated term, the raise is deferred compensation for past services satisfactorily performed." *Id.* Regarding the fifth week of vacation after ten years, the court cited the trial court's opinion: "From the employee's perspective, every day on the job prior to ten years is an investment towards the realization of the promised future compensation." *Id.* As to the sabbatical leave, it was set forth in the employer's Personnel Policies and Procedures as a benefit to which the employee is "entitled . . . upon meeting the specified conditions." *Id.*

The trial court concluded, and the appellate court agreed: "In fact, an outright termination of any one of these benefits penalizes the employee who has contributed continuous service in anticipation of receiving the promised compensation, and allows the [library district] to reap the advantage of continued earned service that it intended to induce, without ever fulfilling its declared and implicit obligation." *Id.* *See also Thorning v. Hollister School Dist.*, 11 Cal. App. 4th 1598 (1992) (holding that retired school board members had a vested right to post-retirement continuation of paid health benefits because those benefits were included in the school district's official declaration of policy pertaining to remuneration and other benefits for board members, and such benefits were important to the board members as an inducement for their continued service on the board and a factor in their decision to retire).

In contrast to the decision of the *California League* court, the Fourth District Court of Appeal held that the trial court erred in concluding that employees represented by a public employee labor organization had vested, contractual rights to personal leave accrual, longevity pay, and retirement health benefits, and that such benefits could not be altered through collective

bargaining. *San Bernardino Public Employees Ass'n v. City of Fontana*, 67 Cal. App. 4th 1215, 1223 (1998). The court found that personal leave accrual and longevity pay were not vested, contractual rights because the benefits were provided in collective bargaining agreements of fixed duration between the city and its employee organizations. *Id.*

The court expressly rejected the holding of the *California League* case, and determined that the benefits in dispute in the *San Bernardino* case were provided in prior collective bargaining agreements reached between the city and its bargaining groups. *Id.* at 1223. Those agreements, as implemented through previous MOU, agreed upon pursuant to the MMBA, were of fixed duration. *Id.* The court concluded that once the MOU's expired, the employees had no legitimate expectation that the benefits would continue unless they were renegotiated as part of a new bargaining agreement. *Id.*

> We conclude that within the context of the [Meyers-Milias-Brown] Act, the collective bargaining process properly included such terms and conditions of employment as annual leave and longevity pay benefits. The benefits at issue could not have become permanently and irrevocably vested as a matter of contract law, because the benefits were earned on a year-to-year basis under previous MOU's that expired under their own terms. . . .
>
> Here, no outside statutory source gives the employees additional protection or entitlement to future benefits; therefore, the benefits are a proper subject of negotiation. . . .
>
> We conclude that personal leave and longevity pay benefits are simply terms and conditions of employment subject to negotiation in the collective bargaining process.

Id. at 1224-1226.

The court concluded that treating employment benefits as vested benefits "would subvert the policies underlying the [Meyers-Milias-Brown] Act . . . the MOU's were negotiated with representatives of the recognized employee organizations and were submitted to and approved by the general membership of those organizations . . . . The Act does not permit the employees to accept the benefits of a collective bargaining agreement and reject less favorable provisions." *Id.* at 1224-1225.

The *San Bernardino* court noted, "a collective bargaining unit may not bargain away individual statutory or constitutional rights which flow from sources outside the collective bargaining agreement itself." *Id.* at 1225 (citing *Wright v. City of Santa Clara*, 213 Cal. App. 3d 1503 (1989)). *See also California Teachers' Ass'n v. Parlier Unified School Dist.*, 157 Cal. App. 3d 174, 183 (1984) (holding that a collective bargaining agreement could not waive

benefits to which employees were statutorily entitled). Further, the *San Bernardino* court recognized that an "outside statutory source" may give employees "additional protection or entitlement to future benefits." *Id.* at 1225.

The *San Bernardino* court set forth a standard to use when determining constitutional vesting as follows: "For purposes of the constitutional ban on the impairment of contracts, "[a] statute will be treated as a contract with binding obligations when the statutory language and circumstances accompanying its passage clearly '. . . evince a legislative intent to create private rights of a contractual nature enforceable against the State.'" *Id.* at 1223 (citing *Valdes v. Cory*, 139 Cal. App. 3d 773, 786 (1983)).

It is important to note that the benefits at issue in the *San Bernardino* case were not pension benefits. Further, the affected labor organization agreed to the modifications of the benefits, and then filed a petition for writ of mandate to set aside the provisions of the memoranda of understanding. *Id.* at 1219. Also, as the court explained, the benefits were negotiated on a year-to-year basis and there was no separate statutory or legislative authority establishing the benefits. *Id.*

The *San Bernardino* case was recently relied upon by the United States Court of Appeals, Ninth Circuit, in a case involving the City benefit reductions for the San Diego Police Officers' Association [SDPOA]. SDPOA contended, in part, that the City violated SDPOA's constitutional rights following labor negotiations in 2005, when the City unilaterally imposed a reduction in salaries of employees who had entered the Deferred Retirement Option Program [DROP], a reduction in the City's pickup of the employee's share of retirement fund contributions, and a modification of eligibility for retiree health benefits. *San Diego Police Officers' Ass'n v. San Diego City Employees' Retirement System*, 568 F.3d 725, 729 (9th Cir. 2009).

SDPOA argued that the unilateral imposition of changes, following failure to reach agreement through negotiations, violated the officers' vested contractual rights, as established by previous collective bargaining agreements. *Id.* at 736. The Ninth Circuit disagreed.

The court held that the salaries paid to employees in DROP were terms of employment and as such employees had no vested contractual rights to a certain salary. *Id.* at 738. The court relied on evidence that a DROP participant is considered an active employee, subject to all terms and conditions of employment, including disciplinary actions up to and including termination. *Id.* at 737. The court pointed out that DROP is "an alternative form of pension benefit accrual under which an employee's final pension benefits under the defined benefit plan are determined and calculated as of the date the employee enters DROP." *Id.* at 732, fn. 3. The court reasoned that merely because a DROP member is considered "retired" for purposes of calculating retirement benefits does not transform a DROP participant's salary into a vested right. *Id.* at 737. Further, the court relied on the "established principle that indirect effects on pension

entitlements do not convert an otherwise unvested benefit into one that is constitutionally protected." *Id.* at 738 (citations omitted).

The court also dismissed SDPOA's argument that the City's pickup of a portion of the employees' retirement contribution was a vested contractual right. The court relied on language in Charter section 143 and the City's labor negotiation history to hold that the City's pickup of a portion of the employees' retirement contribution was an employment right subject to modification.

> Association concedes that pickups are a mandatory subject of bargaining, but it nonetheless claims that they are vested retirement benefits such that any reduction must be accompanied by a corresponding benefit . . . . Rather than citing any direct legal support for its assertion, Association seeks to rely on City's historical practice of negotiating the amount of pickup only in lieu of or in conjunction with salary *increases*. Yet that does not bear on the legal classification of City's pickup amount. Indeed, the very fact that City has historically equated modifications in pickup and salary amounts really confirms that City has treated pickups as a compensation term, not a retirement benefit.

Id. at 738-739.

Regarding modifications to the eligibility of retiree health benefits, the Ninth Circuit found the *San Bernardino* case better reasoned than the *California League* case. The Ninth Circuit emphasized that, in reviewing questions of whether contractual rights have been established, there is a "well-founded [legal] presumption," that an individual asserting a contractual right must overcome, "that a legislative body does not intend to bind itself contractually." *Id.* at 740 (citing *Robertson v. Kulongoski*, 466 F.3d 1114, 1117 (9th Cir. 2006)).[15] The Ninth Circuit said the key inquiry is the legislative intent to create a contract and an analysis of the existence of a contract.

> Were the recognition of constitutional contract rights to be based on the importance of benefits to individuals rather than on the legislative intent to create such rights, the scope of rights protected

[15] The *Robertson* court explained: "For many decades, this Court has maintained that absent some clear indication that the legislature intends to bind itself contractually, the presumption is that 'a law is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise.'" *Robertson*, 466 F. 3d at 1117 (citing *Dodge v. Board of Education,* 302 U.S. 74, 79 (1937)).

> by the Contracts Clause would be expanded well beyond the sphere dictated by traditional constitutional jurisprudence.

Id. at 740.

The Ninth Circuit relied on evidence showing the retiree health benefits were considered a term of employment that could be negotiated through the collective bargaining process, and "[a]s such, they were longevity-based benefits that continued only insofar as they were renegotiated as part of a new agreement and were not protectable contract rights." *Id.*

While there remains a split of authority in California's appellate courts between the *California League* test and the *San Bernardino* test to determine the nature of a benefit, it is our opinion that the *San Bernardino* test is the more appropriate test to use when analyzing this City's benefits. We are within the jurisdiction of the Fourth District Court of Appeal, which is the court that set forth the *San Bernardino* test. Further, the recent Ninth Circuit Court of Appeals case, involving the City's benefits, will serve as persuasive authority for any future litigation in California state court involving the City's benefits.

E. Questions to consider when analyzing the City's retirement benefits and OPEB

When analyzing whether certain City retirement benefits or OPEB are vested, the Charter is a critical document. Applying the analysis of the *San Bernardino* case, the rights and duties as set forth in the Charter are not negotiated on an annual or regular basis, rather they are modified only through a vote of the San Diego electorate; therefore, the Charter is a source of authority that may give employees protection or entitlement to future benefits. The Charter is also a document of restriction and limitation, and, as previously discussed, the Charter may create duties on the part of employees along with obligations of the City. *See* San Diego Charter § 2 ("The City of San Diego . . . shall have the right and power to make and enforce all laws and regulations in respect to municipal affairs, subject only to the restrictions and limitations provided in this Charter.")

The Charter provides the authority to the City Council to establish, by ordinance, a retirement system. San Diego Charter § 141. The Charter establishes the eligibility requirements, specifically the age and years of service needed, for an employee to receive a service retirement. *Id.* The Charter also sets forth the requirement that the retirement system be "conducted on the contributory plan." San Diego Charter § 143.

The Fourth District Court of Appeal, in a case involving the City, has concluded that the Charter cannot be amended to impair a vested pension right:

> Where a city charter provides for pensions, it is well settled that the pension rights of the employees are an integral part of the contract of employment and that these rights are vested at the time the employment is accepted. An amendment to the charter which attempts to take away or diminish these vested rights is an unconstitutional impairment of contract . . . The validity of attempted changes in vested pension rights depends upon the advantage or disadvantage to the individual employee whose rights are involved, and benefits to other employees cannot offset detriments imposed upon those whose pension rights have accrued.

Wisely v. City of San Diego, 188 Cal. App. 2d 482, 485-486 (1961) (citing *Kern v. City of Long Beach*, 29 Cal. 2d 848 (1947); *Allen v. City of Long Beach*, 45 Cal. 2d 128 (1955); and *Abbott v. City of Los Angeles*, 50 Cal. 2d 438 (1958)).

Other key documents for the analysis include the ordinances creating the benefit and any relevant MOUs with applicable employee organizations.

Applying the principles set forth by California courts, an analysis of the nature of a benefit may include the following questions:

1. Is the benefit a core pension benefit, under the City's retirement system, as authorized by the Charter?[16] If the benefit is not a core pension benefit, what is it?

2. Where does the benefit exist: solely in labor agreements or in another source of statutory authority?

3. What is the actual language that sets forth the benefit? What is the contractual agreement regarding the benefit?

4. What was the City Council's stated intent or desire in creating a benefit? What were if any, the factual circumstances surrounding creation of the benefit? Did the City Council intend to create a constitutionally protected right for employees that could not later be modified, except in limited circumstances?

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[16] As explained in this Opinion, the Charter contemplates a "normal retirement allowance" to be provided to eligible employees who attain a certain age and a certain number of years of service. The Charter also mandates that employees and the City contribute an amount "substantially equal" to pay for this retirement allowance.

5. Has the benefit been modified through the collective bargaining process? How has the City implemented the benefit, and what has been the course of conduct of the employees and the City regarding the benefit through the years?

These are not the only questions that may be asked to determine the nature of a benefit; however, they are questions that assist in the analysis.

III. APPLICATION OF GENERAL PRINCIPLES TO EMPLOYEES BY STATUS

A. Active, Represented Employees

The employment benefits of employees represented by one of the City's recognized employee organizations may be modified or eliminated, so long as the City complies with the requirements of the MMBA, at California Government Code sections 3500 through 3511 *See, e.g., Hinchliffe v. City of San Diego*, 165 Cal. App. 3d 722, 725 (1985) ("The public employee, thus, can have no vested contractual right to the *terms* of his or her employment, such terms being subject to change by the proper authority.")

The MMBA requires that the City, as a public agency employer, provide each recognized employee organization representing employees affected by a modification or elimination of a benefit, within the scope of representation, with reasonable written notice and opportunity to negotiate prior to a determination of policy or course of action. Cal. Gov't Code §§ 3504.5, 3505.

Agreements reached as a result of "meet and confer" under the MMBA are binding upon the City and its employees, once the agreement has been approved by the legislative body. *Glendale City Employees' Association, Inc. v. City of Glendale*, 15 Cal. 3d 328 (1975), *cert. denied,* 424 U.S. 943 (1976). The terms of agreements reached under collective bargaining statutes, such as the MMBA, bind individual unit members even though they are not formally parties to the collective bargaining agreement. *See San Lorenzo Education Ass'n v. Wilson*, 32 Cal. 3d 841, 846 (1982).

Future retirement benefits of current employees have been found to be a condition of employment and a mandatory subject of bargaining under the National Labor Relations Act [NLRA],[17] the federal statute governing private-sector bargaining, and the State Educational Employment Relations Act [EERA], governing bargaining for California's K-12 school and

[17] Case law interpreting the NLRA is persuasive in interpreting the MMBA. *Fire Fighters Union v. City of Vallejo*, 12 Cal. 3d 608, 616 (1974). Further, the Public Employment Relations Board [PERB], which administers and enforces the MMBA, will look to its interpretation of similar language in other collective bargaining statutes it administers when making determinations.

community college districts. *See, e.g. Allied Chemical Workers*, 404 U.S. 157 (1971); *Service Employees International Union v. County of San Joaquin*, PERB Dec. No. 1600-M (2004); *Temple City Education Ass'n v. Temple City Unified School District*, PERB Dec. No. 782 (1980).

An employee organization may not bargain away individual statutory or constitutional rights, which flow from sources outside the collective bargaining agreement itself. *San Bernardino Public Employees Ass'n,* 67 Cal. App. 4th at 1225 (citing *Wright v. City of Santa Clara*, 213 Cal. App. 3d 1503 (1989)). *See also California Teachers' Ass'n v. Parlier Unified School Dist.*, 157 Cal. App. 3d 174, 183 (1984) (holding that a collective bargaining agreement could not waive benefits to which employees were statutorily entitled). Further, the *San Bernardino* court recognized that an "outside statutory source" may give employees "additional protection or entitlement to future benefits." *Id.* at 1225.

Any ordinance amending a retirement system benefit that affects system members, who are employees, must be supported by a majority vote of the members of the system. San Diego Charter §143.1. An ordinance that provides a comparable new advantage likely would involve an increased benefit within the meaning of Charter section 143.1, and would trigger a vote of the San Diego electorate.

B. Active, Unrepresented Employees

The City is not required to follow the procedural requirements of the MMBA when modifying terms and conditions of employment for unrepresented employees, but the City must comply with any relevant civil service provisions for all classified employees. *See* San Diego Charter, art. VIII; SDMC ch. 2, art. 3; City of San Diego Personnel Regulations.

As a general rule, employment benefits of unclassified, unrepresented employees, also known as "at will" employees, can be modified by action of the City Council without negotiation or application of civil service provisions. An unclassified, unrepresented employee is deemed to have accepted the modification of an employment benefit if the employee continues the employment. *DiGiacinto v. Ameriko-Omsery Corp.*, 59 Cal. App. 4th 629, 636 (1997). *See also Olson v. Cory*, 27 Cal. 3d 532, 540 (1980) (holding that a statute limiting annual cost of living increases in judicial salaries was unconstitutional as to any judge whose term began before the statute was enacted, but could be applied to judges upon the commencement of new terms because a judge who completes one term during which he is entitled to unlimited cost-of-living increases and elects to enter a new term has impliedly agreed to be bound by the salary benefits then offered by the state for a different term).

The City may not modify a vested retirement benefit except under the *Kern/Allen/Betts* rule, which limits the modifications to keeping the retirement system flexible to respond to changing conditions and maintaining the integrity of the retirement system. The City must also provide a comparable new advantage to the disadvantaged employees. Any ordinance amending

the retirement system that affects the benefits of any employee under the retirement system must be approved by a majority vote of the members of the system, prior to City Council adoption of the ordinance. San Diego Charter § 143.1. Also, a Charter section 143.1 vote of the San Diego electorate would be needed to modify a vested benefit, where the offsetting advantage "increases the benefits of any employee . . ." within the meaning of this Charter section.

C. Future Employees

Prospective employees have no right to any pension or other employment benefit prior to accepting employment. *See Carman v. Alvord*, 31 Cal. 3d 318, 325 (1982). Therefore, benefits for prospective or future employees may be modified or eliminated, without any concern about whether the benefit is vested.

Further, if the City is modifying benefits of future employees, a Charter section 143.1 vote of system members is not required because the modification would not be "affect[ing] the benefits of any employee under such retirement system." The future employee does not yet exist, and therefore the benefit cannot be "affected" within the meaning of section 143.1. Further, no vote of the San Diego electorate is required should the City Council desire to increase benefits of future, prospective employees because, under the plain language of section 143.1, a vote of the electorate is only required when the City Council is contemplating "increase[ing] the benefits of any employee." By definition, a prospective employee does not yet have benefits, so they cannot be increased.

Any modification of core pension benefits that will affect future employees should be reviewed to ensure the City is in compliance with the Social Security Act. The City opted out of the Social Security System in 1982. *See* San Diego Ordinance O-15644 (Jan. 4, 1982); San Diego Resolution R-255609 (Jan. 4, 1982). Effective July 1991, the Social Security Act requires mandatory coverage and participation of public employees, who are not members of a public pension system that provides, at a minimum, benefits equivalent to Social Security benefits. Omnibus Budget Reconciliation Act, Pub. L. No. 101-508, 104 Stat. 1388 (1990).

Further, the City must meet and confer with its recognized employee organizations over any revisions to benefits for any future employees represented by the employee organizations. *See, e.g. Allied Chemical Workers*, 404 U.S. 157 (1971); *Service Employees International Union v. County of San Joaquin*, PERB Dec. No. 1600-M (2004); *Temple City Education Ass'n v. Temple City Unified School District*, PERB Dec. No. 782 (1980). The City must also ensure compliance with any applicable civil service rules. *See, generally*, SDMC ch. 2, art. 3.

D. Retired Employees

The well-established rule in California is that pension rights vest absolutely upon the happening of the event which is determinative of a public employee's pensionable status, that is once the "obligation due a pensioner after his status has become fixed by the happening of the

contingency which made the pension due and payable." *Terry v. City of Berkeley*, 41 Cal. 2d 698, 702-703 (1953). *See also Wallace v. City of Fresno*, 42 Cal. 2d 180, 183 (1954) (stating that vested retirement benefits are subject to an implied qualification that a governing body may make reasonable modifications *before* pensions become payable and that *before* that time the employee does not have a right to any fixed or definite benefits).

Unlike existing employees, retirees have actually relied on a benefit in retiring. Further, retirees are not represented and do not negotiate through the collective bargaining process with the City. In the *Terry* case, the Supreme Court held that a pension allowance could not be changed once a public employee was retired and receiving the benefit:

> In the present case the plaintiff had been retired; he had rendered the called-for performance; he had done everything possible to entitle him to the payment of his pension and all conditions precedent to the obligation of the city were fulfilled upon the determination that he be retired as a result of his service-connected disability. The pension payments are in effect deferred compensation to which the pensioner becomes entitled upon the fulfillment of the terms of the contract which may not be changed to his detriment by subsequent amendment.

Terry, 41 Cal. 2d at 703. *See also Teachers' Retirement Board v. Genest*, 154 Cal. App. 4th 1012, 1036-1037 (2007) (scope of continuing governmental power to modify contractual pension rights is virtually non-existent as to retirees). The *Genest* court cited the *Kern/Allen/Betts* rule and stated that "the retiree [is] entitled to the fulfillment without detrimental modification of the contract which he already has performed." *Id.* at 1036.

The question of whether retirees have a vested right to their post-retirement benefits is answered by looking to the terms of the collective bargaining agreement and other controlling documents under which the individual retired from City service. In *Thorning v. Hollister School Dist.*, 11 Cal. App. 4th 1598 (1992), the Court of Appeal held that elected school board members who had retired under a policy automatically granting post-retirement health benefits had a vested interest in those health benefits. Therefore, the employer could not unilaterally terminate those benefits. *Id.* at 1607.

Changes to a retirees' benefit can only be made if the change is not precluded by the policy that afforded it to them in the first instance. *See, e.g., Retired Employees Ass'n of Orange County, Inc. v. County of Orange,* 632 F.Supp. 2d 983, 984 (C.D. Cal. 2009) (elimination of pooling active and retired employees together to determine rates for health care benefits does not violate the vested benefit as the pooling was not part of the promised benefit); *Sappington v. Orange Unified School District,* 119 Cal. App. 4th 949, 954 (2004) (elimination of free coverage under PPO health insurance plan did not violate the vested benefit as the policy affording the

retiree health benefit provided only that the district would "underwrite" the insurance program, but not that it would provide all insurance policies free of charge).

Any proposed modifications to benefits of retired employees would be subject to the provisions of Charter section 143.1, which require "the approval of a majority vote of the affected retirees of said retirement system," prior to adoption of an ordinance amending the retirement system. San Diego Charter §143.1.

IV. LEGAL ANALYSIS OF PENSION BENEFITS AND OPEB

A. Application of General Principles to Specific Benefits

The general principles set forth in Sections I through III above guide the analysis of the specific retirement benefits and OPEB offered to City employees.

To summarize the general rule, as to active employees, employment benefits may be modified, subject to the procedural requirements of the MMBA and Charter section 143.1. Vested benefits may only be modified under the *Kern/Allen/Betts* rule, and must be accompanied by comparable new advantages. A reviewing court will determine the status of a benefit based on legislative intent and the specific facts surrounding the creation and continuation of the benefit. It will also determine whether modification of a vested benefit is reasonable and permissible.

The City may modify the benefits of future employees without concern for vesting or Charter section 143.1 issues. The City must comply with the MMBA when seeking to modify benefits of future employees who will serve within a specific recognized employee organization.

The benefits of retired employees vest upon their retirement, and retired employees are entitled to fulfillment without detrimental modification of the contract which has been performed. Further, a Charter section 143.1 vote of "affected retirees" would be required, if the City were to seek modification of a benefit within the limited parameters allowed by law.

This Office has analyzed the legislative intent and factual circumstances surrounding the creation and continuation of certain retirement benefits and OPEB. Applying the legal principles discussed in this Opinion, we provide the following chart, which sets forth our conclusions regarding the status of certain benefits. The legal analysis follows in the Appendices.

It is important to note that we have analyzed relevant facts as we have discerned them. If there are additional or different facts, the analysis may change.

BENEFIT	VESTED	SECTION 143.1 EMPLOYEE VOTE REQUIRED	MMBA COMPLIANCE FOR REPRESENTED EMPLOYEES	APPENDIX
Retirement Benefit Factor	**Yes**	**Yes**	**See note 1.**	**A**
COLA	**Yes**	**Yes**	**See note 1.**	**B**
Employer Pickup	**No**	**No**	**Yes**	**C**
13th Check	**Yes**	**Yes**	**See note 1.**	**D**
Disability Retirement	**Yes**	**Yes**	**See note 1.**	**E**
DROP	**No**	**No. See note 2.**	**Yes**	**F**
SPSP	**Yes**	**No. See note 3.**	**See note 1.**	**G**
Retiree Health Benefit	**No**	**No**	**Yes**	**H**

Note 1: If a retirement benefit is vested, it limits the discretion of the City to renegotiate the benefit. As discussed, the *Kern/Allen/Betts* rule applies, which provides that any modification that involves a detriment to employees must be accompanied by comparable new advantages. Further, changes to a benefit that would result in an unconstitutional impairment of vested contract rights are outside of the discretion of the City and employee organizations to negotiate, and are not mandatory subject s of bargaining under the MMBA. *See Wright v. City of Santa Clara*, 213 Cal. App. 3d 1503 (1989). Where a proposed change to a benefit does not impact an individually protected, vested right of an active, represented employee, the proposed change is a mandatory subject of bargaining.
Note 2: SDCERS disagrees and has notified the City that it believes a Charter section 143.1 vote is required prior to City Council approval of an ordinance amending the DROP provisions in the SDMC.
Note 3: Modification to SPSP require a vote of participants as defined by and under the terms of the Plan document.

B. Two-Tiered Plan For Active Employees

To address budget issues, other California jurisdictions are considering pension alternatives, including an elective, two-tier retirement system for active employees. The City presently has a non-elective, two-tier retirement system, in which employees hired on or after July 1, 2009 have a reduced "defined benefit" plan. *See* SDMC § 24.0402.1. It has been suggested that the City of San Diego extend the non-elective, two-tier system to active employees requiring that they elect between the pre-July 1, 2009 defined benefit pension plan and post-July 1, 2009 pension hybrid plan. This suggestion is based on the passage of SB 752 in October, 2009, which amended the County Employees Retirement Law allowing Orange County

to offer this type of mandatory pension election. SDCERS and its outside tax counsel have informed us that this type of mandatory pension election plan for active employees may create tax qualification and IRS concerns. The concern is that giving employees a choice between two plans during the course of employment may violate Internal Revenue Code section 414(h), which in turn may jeopardize the tax qualification of the plan.

CONCLUSION

Under settled case law, core pension benefits are vested benefits, which may not be bargained away through the collective bargaining process. Core pension benefits are considered deferred compensation. They vest upon the first day of employment, and may only be modified or changed to allow for flexibility to adjust to changed economic circumstances and to protect the integrity of the retirement system. Any change in a vested benefit must be accompanied by "comparable new advantages" for employees disadvantaged by the change.

Employment benefits are terms and conditions of employment, which may be modified or eliminated through the collective bargaining process and pursuant to any relevant civil service provisions.

To determine whether a benefit becomes a vested right which a public employer can abrogate in only limited circumstances and by providing a comparable new advantage, a court will look at legislative intent and factual, historical analysis of the benefit. Where benefits have been regularly negotiated or modified through the collective bargaining process, courts are likely to treat the benefit as an employment benefit subject to change or modification, not a benefit that is protected by the federal and state constitutional provisions protecting contracts. However, generally, once an employee retires, the benefit is vested and not subject to modification.

To change benefits under the retirement system, Charter section 143.1 creates an additional procedural requirement of approval, through an election of active members, retirees, or the electorate depending on the proposed change or amendment to the retirement system.

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JFD:WJG:jdf:jab
Attachments
LO-2010-1

APPENDIX A

Retirement Benefit Factors

The retirement benefit factors for General Members of SDCERS are set forth in the tables to SDMC sections 24.0402 and 24.0402.1 and for Safety Members in the table to SDMC section 24.0403. These charts are provided at the end of Appendix A.

The retirement benefit factors were increased as a result of MPI in 1996, the *Corbett* settlement in 2000, and MPII in 2002. MPI and MPII were both negotiated agreements, involving the City's recognized employee organizations and approved by the City Council. The SDCERS Board of Administration also approved the components of the agreements involving funding of the retirement system. In March 2000, the City and SDCERS settled a class action lawsuit brought by SDCERS' members, with Corbett as the named class plaintiff. Under the *Corbett* settlement, the City gave increased pension benefits to both current and retired City employees.

The increase in benefit factors created by MPI and MPII is the subject of pending litigation. San Diego Superior Court Case No. GIC841845. The current issues in the case include the legality of MPI and MPII. The City's complaint alleges, in part, violations of the Government Code section 1090 conflict of interest prohibition and the California Constitution provisions relating to debt limits. The City has asserted that SDCERS officials violated these laws when they approved the underfunding of the trust fund to permit these benefit increases because (1) these officials stood personally to benefit from the increases; (2) the benefit increases were contingent upon allowing underfunding of the pension system the officials were duty-bound to protect; and (3) the debt created exceeded same-year revenues without the required voter approval. The City's complaint seeks to have the benefit increases granted by MPI and MPII rescinded.

The issue of the legality of MPI and MPII remains to be adjudicated Assuming the litigation results in a finding that MPI and MPII were lawfully created, the question is whether the benefit factor increases created by MPI and MPII are vested.

A public pension benefit becomes vested at the commencement of employment. It is that level of benefit that an employee relies upon in accepting employment and upon which the public employer obligates itself. *Carman*, 31 Cal. 3d at 325; *Miller*, 18 Cal. 3d, at 815; *Betts*, 21 Cal. 3d, at 863-864. "An employee's contractual pension expectations are measured by benefits which are in effect not only when employment commences, but which are thereafter conferred during the employee's subsequent tenure." *Betts*, 21 Cal. 3d at 866.

An employee is also entitled to and in fact has a vested right to benefit increases promised during the course of employment. *Phillis v. City of Santa Barbara*, 229 Cal. App. 2d 45, 66 (1964); *Pasadena Police Officers Ass'n v. City of Pasadena*, 147 Cal. App. 3d 695, 703 (1983); *Betts*, 21 Cal. 3d at 866; *United Firefighters of Los Angeles City*, 210 Cal. App. 3d at 1107-1108. Therefore, employees are entitled to the highest benefit factor in existence during their employment for all creditable service years, including those years yet to be worked.

The most reliable evidence of the legislative intent underlying the benefit factor increases created by MPI and MPII is the City's agreement to enter into MPI and MPII. Execution of MPI and MPII were contingent upon the agreement of the City's recognized employee organizations and SDCERS. The provisions of MPI and MPII were included in the memoranda of understanding with the City's employee organizations. This cooperation and agreement was essential for the City to achieve its desire, prompted by financial issues, to postpone full payment of the ARC. The agreement was also needed to place a funding trigger dictating when the City would be required to increase its payments, a component of MPI, and subsequently lowering the funding trigger, a component of MPII. The agreed-upon funding trigger would continually allow the City to avoid payment of the full ARC if the pension system was funded to a certain ratio. In order to achieve its goal, the City promised the employee organizations increases in the benefit factors. The underfunding of the ARC is now prohibited as a result of the amendment to Charter section 143, approved as Proposition G by San Diego voters in November 2004.

The benefit factors in existence at commencement of employment and during employment are core pension benefits that are vested. Applying well-established case law, it is likely that a court would find that diminishing the retirement benefit factor even for years yet to be worked would impair a vested right. The benefit factors may not be modified for existing employees unless the modification is reasonable in nature, necessary to integrity of the system, and accompanied by a comparable new advantage. Additionally, any modification would be subject to a membership vote pursuant to San Diego Charter section 143.1.

City of San Diego Employee Pension Retirement Factor
[Annual pension benefit = Retirement Factor x Highest Salary x Years of Service]

Age	Before MP1	After MP1 (1996)	After Corbett (2000)	After MP2 (2002)
General Employees				
55	1.48	2.00	2.25	2.50
56	1.55	2.00	2.25	2.50
57	1.63	2.00	2.25	2.50

58	1.72	2.00	2.25	2.50
59	1.82	2.08	2.25	2.50
60	1.92	2.16	2.30	2.55
61	1.99	2.24	2.35	2.60
62	2.09	2.31	2.40	2.65
63	2.20	2.39	2.45	2.70
64	2.31	2.47	2.50	2.75
65+	2.43	2.55	2.55	2.80
Police				
50	2.50	2.50	3.00	n/a
51	2.54	2.60	3.00	n/a
52	2.58	2.70	3.00	n/a
53	2.62	2.80	3.00	n/a
54	2.66	2.90	3.00	n/a
55	2.70	2.99	3.00	n/a
56	2.77	2.99	3.00	n/a
57	2.77	2.99	3.00	n/a
58	2.77	2.99	3.00	n/a
59	2.77	2.99	3.00	n/a
60	2.77	2.99	3.00	n/a
61	2.77	2.99	3.00	n/a
62	2.77	2.99	3.00	n/a
63	2.77	2.99	3.00	n/a
64	2.77	2.99	3.00	n/a
65	2.77	2.99	3.00	n/a
Fire				
50	2.20	2.50	3.00	n/a
51	2.32	2.60	3.00	n/a
52	2.44	2.70	3.00	n/a
53	2.57	2.80	3.00	n/a
54	2.72	2.90	3.00	n/a
55	2.77	2.99	3.00	n/a
56	2.77	2.99	3.00	n/a
57	2.77	2.99	3.00	n/a
58	2.77	2.99	3.00	n/a
59	2.77	2.99	3.00	n/a
60	2.77	2.99	3.00	n/a
61	2.77	2.99	3.00	n/a
62	2.77	2.99	3.00	n/a

63	2.77	2.99	3.00	n/a
64	2.77	2.99	3.00	n/a
65	2.77	2.99	3.00	n/a
Lifeguards				
50	2.00	2.20	3.00	n/a
51	2.10	2.32	3.00	n/a
52	2.22	2.44	3.00	n/a
53	2.34	2.57	3.00	n/a
54	2.47	2.72	3.00	n/a
55	2.62	2.77	3.00	n/a
56	2.62	2.77	3.00	n/a
57	2.62	2.77	3.00	n/a
58	2.62	2.77	3.00	n/a
59	2.62	2.77	3.00	n/a
60	2.62	2.77	3.00	n/a
61	2.62	2.77	3.00	n/a
62	2.62	2.77	3.00	n/a
63	2.62	2.77	3.00	n/a
64	2.62	2.77	3.00	n/a
65	2.62	2.77	3.00	n/a

APPENDIX B

Cost of Living Adjustment

The Cost of Living Adjustment [COLA] benefit for retirees is set forth in SDMC section 24.1505. The COLA was created in 1971. San Diego Ordinance O-10479 (Jan. 1, 1971). It provides for a cost of living adjustment for retirees based on increases or decreases of the Bureau of Labor Statistics Consumer Price Index [CPI]. It provides for up to a two percent increase or decrease in a retiree's monthly pension payment based upon the CPI.[18] It is mandatorily adjusted annually.

The COLA provision as presently set forth in SDMC section 24.1505 has been in effect since its initial adoption by the City Council. While amendments have occurred over the years, they were minimal in number and did not involve substantive change.[19] The COLA is actuarially factored into the cost of retirement. SDMC section 24.1506 mandates that any anticipated COLA based upon services rendered after July 1, 1971, be shared equally between the City and the contributing member.

The COLA is designed to deal with inflationary or recessionary pressures for the benefit of the system and its retirees. The impetus for the City Council's approval of the COLA benefit was the financial plight of retirees' pensions in a time of runaway inflation.[20] SDCERS has no discretion regarding the COLA benefit. Further, the benefit has been applied consistently since its inception in 1971.

California courts have held that cost of living adjustments are vested pension benefits for both active employees and retirees. *See Allen v. Board of Administration*, 34 Cal. 3d 114 (1983) (holding that a change from an uncapped COLA tied to CPI to a capped at 2 percent COLA was invalid as impairing a vested benefit for retired legislators); *Claypool v. Wilson*, 4 Cal. App. 4th 646 (1992) (holding that the repeal of COLA and the use of those funds to offset employer's pension contributions was invalid as impairing a vested benefit for active employees and retirees); *Teachers' Retirement Board,* 154 Cal. App. 4th at 1012 (holding that the reduction in mandatory state funding for teachers' "purchasing power supplemental payment" similar to a COLA and the transfer of the funds to the state's general fund was invalid as impairing a vested benefit for retirement board on behalf of retirees); *Pasadena Police Officers Ass'n v. City of Pasadena*, 147 Cal. App. 3d 695 (1983) (holding that the amendment of a COLA from an

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[18] Not to diminish below the level of the monthly retirement benefit at retirement commencement.

[19] Initially, the increases or decreases were capped at 1.5 percent. As a result of the settlement of the *Andrews* litigation, the percentage was increased to 2.0 percent. San Diego Ordinance O-16679 (June 30, 1986). The benefit was also reenacted and renumbered as San Diego Municipal Code section 24.1505. San Diego Ordinance O-18608 (Jan. 11, 1999).

[20] *See e.g.*, Memorandum from Retirement Board of Administration to the Honorable Mayor and City Council, "Proposed Modifications to the City Employees' Retirement System," City Clerk Document No. 728625 (July 3, 1069).

unlimited COLA tied to the CPI to a COLA with a two-percent cap was invalid as impairing a vested benefit for active and retired police officers and firefighters); *Olson v. Cory*, 26 Cal. 3d 672 (1980) (holding that a change from an unlimited COLA tied to California CPI to a COLA tied to California CPI, but not to exceed five percent of individual judge's salary ,was invalid impairment of a vested benefit for both active and retired judges); *United Firefighters of Los Angeles City v. City of Los Angeles*, 210 Cal. App. 3d 1095 (1989) (holding that a change from an uncapped COLA tied to CPI to one capped at three percent impaired a vested benefit of active employees). *See also Association of Blue Collar Workers v. Wills*, 187 Cal. App. 3d 780 (1986) (holding that unfunded retroactive liability attributable to full City-paid COLA was financial liability of City and not that of active employees).

Based on the legislative history of the benefit and applying existing case law, we contend the COLA was intended to be a binding contractual obligation entitled to constitutional protection from impairment. Therefore, the COLA benefit is a vested pension benefit.

Questions have been raised regarding whether the COLA can be limited prospectively. As to retirees, the COLA cannot be limited because, as previously discussed, the benefit is vested and has been conferred. *See Kern*, 29 Cal. 2d at 854- 855; *Allen,* 34 Cal. 3d at 119-20; *Claypool,* 4 Cal. App. 4th at 664; *Betts*, 21 Cal. 3d at 864-65. As to active employees, it is our opinion that the benefit is vested and cannot be modified unless the modifications are necessary to preserve the integrity of the pension system and are accompanied by comparable new advantages, as required by the *Kern/Allen/Betts* rule. Further, the offsetting improvement must relate to the benefit that has been diminished. *Betts*, 21 Cal. 3d at 864-65. Additionally, any modification would be subject to membership vote under Charter section 143.1.

APPENDIX C

Employer "Pickups" of Employees' Contributions

The rates of contributions for employees into the retirement system are set forth in SDMC sections 24.0201 (General Members) and 24.0301 (Safety Members). Those sections provide that the normal rate of contribution is determined by SDCERS, and is based upon the member's age upon entry into the system.

San Diego Charter section 143 provides that the contributions are to be made jointly by the City and the employees, and the City shall contribute annually an amount "substantially equal to that required of the employees for normal retirement allowances." San Diego Charter § 143.

Historically, the City has "picked up" a portion of the employee's share of contributions. The amount or percentage of this "pickup" has been negotiated through the collective bargaining process, and has been memorialized in MOU's between the City and its recognized employee organizations (or imposed where no agreement is reached). The pickup has been adopted by the City Council in the annual salary ordinance. This practice is recognized in that the definition of "base compensation" for purposes of determining retirement allowance expressly does not include "the amount of an employee's retirement system contribution which the City pays on behalf of the employee [the Retirement Offset]." SDMC § 24.0103. It may be argued that this practice violates the Charter mandate that the contributions of the City and the employees be "substantially equal." San Diego Charter § 143.

In light of the practice of negotiating the pickup pursuant to the collective bargaining process, the City and its bargaining groups have treated the pickup as an employment benefit changing from year to year, and differing as to each represented class of employees depending on the respective agreements reached. Under the rule expressed in the *San Bernardino* case, the pickup is an employment benefit, subject to collective bargaining procedures. Further, the pickup is not a benefit under the retirement system, as defined by Charter section 143.1. Therefore, modification of the pickup does not require a Charter section 143.1 vote. During the Fiscal Year 2010 meet and confer process, pickups were either reduced or eliminated altogether as to most employee groups. To the extent they still exist, they can continue to be modified or eliminated through the meet and confer process.

Moreover, the recent Ninth Circuit opinion, in *San Diego Police Officers' Ass'n v. San Diego City Employees' Retirement System*, 568 F.3d 725, 739 (9th Cir. 2009), concluded that the amount of the City's "pickup" was a negotiated employment benefit not entitled to constitutional protections.[21]

The City's pickup of employees' contributions is a negotiated employment benefit not entitled to constitutional protection. Consequently, it may be altered premised upon satisfaction of the collective bargaining requirements.

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[21] This conclusion is limited to the amount of the City's pickup of the employee's contribution. If the amount of the employee's percentage of contribution were increased to a level that in essence would constitute a pickup of a portion of the City's contributory share, it is likely such an arrangement would be found invalid. *See Allen v. City of Long Beach*, 45 Cal. 2d 128 (1955) (attempts at increasing employee contributions beyond that which were legally required were invalid); *Wisley v. City of San Diego*, 188 Cal. App. 2d 482 (1961). In *Wisley*, the court reviewed the question of whether or not increases in the percentage of salary deductions, modified by Charter amendment, were reasonable and constitutional. *Wisely*, 188 Cal. App. 2d at 485. The court concluded that an increase in the percentage of an employees' contribution to the retirement fund was not reasonable because it was a detriment to employees, which was not offset by a commensurate benefit. *Id.* at 487. *but see International Ass'n of Firefighters v. City of San Diego*, 34 Cal. 3rd 292 (1983).

APPENDIX D

13th Check

Pursuant to SDMC section 24.1503, the Annual Supplemental Benefit or "13th Check" [13th Check] is paid to retirees who: (1) have a minimum of ten years of creditable service; (2) are on the retirement roll for the month of October in any year that the benefit is paid; and (3) are retired General Members, retired Safety Members, Retired Unified Port District Members, or Special Class Safety Members who are receiving a fixed monthly benefit, or survivors of these members. Legislative Members and Special Class Safety Members receiving fluctuating monthly benefits are not eligible.

The 13th Check is paid by SDCERS in years during which the investment earnings received exceed $100,000 after interest is paid to all members' contribution accounts and SDCERS' administrative expenses are paid. In any year when the net amount is less than $100,000, the benefit is not paid. If the net amount is positive, but less than $100,000, it is carried over to subsequent years until the $100,000 base is met. With limited exceptions, the benefit has been paid almost every year.

The 13th Check was initially created by the City Council in 1980 for the purpose of addressing the problems "faced by retired employees as a result of extreme inflationary factors." San Diego Ordinance O-15353 (Oct. 6, 1980).[22]

The amount of the 13th Check is capped with the amount of the cap varying depending on date of retirement, with the most being $75 and the least being $30 per creditable service year. SDMC § 24.1503(b). This cap was initially instituted by SDCERS as a result of excellent investment earnings in the early 1980s, which resulted in larger than expected payments to retirees.

As a result of the cap instituted by SDCERS in the early 1980s, the *Andrews* lawsuit was filed.[23] The litigation settled with the City agreeing to certain benefit enhancements and making a one time payment of 9.7 million dollars to the member classes, as well as continuation of the 13th Check with the annual cap imposed by SDCERS. *See* San Diego Ordinance O-16679 (June 30, 1986).

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[22] The benefit was amended in 1981 to extend to Special Safety Members. San Diego Ordinance O-15593 (Oct. 5, 1981). It was amended in 1985 with no substantive change. San Diego Ordinance O-16449 (June 24, 1985). It was amended in 1986 to institute a $30 per creditable service year cap instituted by SDCERS. San Diego Ordinance O-16679 (June 30, 1986). It was amended in 1996 to increase the annual $30 cap . San Diego Ordinance O-18364 (Dec. 2, 1996). It was amended in 1999 with no substantive change. San Diego Ordinance O-18608 (Jan. 11, 1999).

[23] *Andrews v. City of San Diego*, San Diego County Superior Court Case No. 515699.

The 13th Check's creation and formation is relevant to whether or not it can be eliminated. It exists in its present form pursuant to the settlement and judgment in the *Andrews* litigation. Therefore, any elimination or even diminishment to existing employees or retirees might equate to a breach of the settlement agreement and judgment resulting in possible liability to the City. The 13th Check was prospectively eliminated for those hired or assuming office on or after July 1, 2005. SDMC § 24.1503.1.

We assert that the 13th Check may not be eliminated for members hired or assuming office prior to July 1, 2005 because that would constitute a breach of the settlement agreement and judgment entered in the *Andrews* litigation. Even without the *Andrews* settlement as a factor, it is our opinion that a court would likely find the 13th Check to be a vested retirement benefit. It has been paid almost every year since 1980. It is a component of a member's retirement benefit administered by the SDCERS Board of Administration and paid for from the retirement trust fund. The benefit is not negotiated in labor negotiations. It has never been reduced since the codification of the annual cap and it cannot be reduced. As a benefit to battle "extreme inflationary factors," the 13th Check is similar to the COLA, intended to continue indefinitely to battle inflationary pressures on a retiree's retirement benefit.

APPENDIX E

Disability Retirement

Disability retirement benefits are set forth in chapter 2, article 4, division 5 of the SDMC. The stated purpose for the benefit is to "eliminate hardship or prejudice" to an employee who becomes incapacitated.[24] Two different types of disability retirements are provided, Industrial Disability Retirement [IDR][25] and Non Industrial Disability Retirement [DR].[26]

A member is eligible for an IDR when: (1) the member is permanently incapacitated from the performance of duty; (2) the member's incapacity is the result of injury or disease arising out of or in the course of his or her City employment; and (3) the member's incapacity renders his or her retirement necessary.[27] The benefit payable for an IDR is fifty percent of the final compensation. A member may also receive an additional annuity, if he or she purchased the annuity with accumulated additional contributions. SDMC §§ 24.0503, 24.0505.

If the incapacity is not the result of injury or disease arising out of the course of employment, the member is entitled to a DR. The benefit payable for a DR is an annuity, which is the actuarial equivalent of the accumulated contributions at the time of retirement. Additionally, and assuming the incapacity is not the result of willful misconduct or a violation of law, the member receives an amount derived from City contributions that would equal ninety percent of 1/60th of the member's final compensation multiplied by the member's years of creditable service, or 1/3 of his or her final compensation, whichever is greater. SDMC §§ 24.0504, 24.0506.

Regardless of whether an employee is provided an IDR or a DR, if an incapacitated member is otherwise eligible for a service retirement, the member will receive his or her full service retirement, if the service retirement provides a greater benefit than the IDR or DR. SDMC § 24.0502.

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[24] San Diego Ordinance O-6168 (June 22, 1954).

[25] SDMC § 24.0501. Although less than clear from historical research, it appears the IDR benefit was initially created on June 22, 1954 by San Diego Ordinance O-6168, and was created to eliminate the hardship for those who become incapacitated. Numerous amendments have occurred over the years, most of which were not substantive. The few substantive amendments located increased the benefit. *See e.g.*, San Diego Ordinances O-18840 (Sept. 12, 2000) (expanding the benefit to medical conditions previously exempted); O-17938 (July 12, 1993) (eliminating or limiting preexisting conditions historically a bar to an IDR); and O-19121 (Nov. 18, 2002) (expanding the benefit to employees who are violently attacked).

[26] SDMC §§ 24.0504 , 24.0506. The DR benefit was created in 1965 by San Diego Ordinance O-9247. (June 6, 1065).

[27] Employees enrolled in the system after September 3, 1982, are subject to the additional criteria that the incapacity did not arise from a preexisting medical condition or a nervous or mental disorder. SDMC § 24.0501(b)(4).

As a retirement benefit, a disability retirement is a vested benefit. *Dickey v. Retirement Board*, 16 Cal. 3d 745, 748 (1976). The benefit provides retirement income when an employee is injured or ill and unable to work. The City's obligations to pay a service retirement and a disability retirement are the same. The difference between the two for the employee is the contingent factors of when the retirement is to be paid and the amount that is to be paid. *See Frank v. Board of Administration*, 56 Cal. App. 3d 236, 243 (1976) ("No reason exists in plaintiff's case to apply a different rule [vested entitlement] to disability retirement benefits than to service retirement benefits.") The right to a DR or IDR, like a service retirement, is promised at commencement of employment, and employees rely on the City's representation of the benefit when they accept City employment. The benefit has not been negotiated or otherwise diminished. It is our opinion that the benefit cannot be eliminated as to present employees in the absence of application of the *Kern/Allen/Betts* rule and a Charter section 143.1 vote.

"Double Dipping" is a phrase commonly used when an employee receives both workers' compensation benefits and IDR. While workers' compensation benefits and IDR differ in terms and are governed by different legal standards, they are similar in that they both provide monetary compensation for work-related injuries or illnesses that prevent employees from returning to work. Further, in most circumstances, workers' compensation benefits cease if an employee becomes eligible for IDR. There are instances when an employee may be awarded a workers' compensation total disability award, which may be paid out as an annuity. In such cases, the employee may receive both benefits.

SDMC section 24.0515[28] provides for an offset of workers' compensation disability compensation that an employee receives because of an injury or illness that subsequently gives rise to an IDR. The offset freezes IDR payments for the time period that would monetarily equate to the workers' compensation amount received. However, by its own terms, the offset of SDMC section 24.0515 only applies to Safety Members hired on or after October 1, 1978 and before January 1, 1988, and General Members hired on or after October 1, 1978 and before July 1, 1989. The January 1, 1988 sunset of this offset for Safety Members and the July 1, 1989 sunset for General Members were the result of labor negotiations. San Diego Ordinances O-16992 (Dec. 7, 1987), O-17295 (May 15, 1989).

In order to eliminate "double dipping," the sunset provisions of section 24.0515 need to be eliminated prospectively. The sunset provisions are not retirement benefits capable of vesting. Rather, they act as a bar to an offset for two income streams for the same injury or condition. The right to a disability retirement would still exist without any diminishment.

This conclusion is not inconsistent with the conclusion that a disability retirement is a vested benefit. There would be a temporary suspension of the benefit while receiving a similar benefit in the workers' compensation context. Because this would serve to prevent possible double payments, as opposed to diminishing the right to payment, it is our opinion that the City

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[28] Created by San Diego Ordinance O-12430 (Aug. 28, 1978).

Council may amend SDMC section 24.0515 to extend its application to all employees. However, modification or elimination would be subject to meet and confer requirements and a membership vote pursuant to Charter section 143.1.

"Topping Off" is a phrase erroneously used to describe an amount paid in excess of the disability retirement benefit to reach the higher level of a full service retirement. The disability payment is mathematically set by the SDMC with a maximum benefit of fifty percent of final compensation (plus any annuity based on additional employee contributions if they were made). SDMC §§ 24.0503, 24.0505. There is no "top off" or other enhancement provision in the SDMC that would elevate an IDR payment beyond that which is set forth in the SDMC. However, a disabled employee is entitled to receive a retirement benefit higher than the IDR maximum amount if he or she is eligible for a service retirement at the time of disability and that service retirement benefit is greater than the IDR benefit. SDMC § 24.0502. In other words, if the disabled member is already eligible for a service retirement, the member cannot be "penalized" for his or her disability by being compelled to take a lower IDR benefit than what he or she is already entitled to receive for service. In such a case, there is no additional cost to the City. Rather, there are favorable tax consequences for the retiree because a portion of a disability retirement is tax exempt. This cannot be construed as a "topping off," or an otherwise enhancement of an IDR benefit.

APPENDIX F

Deferred Retirement Option Plan

The Deferred Retirement Option Plan [DROP] is a form of benefit accrual that allows retirement-eligible employees to defer their retirement for up to five years, be paid their retirement allowance, and at the same time remain employed receiving their full salaries. DROP participants no longer receive credit for additional years of City service while in DROP.

DROP was created on March 4, 1997 for a three-year trial period. San Diego Ordinance O-18385 (Mar. 4, 1997). DROP is defined "an alternative method of benefit accrual in the Retirement System." SDMC § 24.1401. By ordinance in 2002, the City Council stated: "DROP was initially offered on a trial basis for a period of three years beginning on April 1, 1997. DROP became a permanent benefit effective April 1, 2000." San Diego Ordinance O-19071 (June 18, 2002); *see also* SDMC § 24.1401(c). Its stated purpose is "to add flexibility to the Retirement System and its Members. It provides Members who elect to participate in DROP access to a lump sum benefit at the time of their actual retirement, in addition to their normal monthly retirement allowance." SDMC § 24.1401. "DROP is intended to be cost neutral." SDMC § 24.1401(b). By ordinance adopted by the City Council on January 17, 2007, employees hired or assuming office on or after July 1, 2005 may not participate in DROP. San Diego Ordinance O-19567 (Jan. 17, 2007).[29]

The initial ordinance creating DROP expressly stated that it would not continue beyond the three-year trial period without an SDCERS actuarial study that demonstrated its cost-neutrality. This ordinance was amended four weeks later to include a provision that DROP would continue in the event the City took no action to complete the cost study. San Diego Ordinance O-18392 (Mar. 31, 1997).

In March 2000, the three-year trial period ended, and the City Council did not consider a cost neutrality study. Despite the lack of a study, in 2002, the City Council amended SDMC section 24.1401 to set forth the permanency of the DROP program retroactive to April 1, 2000. San Diego Ordinance O-19071 (June 18, 2002).

Any employee who is eligible for a service retirement may participate in DROP. SDMC § 24.1402. A DROP participant must "voluntarily and irrevocably" designate a participation period of 60 consecutive months or less, elect to receive a specific retirement benefit, designate a

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[29] The ordinance that eliminated DROP for employees and officers hired on or after July 1, 2005 was not adopted by the City Council until January 17, 2007, with an effective date of February 16, 2007. San Diego Ordinance O-19567 (Jan. 17, 2007). The City is presently in litigation with SDCERS over the legal question of whether the elimination of DROP in 2007 can be retroactively applied to employees hired between July 1, 2005 and February 16, 2007.

beneficiary, and "stop accruing benefits under any other Division of [Article 4: City Employees' Retirement System] starting on the date the Member enters DROP." SDMC § 24.1402 (b).

When an employee enters DROP, both the employee and the City cease making retirement contributions on behalf of the employee to SDCERS. SDCERS establishes a DROP Participation Account, and pays into the account an amount equal to a participant's Unmodified Service Retirement Allowance, as well as the 13th Check, if applicable, and interest as determined by the SDCERS Board of Administration. SDMC § 24.1404 (a), (c). The City and DROP participants also pay into the account an amount equal to 3.05 percent of a participant's base compensation credited on a bi-weekly basis. *Id.* All funds in the DROP Participation Account are fully vested. SDMC § 24.1404(b). However, the account funds may only be accessed upon the termination of DROP participation. SDMC § 24.1403.

SDCERS treats DROP participants as "retired" for purposes of determining their retirement allowance, which is calculated using the employee's age, creditable service, final compensation, and selected retirement option on the date the employee enters DROP. SDMC § 24.1404. However, DROP participants continue for a period of up to five years as active employees, with "all of the rights, privileges and benefits, and . . . subject to all other terms and conditions of active employment, including the City Flexible Benefit Plan." SDMC § 24.1409. As with any employee, a DROP participant is subject to termination from City service, with or without cause. SDMC § 24.1403. Upon retirement, DROP participation ceases. SDMC § 24.1403(b).

We contend that, for those employees who have not yet entered DROP, the program is an employment benefit, subject to modification through the collective bargaining process. Once an employee has entered DROP, the employee is considered retired for purposes of retirement and cannot rescind the decision to retire. At that point, DROP cannot be modified except as permitted by the terms of the DROP program and by the vesting rules.

By definition, DROP is not a core or distinct pension benefit. It is a mechanism of "benefit accrual." SDMC § 24.1401(a). It is a means to calculate the benefit an employee will receive upon retirement. With elimination of DROP, employees would still be able to retire with the same retirement formula. *See Miller v. State of California*, 18 Cal. 3d 808, 815-817 (1977) (holding that employee had no vested contractual right to remain in public employment beyond the age of retirement; therefore, reduction in mandatory retirement age and consequent reduction in potential to receive larger retirement allowance did not impair a constitutionally protected right).

Recent litigation related to DROP supports the likelihood that California courts will view DROP as an employment benefit, subject to modification. In *City of San Diego v. San Diego Police Officers' Ass'n,* San Diego Superior Court Case No. 37-2009-00086499-CU-PT-CTL, the trial court denied the San Diego Police Officers' Association's cross-petition for a writ of mandate and preliminary injunction in which the POA contended that DROP was a vested

benefit. The court also granted the City's writ of mandate to compel the meet and confer process on changes to or elimination of the DROP program. This case is currently on appeal.

In *San Diego Police Officers' Ass'n v. San Diego City Employees' Retirement System*, 568 F.3d 725, 739 (9th Cir. 2009), the court held that the salaries of DROP participants are not vested benefits, but are a fluctuating aspect of compensation, which is a term of employment. The court did not address the issue of whether DROP itself is a vested benefit because that question was not before the court. However, the court concluded that DROP participants are active City employees and their salaries are subject to modification through the collective bargaining process. *Id.*

While the City Council has stated that DROP is "a permanent benefit," the benefit is also premised on cost neutrality. The City is presently conducting a cost neutrality study. If the study determines that DROP is not cost neutral, the Ninth Circuit opinion involving SDCERS and the San Diego Police Officers' Association supports the position that the City may take any action in terms of employment benefits necessary to make the program cost neutral. Action may include reducing salaries of DROP participants or requesting a change to the interest rate accruing on DROP Participation Accounts.

Regarding the requirement of a vote under Charter section 143.1, this Office has opined that the initial vote under Charter section 143.1 was not legally sufficient; therefore, DROP was not adopted as a benefit under the retirement system in a manner consistent with the Charter. As a result, there is no need to conduct a vote under Charter section 143.1 to now modify or eliminate the benefit. City Att'y MOL No. 2009-5 (June 1, 2009).[30]

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[30] SDCERS disagrees with this opinion, and has publicly stated that the adoption by the City Council of any ordinance amending DROP must be preceded by a vote pursuant to Charter section 143.1.

APPENDIX G

Supplemental Pension Savings Plan

In January 1982, the City Council, with agreement of City employees, created the Supplemental Pension Savings Plan [SPSP or Plan], as a replacement for Social Security. San Diego Resolution R-255609 (Jan. 4, 1982). SPSP is not a benefit under the retirement system as defined by article IX of the Charter. It is a benefit provided and administered by the City.

The Plan document, which was amended and restated on March 10, 1992, provides:

> The Plan has been established pursuant to the City of San Diego's withdrawal from the Federal Social Security System, and to the Federal Government's mandate of a Social Security Medicare tax for all employees not covered by Social Security hired on or after April 1, 1986, with the purpose of providing eligible employees a convenient method of saving and to provide supplemental pension benefits.

City of San Diego Supplemental Pension Savings Plan, City Clerk Document No. RR-280706.[31]

The history of the SPSP dates back to December 14, 1978, when the City filed notice with the Social Security Administration of the City's intention to withdraw from participation in the financially-troubled Social Security System, effective December 31, 1980.[32] The City, with input from a committee of employees and an outside consultant, studied the consequences of withdrawing from Social Security and establishing a supplemental pension system, but the City and its recognized employee organizations were not able to reach consensus. The City's employee organizations stated that they would not agree to a withdrawal from Social Security without an alternative benefit. The City received a one-year extension of its notice to withdraw.

In 1981, the City made changes to other employee benefits, including establishing a long term disability plan and increasing life insurance coverage. These benefits provided a new impetus to revisit the issue of Social Security withdrawal and develop an alternate supplemental plan. The City reached agreement with its employee organizations to provide SPSP, coupled with City-paid health insurance for eligible employees who retire after January 7, 1981, in lieu of Social Security.

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[31] There are presently two SPSP plans: the SPSP Plan is for full-time, benefitted eligible employees (City Clerk Document Number RR-280703) and SPSP H is for hourly, non-benefitted eligible employees (City Clerk Document Number RR-280705).

[32] At that time, public entities had the ability to opt out of Social Security participation. Subsequent to the City's election to opt out, the law changed and now public entities may not opt out of Social Security. Social Security Amendments of 1983, Pub. L. No. 98-21, 97 Stat. 65 (1983).

On November 7, 1981, the City Council authorized an employee vote on the issue of withdrawal from the Social Security System and adoption of the Plan document.[33] By resolution, the City Council made SPSP effective as of January 8, 1982. San Diego Resolution R-255609 (Jan. 4, 1982). It was the City Council's stated intent that SPSP would be a permanent benefit.[34]

The initial SPSP benefit was provided to a closed class, defined as "each employee of the City of San Diego who is a member of [four designated] classifications and whose initial date of hire or rehire is on or prior to June 30, 1986." San Diego City Clerk Document No. RR-280703 (July 1, 1991). The Plan document was amended and restated on March 10, 1992 to define an "employee" as an open class, as follows:

> [E]ach employee of the City of San Diego who is a member of one of the following classifications and whose initial date of hire or rehire is on or after July 1, 1986.
> (a) All employees eligible to participate as General Members of CERS or the 1981 Pension Plan.
> (b) Legislative Members of CERS or the 1981 Pension Plan (the Mayor and City Council members of the City of San Diego).
> (c) Safety Members of CERS or the 1981 Pension Plan covered by Social Security as of December 31, 1981.
> (d) All salaried employees working at least one-half time in the Unclassified Service and who have opted not to become members of the 1981 Pension Plan.

SPSP Plan Document, § 1.08, City Clerk Document No. RR-280706 (July 1, 1991).

In 2008, the City Council closed the class of SPSP-eligible General Member employees. By agreement with the City's recognized employee organizations that represent General Members of SDCERS, the City Council eliminated the SPSP benefit for General

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[33] City employees approved the adoption of SPSP and withdrawal from Social Security by a vote of 2,318 for approval and 1,129 against approval. Police and Fire safety classifications are not presently eligible for SPSP.

[34] In 1984 and again in 1986, the City applied for and received favorable determinations from the Internal Revenue Service that the SPSP plan was a tax qualified plan under section 401(a) of the Internal Revenue Code. The City Council has amended the plan several times: in 1982, 1984, 1986, 1987, 1989, 1992, 1994, 1995, 1996, and 2001. These amendments were voted upon and approved by the membership, or where they were approved without a vote, the changes were required by federal or state law necessary to maintain the qualified status of the plan. SPSP Plan, at § 11.01.

Member employees hired on or after July 1, 2009. *See* San Diego Resolution R-303977 (Aug. 6, 2008); San Diego Resolution R-304862 (May 4, 2009); San Diego Ordinance O-19874 (June 25, 2009). General Member employees hired on or after July 1, 2009 are eligible for a 401(a) defined contribution plan. San Diego Resolution R-304862 (May 4, 2009).

The SPSP Plan defines "Participant" as "an Employee who is participating in the Plan in accordance with Article II [defining "Participation"] and for whom Accounts are being maintained." SPSP Plan, at § 1.19.

Participation is mandatory for defined "employees": "Each Employee will become a Participant in the Plan on his or her date of employment or reemployment, or the date on which he or she becomes an Employee, if later." *Id.* at § 2.01.

The Plan mandates that participants contribute an amount equal to three percent of compensation; participants may voluntarily contribute an additional amount up to 3.05 percent of compensation. *Id.* at § 3.01(a), (b). The Plan mandates that the City contribute "100 % of the Mandatory and Voluntary Contribution made to the Plan by Participants employed by the Employer." *Id.* at § 3.02. A participant is 100 percent vested at all times in the amounts held in the employee mandatory and voluntary contribution accounts. *Id.* at § 8.02 (a). An employee fully vests in the value of the employer matching mandatory and voluntary contribution accounts with five or more years of service. With one year or more of service and less than five, an employee's vesting percentage increases with each year of service. *Id.* at § 8.02.

The Plan sets forth specific requirements to amend it:

> The Employer, after approval by a simple majority vote of all active Participants, shall have the right to amend the Plan at any time, and from time to time, to any extent that it deems advisable. Notwithstanding the previous sentence, the Employer shall have the right to amend the Plan at any time to comply with federal or state laws necessary to maintain the qualified status of the Plan . . . . No amendment shall deprive any Participant or Beneficiary of any benefits to which he or she is entitled under the Plan with respect to contributions previously made to the Plan.

Id. at § 11.01.

As a result of labor negotiations for the Fiscal Year beginning July 1, 2009 with the San Diego Municipal Employees' Association [MEA], certain employees represented by MEA and certain unrepresented employees have agreed to waive their rights to the City's mandatory contribution in lieu of a three percent salary reduction. San Diego Resolution R- 305370 (Oct. 27, 2009) (approving MEA MOU). This waiver was provided as an option by the City, through agreement with MEA; however, because of the nature of the SPSP benefit, the waiver is

accomplished through written agreements between individual employees and the City. The agreements by the employees with the City to waive the City's mandatory contribution have termination dates, and do not continue indefinitely.

Given the legislative history of the benefit and the terms of the Plan, SPSP constitutes a vested benefit for eligible employees. The Plan mandates that designated, eligible employees participate from the first day of their employment with the City. The Plan mandates contributions by both employees and the City. Further, there are specific vesting requirements. The benefit has not changed substantively since its creation. Modifications require participant approval, except when the modification is necessary to maintain the qualified tax status of the Plan. SPSP is not a benefit that is negotiated year after year through the collective bargaining process. The City created the benefit as a "supplemental" benefit to participation in SDCERS and in exchange for employees voting to withdraw from Social Security.

In a "Special Notice" provided by the City Manager to "All City Employees Paying Social Security," then-City Manager Ray Blair provided answers to common questions about withdrawal from Social Security, which are relevant in establishing the knowledge and intent of the City and the employees in replacing Social Security with SPSP.

> Question 3. Will the City Council guarantee this Supplemental Pension Plan?
> Answer: This Plan will have the same guarantees as the current retirement system. Changes will have to be voted on by the members.
> Question 4: Will the employees have to negotiate for this Plan every year?
> Answer: No.
> . . . .
> Question 6: If the City drops Social Security will we be able to rejoin?
> Answer: No, unless mandated by Federal law.
> . . . .
> Question 10. The City's Plan calls for a mandatory contribution of 3%. Why?
> Answer: To insure tax exempt status for employer contribution and investment earnings and to insure that employees have some future benefits.
> Question 11: What's in the Plan for the City of San Diego?
> Answer: Cost avoidance. Both the City and the employees continue to pay higher and higher Social Security taxes and on a higher maximum salary. By taking both the City and the employee's taxes at today's rate and putting that money in another plan the future increases are avoided.

"What Happens If We Pull Out of Social Security?" Memo from City Manager Ray Blair, Jr., to City Employees (Nov. 20, 1981).

Any future modification or elimination of the benefit for active participating employees requires their approval by simple majority vote under the terms of the Plan. Further, although the Plan document provides the City with a "right to amend" after participant approval, the City may have to provide comparable new advantages to those active participants if the benefit were modified or eliminated. SPSP is reported by the City on its financial reports as a pension plan, and the IRS has determined that it is a qualified public pension plan.[35] A comparable new advantage may be reinstatement of Social Security benefits for disadvantaged employees.

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[35] The IRS positive tax qualification determination formed the basis for this Office's previous conclusion that SPSP is a qualified public retirement plan. 1990 City Att'y MOL 90.

APPENDIX H

Retiree Health Benefit

Retiree health benefits are set forth in article 4, division 12 of the SDMC. The retiree health benefit is available to all system members who: (1) were on the active City payroll on of after October 5, 1980; (2) were hired before July 1, 2005; (3) retire on or after October 6, 1980; (4) are eligible for and are receiving a retirement allowance; and (5) have at least 10 years of creditable service.[36] SDMC § 24.1201. Employees with ten or more years of service, but less than twenty years upon retirement are entitled to a proportionally reduced benefit, depending on the number of years of service. SDMC § 24.1201(a)(4).

A "Health Eligible Retiree" is entitled to participate in and obtain health coverage under any currently available City-sponsored health insurance plan or any other health insurance plan of their choice. SDMC § 24.1202(a). The City pays or reimburses the health insurance premiums for eligible retirees, with certain limitations. *Id.* An eligible retiree will not be paid or reimbursed any more than the actual premium cost the retiree incurs. SDMC § 24.1202(a)(4). The maximum payment or reimbursement level is adjusted annually based on federally-determined projected increases in national health expenditures. SDMC § 24.1202(a)(3). As a result of negotiations with the City's recognized employee organizations in 2009, the annual adjustment of the maximum payment or reimbursement level is suspended for designated employees for a two-year period, and frozen at $740.00 a month/$8,880.00 a year for other designated employees. SDMC §§ 24.1202(a)(7), 24.1202 (a)(8). An eligible retiree enrolled in Medicare is also entitled to reimbursement of the cost of the Part B Supplemental Medical Expense Program. SDMC § 24.1202 (a)(5).[37]

By agreement with the City's employee organizations, the City Council eliminated the benefit for members of the retirement system, who were hired or assumed office on or after July 1, 2005. *See* San Diego Ordinance O-19567 (Jan. 17, 2007); SDMC § 24.1201(d) ("General Members hired or assuming office on or after July 1, 2005, but before July 1, 2009, are not entitled to the Health Eligible Retiree benefit."). However, effective July 1, 2009, the City has agreed to establish a trust vehicle for a defined contribution plan to fund retiree medical benefits for employees who are excluded from the current plan. This defined contribution plan requires a mandatory employee contribution of 0.25 percent of gross salary with a corresponding 0.25 percent match by the City. SDMC § 24.1202(c)

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[36] The ten year threshold results in a 50 percent benefit, with an additional 5 percent benefit with each corresponding year of creditable service above ten years to a maximum of 100 percent benefit with twenty years of creditable service. To qualify for the benefit, unrepresented employees may not use "air time" or purchased years of credit, but may only apply actual years worked.

[37] A "Non Health Eligible" benefit is provided to those former employees who terminated or retired prior to October 6, 1980, consisting of reimbursement of medical expenses up to an annual maximum of $1,200.

Retiree health benefits have been the subject of meet and confer between the City and its represented employee organizations over the years, resulting in modifications to the benefit. *See, e.g.*, MOU between the City and Local 145, International Ass'n of Fire Fighters, AFL-CIO, art. 23, ¶ 10(E) (July 1, 2006); MOU between the City and the San Diego Municipal Employees' Ass'n, art. 22, ¶ 2(C) (July 1, 2005); MOU between the City and the San Diego Police Officers Ass'n, art. 44, ¶ 9 (July 1, 2007); MOU between the City and Local 127, American Federation of State, County and Municipal Employees, art. 43, ¶¶ 1(D), 2(D) (July 1, 2005).

The retiree health benefit was initially created when the City withdrew from the Social Security System, effective January 1, 1982. The City Council first authorized the establishment of a City-sponsored group health insurance plan for eligible retirees by Resolution R-255610, adopted on January 4, 1982. The City declared that certain benefits would be provided to employees in lieu of Social Security participation including City-sponsored group health insurance for eligible retirees of the City. San Diego Resolution R-255610 (Jan. 4, 1982). The City Council stated, "it is the intent of this Council to provide such coverage as a permanent benefit for eligible retirees." *Id.*

In June 1982, the City Council adopted Ordinance O-15758 amending article 4 of the SDMC to add section 24.0907.2 related to City-sponsored group health insurance for eligible retirees.[38] It was the stated intent of the ordinance that the premiums for the insurance would be paid by the City from the City's share of surplus undistributed investment earnings of the retirement fund. San Diego Ordinance O-15758 (June 1, 1982).

Significantly, the City reserved the right to modify health plan coverage, as follows: "Health plan coverage for retirees and eligible dependents is subject to modification by the City and the provider of health care services, and may be modified periodically as deemed necessary and appropriate." *Id.* This language is evidence of the City's intent that the benefit was not intended to become a protected contractual right of employees, but was subject to modification. The language providing for modification by the City was set forth, again, in former section 24.1205, which stated in part: "Premium rates for eligible retirees shall be determined and established by the City. *Health plan coverage for eligible retirees and eligible dependents is subject to modification by the City and the provider of health care services, and may be modified periodically as deemed necessary and appropriate.*" San Diego Ordinance O-17770 (May 26, 1992) (italics added).

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[38] SDMC section 24.0907.2 was subsequently repealed, and retiree health benefits are presently provided in article 4, division 12 of the SDMC, at sections 24.1201 through 24.1204.

When the benefit was first created by the City Council, it was limited to a closed group of General Member employees, legislative officers, and lifeguards who were on the active payroll as of January 1, 1982. As a result of labor negotiations, between 1982 and 1996, as well as settlement of litigation, there were numerous modifications to the retiree health benefit, including expansion of the eligible retirees.[39] In 1985, as a result of meet and confer, the class of eligible employees was expanded to include Police and Fire Safety Members on the active payroll on or after June 30, 1985. The eligibility requirements for the benefit were amended and expanded again in 1986 as a result of the settlement of the *Andrews* litigation. San Diego Ordinance O-16679 (June 30, 1986). In 1992, the eligibility requirement was expanded to include General Members hired on and after September 3, 1982. San Diego Ordinance O-17770 (May 26, 1992).

Prior to 1997, retiree health benefits were not a retirement trust liability. On November 5, 1996, San Diego voters approved an amendment to the Charter that provided the authority and discretion to the City Council to fund and administer retiree medical benefits

[39] *See* San Diego Ordinance O-16449 (June 24, 1985). The City Council has amended the retiree health benefit provisions numerous times, including amendments to eligibility, definition of the benefit, and funding of the benefit. *See* San Diego Ordinance O-16449 (June 24, 1985); San Diego Ordinance O-16510 (Sept. 30, 1985); San Diego Ordinance O-16679 (June 30, 1986); San Diego Ordinance O-017295 (May 15, 1989); San Diego Ordinance O-017770 (May 26, 1992); San Diego Ordinance O-18383 (Feb. 25, 1997); San Diego Ordinance O-18392 (Mar. 31, 1997); San Diego Ordinance O-18608 (Jan. 11, 1999); and San Diego Ordinance O-19740 (Apr. 15, 2008).

through the City retirement system. Proposition D amended Charter section 141, which now reads in relevant part:

> The Council of the City is hereby authorized and empowered by ordinance to establish a retirement system and to provide for death benefits for compensated public officers and employees . . . . The Council may also in said ordinance provide: . . . (d) For health insurance benefits for retired employees.

San Diego Charter § 141.[40]

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[40] The stated purpose of Proposition D was to allow the shift of funding from the City's operating funds to the contributory "retirement system." The question presented to voters in Proposition D was as follows:

> Rather than paying for health insurance benefits to retired City employees directly from the City's operating funds, as is the current practice, shall San Diego City Charter Section 141 be amended to authorize the City Council to provide these benefits through the San Diego City Retirement System?"

San Diego Resolution R-288173 (Dec. 9, 1996).

The argument in favor of Proposition D, signed by leaders of the police and fire labor unions, read in relevant part:

> The cost of providing health care benefits for employees in both the public and private sectors has skyrocketed in recent years. Proposition D would change the City Charter to permit shifting this costly item from the city's General Fund, paid by all taxpayers – to the city's retirement system, paid for by the retirement system's investment earnings and assets. . . . Proposition D also brings health benefits for retired city workers – especially police and firefighters – into line with workers in comparably-sized cities. . . . Most important, Proposition D protects the fiscal integrity of the city's retirement fund, using excess earnings to cover the full costs of workers retirement health benefits.

County of San Diego Ballot materials, General Election (Nov. 5, 1996).

Under Proposition D, the City Council may provide for retiree health benefits under the "retirement system," but it is discretionary, not mandatory. "May" means "to be permitted to." Black's Law Dictionary (8th ed. 2004).

In 1997, the City Council exercised its authority provided by Proposition D and, through the adoption of two ordinances, brought the retiree health benefit under the "retirement system." San Diego Ordinance O-18383 (Feb. 25, 1997) (establishing the retiree health benefit);[41] San Diego Ordinance O-18392 (Mar. 31, 1997) ("clean-up ordinance" re-establishing the benefit and establishing a 401(h) account to manage the funds). The ordinances memorialized the agreement between the City and its recognized employee organizations, which is known as MPI.[42]

The two 1997 ordinances are important because, as stated by California courts, a statute or ordinance will be treated as a contract with binding obligations when the statutory language and circumstances accompanying its passage clearly evince a legislative intent to create private rights of a contractual nature enforceable against the City.

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[41] In SDMC section 24.1201, as set forth in Ordinance 18383 "City Sponsored Health Insurance Plan" was defined as "a group health insurance plan which has been selected by and is in contractual privity with The City of San Diego, made available to Health Eligible Retirees, and administered by the Retirement System." Former SDMC § 24.1201 adopted by San Diego Ordinance O-18383 (Feb. 25, 1997). This language gave discretionary authority to the City to select and enter into a contract with a provider of its choice.

[42] In a document, dated January 28, 1997 and amended February 6, 1997, entitled "Management's Final Offer on Outstanding Issues Related to Retirement Proposal," the retiree health benefit for future retirees was defined as follows:

> I. Retiree Health Insurance – Future Retirees
>
> a. Effective July 1, 1997, the City will pay for the actual premium cost for retiree-only health insurance for the applicable Medicare-eligible or non-Medicare eligible rate for HMO plans offered to retirees by the City (excluding union-sponsored plans). The City agrees that it will not diminish the benefits contained in its current retiree HMO plans *without mutual agreement with the exclusive bargaining representatives*; nor convert to a blended premium for active employees and retirees without mutual agreement with the exclusive bargaining representatives.
>
> b. If the retiree elects to purchase coverage through a labor organization or to privately secure coverage, the City will pay for or reimburse the retiree for the actual cost of such retiree-only health insurance in an amount not to exceed the applicable Medicare-eligible or non-Medicare eligible premium for the highest cost HMO Plan offered to the retiree by the City (e.g. currently Blue Cross California Care).
>
> c. Any eligible dependent health insurance coverage will be paid for by the retiree. The "sliding scale" benefit with a $2,000 cap referred to in respective MOU's is eliminated.

Key language in this document is highlighted in italics. The retiree health benefit was a negotiated benefit, and the language can be interpreted as contemplating that there could be future modifications to the benefit so long as there was "mutual agreement with the exclusive bargaining representative."

The Purpose and Intent of Division 12 of the Municipal Code was set forth as follows:

> Effective August 1, 1997, a health insurance program shall be offered to Health Eligible Retirees as set forth in this Division. This benefit shall be administered by the Retirement System. Notwithstanding any other interpretation of law to the contrary, *it is the intent of the City Council to deem this benefit as defined and vested within the meaning of City Charter section 143.1 for those individuals who are retired on the date this benefit becomes effective* and thus attain the status of Health Eligible Retiree by operation of law. Health Eligible Retirees may enroll in a City Sponsored Health Insurance Plan or participate in the plan of their choice, subject to payment and reimbursement limitations set forth in this Division. *For active employees, this benefit may only be modified in accordance with provisions set forth in Section 24.1204 and after a vote of approval by the active Members.* This City Sponsored Health Insurance Plan shall include at least one HMO plan and at least one PPO plan.

Former SDMC § 24.1202, as adopted in San Diego Ordinance O-18383 (Feb. 25, 1997) (italics added).

The City Council specifically stated that it intended to create a "defined and vested" benefit "for those individuals who are retired on the date this benefit becomes effective." However, the City Council contemplated modification of the benefit for active employees under certain circumstances.

This section was repealed by the Council approximately one month later when the Council approved a "clean up" ordinance to O-18383; however, similar language regarding the intent of the Council was set forth in the recitals to the "clean-up ordinance." The stated purpose of the "clean-up ordinance" was to "technically amend language to assure that the provisions meet with and satisfy all applicable state and federal requirements," in particular the tax issues raised. San Diego Ordinance O-18392 (Mar. 31, 1997). The recitals in the March 31, 1997 ordinance specifically refer to O-18383, as the document that changed the benefits under the retirement system.

As a result of issues raised by the Internal Revenue Service [IRS] and a voluntary compliance agreement to protect the qualified tax status of the SDCERS, on April 15, 2008, the City Council removed the retiree health benefit from the retirement system. San Diego Ordinance O-19740 (Apr. 15, 2008). "The retiree health benefits described in this

Division [12: Retiree Health Benefits] will be paid by the City, directly, from any source available to it other than the Plan." SDMC § 24.1204.[43]

With removal of the funding liability from the retirement system, the benefit cannot be considered a benefit under SDCERS. Further, it is not a benefit that is enforceable against SDCERS. *See, e.g.*, *Elmore v. Cone Mills Corp.*, 23 F.3d 855, 860-861 (4th Cir. 1994) (stating that representations not incorporated into a written retirement plan document do not become part of the plan, and are not enforceable as a valid plan amendment); *Dougherty v. Chrysler Motors Corp.*, 840 F.2d 2, 3-4 (6th Cir. 1988) (rejecting claim of salaried employees that increases in benefits to union employees became a de facto part of retirement plan for non-union salaried employees).

The City is presently facing an estimated $1.3 billion unfunded liability as a result of the retiree health benefit. The current benefit for eligible retirees is a defined benefit plan. One method of addressing the unfunded liability is to change the plan for current eligible employees, who have not yet retired, from a plan funded entirely by the City to one that is "contributory," meaning that the employee and the City would jointly contribute into the plan. A "contributory" plan could be either a defined benefit plan into which employees contribute or a defined contribution plan, meaning the amount the City contributes toward the benefit is defined, but not the benefit itself.

Opponents of modifications may argue that the City may not change the current defined benefit plan because it is a vested pension right. However, the better argument is that, historically, there have been modifications to the retiree health benefit achieved through the collective bargaining process. Therefore, the benefit is more properly characterized as an employment benefit that may be modified through negotiations with represented employee organizations.

This argument is supported by the recent opinion of the Ninth Circuit Court of Appeals. In *San Diego Police Officers' Ass'n v. San Diego City Employees' Retirement System*, 568 F.3d 725, 740 (9th Cir. 2009), the court reviewed the historical facts related to implementation of the City's retiree health benefit and determined that the benefit was a longevity-based benefit, that has been treated as an employment benefit and that was negotiated through the collective bargaining process. The Ninth Circuit followed the holding in *San Bernardino Public Employees' Ass'n v. City of Fontana,* 67 Cal. App. 4th 1215, 1221 (1998) (constitutional protections do not extend to longevity-based benefits negotiated in an MOU), which relied on a

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[43] Prior to the amendment on April 28, 2008, SDMC section 24.1204 read as follows: "The retiree health benefits described in this Division will be paid from the following sources of funds in descending order of availability: (a) the 401(h) Fund, until exhausted, and (b) the City, directly, from any source available to it. The ordinance also repealed SDMC section 24.1203, which was the provision establishing a 401(h) Fund, which was a separate account under the Retirement System solely for the purpose of providing retiree health benefits. "

history of collective bargaining related to a benefit to determine that the benefit was not individually vested.

Based on the legislative history, it is this Office's opinion that the retiree health benefit for active employees is not vested, but is an employment benefit, subject to modification through the collective bargaining process. It is also important to note that the City Council has maintained that the health plan coverage for eligible retirees is subject to modification by the City and the provider of health care services, and may be modified periodically as deemed necessary and appropriate.

Any changes to the retiree health benefit for existing employees must be negotiated pursuant to the MMBA, but are not be subject to a Charter section 143.1 vote because the benefit is not presently under the retirement system. If the retiree health benefit in the future is modified and restored as a retirement system benefit, it must be "contributory," meaning employees jointly pay with the City for the benefit. San Diego Charter §143. If the retiree health benefit is found by a court to be a vested benefit under the City's retirement system, then the "substantially equal" contribution requirement of Charter section 143 would apply.

As to the question of whether the retiree health benefit can be modified for retired employees, it is our opinion that a court would find the benefit vested and would look to the language of the benefit at the time of an employee's retirement to determine what aspect of the benefit is vested.[44] In *Thorning v. Hollister School District*, 11 Cal. App. 4th 1598 (1992), the court held that retiree health benefits for retirees were vested, and vested on the terms set forth in the policy providing for the benefits that existed at the time of their retirement. *Id.* at 1609.

In addition to the holding in *Thorning*, there are several factors that support the conclusion that retiree health benefits as to retirees are vested. First, unlike active employees, retirees can demonstrate a detrimental reliance on the representations and promises made by the City in relation to the provision of the benefit. Second, unlike active employees, retirees have retired with the actual provision of the benefit. Third, unlike most active employees, retirees likely were employed in the 1981-1982 time period when the City ceased Social Security participation, and in turn promised a retiree health benefit. Fourth, unlike active employees, retirees are not represented by the employee bargaining groups that negotiate changes in the benefit. Even if a court does not find the retiree health benefit to be a vested benefit for retirees, it is likely that retirees can successfully claim that the City is estopped from eliminating or detrimentally modifying their benefit.

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[44] While holding that retiree health benefits were not vested, the courts in the *San Diego Police Officers' Association* and *San Bernardino Public Employees' Retirement System* cases were faced only with claims by the active employees.