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**OPINION NUMBER 2011-1**

**DATE:** January 10, 2011  
**SUBJECT:** Freezing Base Compensation under the City's Retirement Plan  
**PREPARED FOR:** Honorable Mayor and Members of the City Council  
**PREPARED BY:** City Attorney

**QUESTIONS PRESENTED**

1. Can the City of San Diego freeze "Base Compensation" within the meaning of the defined benefit retirement plan, as a means to reduce the City's long-term retirement liability?
2. If the City can freeze "Base Compensation," can the City then offer performance-based increases to compensation that would not be included in retirement calculations?

**SHORT ANSWERS**

1. Yes. The City, acting through the San Diego City Council (City Council), has the authority to freeze "Base Compensation" within the meaning of San Diego Municipal Code (Municipal Code) section 24.0103, subject to the Meyers-Milias-Brown Act (MMBA) and the City's Civil Service provisions.<sup>1</sup>

2. Yes. Although employees have a vested right to have their "base salary or wages paid" included in their retirement calculations, they do not have a vested right to have amounts paid in addition to base salary or wages included in their pensions. The City, acting through the City Council, may exclude additional pay categories, such as specialty pay, from retirement allowance calculations, by amending the Earnings Codes Document, which is adopted annually during the budget process. Further, San Diego Municipal Code (Municipal Code) section 24.0103 presently provides that certain types of pay, including overtime pay and "payments made by the City to an employee for exceptional performance or pursuant to a 'pay

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<sup>1</sup> An actuary would need to analyze the extent to which freezing "Base Compensation" over time would reduce the City's long-term pension liability.

for performance' plan" are excluded from the retirement allowance calculation, "unless such payments are expressly designated in the annual Salary Ordinance for inclusion in Base Compensation." SDMC § 24.0103. The City Council may create a new pay category and exclude it from Base Compensation, after meeting and conferring with the City's recognized employee organizations.

## ANALYSIS

### I. THE CITY CAN FREEZE "BASE COMPENSATION" FOR RETIREMENT PURPOSES SUBJECT TO THE MEYERS-MILIAS-BROWN ACT AND THE CITY'S CIVIL SERVICE PROVISIONS.

#### A. Public Employees have no Vested Right to Future Increases in Compensation.

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 salaries, 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 *San Bernardino Public Employees Ass'n v. City of Fontana*, 67 Cal. App. 4th 1215, 1221 (1998) (*San Bernardino*) (citing *California League of City Employee Ass'ns v. Palos Verdes Library Dist.*, 87 Cal. App. 3d 135, 139 (1978) (*California League*)). California courts have long held that public employees have no vested right in any particular measure of compensation or employment benefits, and that compensation or employment benefits may be modified or reduced by the proper statutory authority. *Butterworth v. Boyd*, 12 Cal. 2d 140, 150 (1938).

There is an exception to this general rule. Public employment does give rise to certain obligations that are protected by the contract clause of the California and United States Constitutions, including the right to salary that has already been earned. *Kern v. City of Long Beach*, 29 Cal. 2d 848, 852-853 (1947).<sup>2</sup> 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). See also *Miller*, 18 Cal. 3d at 815 (stating that 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).

California courts distinguish employment benefits, which can be modified during employment, and vested pension rights, which are entitled to contract clause protection. *Vielehr v. State of California*, 104 Cal. App. 3d 392, 395-396 (1980).<sup>3</sup> Vested pension benefits cannot be abolished or impaired by repeal or changes in the law. *Kern*, 29 Cal. 2d at 853 (citing *Dryden v. Board of Pension Commissioners*, 6 Cal. 2d 575, 579 (1936)). Further, once salary has been earned, it is vested, must be paid, and may not be modified. *Kern*, 29 Cal. 2d at 853.

<sup>2</sup> Under the United States Constitution, "No state shall . . . pass any . . . [l]aw impairing the [o]bligations of [c]ontracts . . ." U.S. Const. art. I, § 10, cl. 1. Similarly, under the California Constitution, a "law impairing the obligation of contracts may not be passed." Cal. Const. art. I, § 9.

<sup>3</sup> "Vested" means "having become a completed, consummated right for present or future employment; not contingent; unconditional; absolute." Black's Law Dictionary (9th ed. 2009).

Under the City's retirement system, employees have a right to calculation of their retirement allowances based on either their highest one or three years of salary, depending on their hire date (discussed in more detail in subsection I.E. below). Once that period of salary has been earned, it cannot be reduced. However, City employees have no right to future enhancements to compensation, except, arguably, to the extent mandated under the current Civil Service system, which allows for "normal merit increases," discussed below.<sup>4</sup>

**B. The City Council Has the Authority to Set Employees' Salaries Through Adoption of the Salary Ordinance.**

It is within the City Council's non-delegable legislative authority to set City employees' salaries every year with the adoption of the Salary Ordinance. San Diego Charter § 11.1 ("The City Council shall annually adopt an ordinance establishing salaries for all City employees."). In establishing salaries, the City Council considers "all relevant evidence including but not limited to the needs of the citizens of the City of San Diego for municipal services, the ability of the citizens to pay for those services, local economic conditions and other relevant factors as the Council deems appropriate." San Diego Charter § 11.1. It is also within the City Council's authority to approve memoranda of understanding (MOUs) with the City's recognized employee organizations concerning wages, hours, and other terms and conditions of employment. San Diego Charter §§ 11.1, 11.2. *See also* Council Policy 300-06, § VIII (provisions regarding implementation of memorandum of understanding (MOU) as set forth in the City's Employee-Employer Relations Policy).

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<sup>4</sup> No vested contractual right is conferred on a public employee because he or she occupies a civil service position. *Miller*, 18 Cal. 3d at 814. It is "well settled that '[t]he terms and conditions of civil service employment are fixed by statute and not by contract.'" *Id.* (quoting *Boren v. State Personnel Board*, 37 Cal. 2d 634, 641 (1951)). In *Miller*, the California Supreme Court rejected the plaintiff employee's argument that he had a vested, contractual right to remain in state service beyond the age of 67 notwithstanding a change in the mandatory retirement age applicable to his position. *Id.* at 813, 818. When the employee first accepted his position with the state, the retirement age was 70. *Id.* at 813. During his employment, the mandatory retirement age was lowered to 67. *Id.* at 811-812. The Court concluded that "the power of the Legislature to reduce the tenure of plaintiff's civil service position and thereby to shorten his state service, by changing the mandatory retirement age was not and could not be limited by any contractual obligation." *Id.* at 814. The Court summarized its holding, as follows:

[W]e hold that plaintiff had no vested contractual right to remain in public employment beyond the age of retirement established by the Legislature. Upon being required by law to retire at age 67 rather than age 70, plaintiff suffered no impairment of vested pension rights since he had no constitutionally protected right to remain in employment until he had earned a larger pension at age 70.

*Id.* at 818.

The California Supreme Court has held that permanent civil service employees have procedural due process rights to challenge a dismissal from civil service employment for cause. *Skelly v. State Personnel Board*, 15 Cal. 3d 194, 206-207 (1975). Although the *Skelly* case sets forth general language regarding the nature of civil service systems, the *Skelly* case is not relevant to a discussion of whether a civil service employee has vested contractual rights related to employment.

The San Diego Charter (Charter) describes the process for adopting the Salary Ordinance, in pertinent part, as follows:

The Council shall have the power to fix salaries of the City Manager, the City Clerk, the City Treasurer, the City Auditor and Comptroller, and all other offices under its jurisdiction. . . . Except as otherwise provided by law, the City Manager [now, the Mayor, under the Strong Mayor form of governance] and other departmental heads outside of the departments under the control of the City Manager [now, Mayor] shall have power to recommend salaries and wages subject to the personnel classification determined by the Civil Service Commission, of all other officers and employees within the total amount contained in the Annual Appropriation Ordinance for personal service in each of the several departments of the City Government. All increases and decreases of salary or wages of officers and employees shall be determined at the time of the preparation and adoption of the budget, and no such increase or decrease shall be effective prior to the fiscal year for which the budget is adopted . . . .

San Diego Charter § 70.

Charter section 290 provides, in pertinent part:

No later than April 15 of each year, the Council shall introduce a Salary Ordinance fixing the salaries of all officers and employees of the City in accordance with Charter section 70. The Salary Ordinance shall be proposed by the Mayor for Council introduction in a form consistent with any existing Memorandum of Understandings with recognized labor organizations, or otherwise in conformance with procedures governed by the Meyers-Milias-Brown Act or any other legal requirements governing labor relations that are binding upon the City.

San Diego Charter § 290(a).

The Salary Ordinance may be amended each year, and the salaries set forth therein may be modified subject to applicable procedural requirements, as discussed more fully below.

**C. The City Council, as a Public Agency Employer, Must Comply With the MMBA, Regarding Collective Bargaining in California.**

Salaries and wages are a mandatory subject of bargaining under the MMBA, the preemptive state law that governs labor relations between certain public employers and public employee organizations in California. *See* Cal. Gov't Code §§ 3500, 3505.<sup>5</sup> If the City, acting through the City Council, desires to modify the salaries of represented City employees, the City must meet and confer in good faith with representatives of the recognized employee organizations and consider fully the proposals made by the employee organizations on behalf of their members prior to arriving at a determination of policy or course of action. Cal. Gov't Code § 3505.

If agreement is reached between the City representatives and a recognized employee organization during the meet and confer process, the parties jointly prepare a non-binding written MOU and present it to the City Council for determination. Cal. Gov't Code § 3505.1, Council Policy 300-06, § VIII. If no agreement is reached after meeting and conferring in good faith, the City Council may implement its last, best, and final offer to an employee organization, after exhausting the impasse procedures set forth in Council Policy 300-06, section VII. Cal. Gov't Code § 3505.4. The City Council may not, however, implement an MOU. *Id.* Further, the unilateral implementation of the City's last, best, and final offer may not deprive a recognized employee organization of the right each year to meet and confer on matters within the scope of representation, including wages. *Id.*

It is within the City Council's authority, subject to the MMBA, to modify or reduce employee salaries.<sup>6</sup> A policy setting forth a long-term salary freeze is a mandatory subject of bargaining and could be negotiated. *See, e.g., People ex rel. Seal Beach Police Officers Ass'n v. City of Seal Beach*, 36 Cal. 3d 591, 602 (1984) (*Seal Beach*) (policy affecting matters within the scope of representation is negotiable). However, if the City Council implements a policy regarding salary freezes, the City must, in good faith, consider any future proposals related to the policy should the City's recognized employee organizations make such a proposal. *See* Cal. Gov't Code §§ 3505, 3505.4. Further, the City Council may not use the policy to abrogate its present or future duties under the MMBA to meet and confer in good faith with represented City

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<sup>5</sup> Future retirement benefits of current employees are also mandatory subjects of bargaining under the MMBA. *County of Sacramento*, PERB Dec. No. 2045-M (2009); *Madera Unified School District*, PERB Dec. No. 1907 (2007); *Temple City Unified School District*, PERB Dec. No. 782 (1989); *Jefferson School District*, PERB Dec. No. 133 (1980).

<sup>6</sup> It is important to note that the City is presently bound by existing, approved MOUs with two of the City's recognized employee organizations -- the San Diego Police Officers Association and Local 127, American Federation of State, County, and Municipal Employees, AFL-CIO -- for a two-year-period, ending June 30, 2012. Further, the City is presently bound by existing, approved MOUs with the City's other four recognized employee organizations until June 30, 2011. "An MOU is binding on both parties for its duration." *San Bernardino*, 67 Cal. App. 4th at 1220. Any City proposal to modify or reduce employee salaries must take into consideration the existing MOUs, and may not be effective until after the term of the existing agreements unless there is an agreement with the employee organizations otherwise. *See* 1994 City Att'y MOL 548 (94-61; Jul. 19, 1994).

employees.<sup>7</sup> Any policy related to freezing of salaries should be subject to the MMBA. *See Seal Beach*, 36 Cal. 3d at 602 (stating, in part, a city council in a charter city is required to meet and confer with its recognized employee organizations before it proposes charter amendments which affect matters with their scope of representation, and “the city council cannot avoid the requirement by use of its right to propose charter amendments”). *See also San Leandro Police Officers Ass’n v. City of San Leandro*, 55 Cal. App. 3d 553, 557 (1976) (stating that fixing compensation for city employees is a municipal legislative function; however, local legislation may not conflict with statutes such as the MMBA, which are intended to regulate the entire field of labor relations of affected public employees through the state).

**D. The City Council Must Work Within the Existing Framework of the City’s Civil Service System, Unless and Until it is Changed.**

Any general salary freeze must be evaluated within the parameters of the City’s Civil Service system, which provides for “merit step increases” over time. Civil service systems are based on the concept that appointments and promotions are determined by merit. The California Supreme Court has explained:

The use of merit as the guiding principle in the appointment and promotion of civil service employees serves a two-fold purpose. It at once “abolish[es] the so-called spoils system, and [at the same time] . . . increase[s] the efficiency of the service by assuring the employees of continuance in office regardless of what party may then be in power. Efficiency is secured by the knowledge on the part of the employee that promotion to higher positions when vacancies occur will be the reward of faithful and honest service.”

*Skelly v. State Personnel Bd.*, 15 Cal. 3d at 201 (quoting *Steen v. Board of Civil Service Commissioners*, 26 Cal. 2d 716, 722 (1945)).<sup>8</sup> *See also* San Diego Charter § 124.<sup>9</sup>

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<sup>7</sup> The MMBA defines “meet and confer in good faith” as follows:

[A] public agency, or such representatives as it may designate, and representatives of recognized employee organizations, shall have the mutual obligation personally to meet and confer promptly upon request by either party and continue for a reasonable period of time in order to exchange freely information, opinions, and proposals, and to endeavor to reach agreement on matters within the scope of representation prior to the adoption by the public agency of its final budget for the ensuing year. The process should include adequate time for the resolution of impasses where specific procedures for such resolution are contained in local rule, regulation, or ordinance, or when such procedures are utilized by mutual consent.

Cal. Gov’t Code § 3505.

<sup>8</sup> *See* footnote 4, herein.

<sup>9</sup> San Diego Charter section 124 provides, in pertinent part: “Whenever practicable vacancies in the classified service shall be filled by promotion, and the Civil Service rules shall indicate the lines of promotion, from each lower to higher grade whenever experience derived in the lower grade tends to qualify for the higher. Any advancement in rank shall constitute promotion.”

Most City employees are “Classified Employees” within the City’s Civil Service system, which is governed by Article VIII of the Charter. Charter section 130 provides that the City Council shall by ordinance, before the beginning of each fiscal year, establish a schedule of compensation for officers and employees in the Classified Service, “which shall establish a minimum and a maximum for any grade and provide uniform compensation for like service.” San Diego Charter § 130. Civil Service Rule I, section 2, which was adopted by the City Council, provides that the compensation schedule for the Classified Service shall include “[a] table of standard rates of pay, indicating the minimum, maximum, and intermediate range steps for each standard rate.”

The compensation schedule for Classified Employees is adopted as part of the City’s Salary Ordinance each year. *See* San Diego Charter §§ 70, 130, 290. It is the duty of the Civil Service Commission to prepare and furnish to the City Council, prior to adoption of the Salary Ordinance, “a report identifying classifications of employees in the Classified Service which merit special salary consideration because of recruitment or retention problems, changes in duties or responsibilities, or other special factors the Commission deems appropriate.” San Diego Charter § 130.

Under the City’s Civil Service system, Classified Employees with satisfactory performance, including permanent, probationary, and limited employees, are eligible to receive “normal merit increases,” “[e]xcept as otherwise provided in current Management policies or current ratified memoranda of understanding.” San Diego Personnel Reg. H-8 § II.A.1. There are presently five steps, Step A through Step E. *Id.* at § II.A.1.<sup>10</sup> *See also, e.g.,* San Diego Ordinance O-19952 (May 4, 2010), Ex. A. The language, setting forth the ability to create exceptions to “normal merit increases,” provides support that the merit system process can be modified, if applicable procedural requirements are followed.<sup>11</sup> Further, the Personnel Regulation provides: “Merit step increases are not an automatic process or right, but are granted only as an award for competent and meritorious performance of the full range of duties assigned to an employee.” *Id.* at § II.A.1.a(2).

The current pay range between steps is approximately five percent, as set forth in the Salary Ordinance. *See, e.g.,* San Diego Ordinance O-19952 (May 4, 2010), Ex. A. If members of a bargaining unit are granted a pay raise, it is reflected by adjustments to the steps set forth in the Base Salary Table for Classified Employees, which is adopted as part of the Salary Ordinance. Likewise, if members of a bargaining unit agree to a pay reduction, or a pay reduction is imposed

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<sup>10</sup> Full-time salaried employees are considered for normal one-step merit increases after completing 26 weeks of continuous service at Step A, 26 weeks of continuous service at Step B, 52 weeks of continuous service at Step C, and 52 weeks of continuous service at Step D. San Diego Personnel Reg. H-8, § II.A.1(d). Effective July 1, 1994, Step B was eliminated for all new hires. *Id.* at § II.A.1(f). Employees hired on or after July 1, 1994 move from Step A directly to Step C, after 52 weeks of continuous service if the employee is full-time salaried, or after 52 weeks of continuous service and 800 hours if the employee is paid on an hourly or daily basis and is “not in full charge of regularly scheduled activity.” *Id.*

<sup>11</sup> Under the Charter, the Civil Service Commission recommends to the City Council Civil Service Rules and amendments thereto “for the government, supervision and control of the classified service.” San Diego Charter § 118. No rule or amendment is effective until it is adopted by the City Council, by ordinance, after a noticed public hearing. *Id.* Changes to policies that affect matters within the scope of representation, including wages, are subject to meet and confer. *See Seal Beach*, 36 Cal. 3d at 602.

following impasse procedures, it is also reflected by adjustments to the steps in the Base Salary Table. Recently negotiated MOUs included a general salary freeze and no general salary increase, although employees remain eligible for other current forms of compensation, including step advances on the salary schedule. *See, e.g.,* San Diego Resolution R-305370 (Oct. 27, 2009) (approving MOU with San Diego Municipal Employees' Association; Art. 21, § 1, of MOU relates to salaries). In addition to "normal merit increases," the Personnel Regulations and specified, negotiated labor agreements provide for "exceptional merit increases." San Diego Personnel Reg. H-8, § II.B.<sup>12</sup>

However, it is this Office's view that the pay range between steps is compensation that can be prospectively modified through the meet and confer process. Further, the actual amounts paid at each step can be prospectively modified or reduced, subject to meet and confer. *See NLRB v. Katz*, 369 U.S. 736, 745-746 (1962) (merit increases are within the scope of bargaining); *Healdsburg Union High School District & Healdsburg Union School District/San Mateo City School District*, PERB Dec. No. 375 (1984) (regarding merit increases); *Trustees of the California State University (San Marcos)*, PERB Dec. No. 1635-H (2004) (merit systems are within the scope of representation).

The City's Civil Service structure can also be modified through a Charter amendment.<sup>13</sup> However, the City must first meet and confer before the City Council proposes amendments to the Charter that affect the terms and conditions of public employment. *Seal Beach*, 36 Cal. 3d at 602.

If the City Council were to propose a change to the Civil Service system, Classified Employees may argue that they have a vested right to receive merit step increases if they perform satisfactorily over a period of time. There is some support for this contention in California case law. In *California League*, the Court of Appeal held that longevity salary increases, equal to two percent of base pay, awarded at the end of the 9th, 12th, 15th, and 18th years of service were an "inducement to remain employed with the district, and were a form of compensation which had been earned by remaining in employment." *California League*, 87 Cal. App. 3d at 140. The longevity salary increases were awarded automatically, and without any attendant labor negotiations. *Id.* at 138. They were implemented only on the condition that an employee serve a

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<sup>12</sup> The Personnel Regulations provide, in pertinent part: "The Civil Service Commission advocates the granting of exceptional merit increases to encourage and reward employees whose work can be shown to be outstanding in relation to other employees in the same class." San Diego Personnel Reg. H-8, § II.B. *See also* MOU with the San Diego Municipal Employees' Ass'n, art. 25, San Diego Resolution R-305370 (Oct. 27, 2009); MOU with Local 127, American Federation of State, County, and Municipal Employees, AFL-CIO, art. 19, San Diego Resolution R-306359 (Nov. 29, 2010).

<sup>13</sup> It is important to note that Charter section 130 provides that the schedule of compensation for Classified Employees, established each year by ordinance of the City Council, is to contain "a minimum and maximum for any grade and provide uniform compensation for like service." San Diego Charter § 130. Civil Service Rule I, adopted by ordinance of the City Council, sets forth that the compensation schedule shall include a table of standard rates of pay, "indicating the minimum, maximum, and intermediate range steps for each standard rate." *See* San Diego Ordinance O-8581 (Jan. 23, 1962). The Personnel Regulations establish the five steps, A through E. It is this Office's opinion that the intermediate steps could be prospectively changed, following meet and confer with the affected employee organizations and review and recommendation by the Civil Service Commission, without a Charter amendment as long as the modified plan contained "a minimum and maximum" compensation for each classification and "uniform compensation for like service."

stipulated term of employment; therefore, the appellate court concluded that the raises were deferred compensation for past services satisfactorily performed and could not be eliminated without affecting a vested right. *Id.* at 138. *See also Ivens v. Simon*, 212 Cal. App. 2d 177, 182 (1963) (stating that employee could state a cause of action in mandamus to direct future action of city council under existing employment agreement, where employee sought to move up in five step pay plan with higher step available after a certain period of time in a particular class).

More recent appellate authority casts doubt on the argument that “merit step increases” are vested. The Fourth District Court of Appeal, the District in which this City is located, has held that employees represented by a public employee labor organization do not have vested, contractual rights to longevity pay and that such benefits can be altered through collective bargaining. *San Bernardino*, 67 Cal. App. 4th at 1223.

The *San Bernardino* 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 collective bargaining agreements of fixed duration reached between the city and its bargaining groups. *Id.* at 1223. The court concluded that once the MOUs expired, the employees had no legitimate expectation that the benefits would continue unless they were renegotiated as part of a new bargaining agreement. *Id.*<sup>14</sup> The court wrote:

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 MOUs that expired under their own terms.

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Here, no outside statutory source gives the employees additional protection or entitlement to future benefits; therefore, the benefits are a proper subject of negotiation.

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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.

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<sup>14</sup> The *San Bernardino* court noted that “a collective bargaining unit may not bargain away individual statutory or constitutional rights which flow from sources outside the collective bargaining agreement itself.” *San Bernardino*, 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).

The court concluded that treating employment benefits as vested benefits “would subvert the policies underlying the [Meyers-Milias-Brown] Act. . . . [T]he 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 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)).

The *San Bernardino* case was recently relied upon by the United States Court of Appeals, Ninth Circuit, in a case involving 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, 730-731, 736 (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, in part, that the salaries paid to employees in DROP were terms of employment and that the employees had no vested contractual right 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 n. 3. The court reasoned that the fact that 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 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)).<sup>15</sup> 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 by the Contracts Clause would be expanded well beyond the sphere dictated by traditional constitutional jurisprudence.

*Id.* at 740.

The 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.

Classified Employees may seek to distinguish the *San Bernardino* and *SDPOA* cases, by arguing that the Charter, Civil Service Rules, or Personnel Regulations constitute outside legislative or administrative sources that provide protection for the employees. However, compensation, as set forth in the Salary Ordinance, is a mandatory subject of bargaining. Further, it is this Office’s view that how the City compensates employees can also be negotiated, subject to applicable Charter provisions. Further, there is no provision within the Charter, Civil Service Rules, or Personnel Regulations that expressly provides that the Civil Service system is to be treated as a protected right of employees. *See Miller*, 18 Cal. 3d at 814 (stating there is no vested contractual right conferred a public employee because he or she occupies a civil service position).

**E. A Freeze on Salaries Will Result in a Freeze on “Base Compensation,” Which is Used to Calculate Retirement Benefits and Contributions.**

“Base Compensation” is defined as “base salary or wages paid” in the City’s retirement plan, which is set forth in Article IX of the Charter and Chapter 2, Article 4 of the Municipal Code (the Plan). The Plan provides the formulas used to calculate retirement allowances of employees who qualify for a service retirement. *See SDMC* §§ 24.0402 (General Members hired before July 1, 2009), 24.0402.1 (General Members hired on or after July 1, 2009), and 24.0403 (Safety Members).

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<sup>15</sup> 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)).

Each employee's retirement allowance is calculated by multiplying the employee's years of service credit by the calculation factor applicable to his or her retirement classification and age at retirement. The resulting number is the percentage of the employee's "Final Compensation" that equals his or her annual Unmodified Service Retirement Allowance.

For General Members hired before July 1, 2009, and Safety Members, the Plan defines "Final Compensation" as the highest one-year period of the employee's "Base Compensation" during membership in the Retirement System. SDMC § 24.0103. "Final Compensation" for General Members hired on or after July 1, 2009, is defined as an average of the employee's highest three years of "Base Compensation" while he or she is a member of the Retirement System. *Id.*

The Plan defines "Base Compensation" as:

*. . . the base salary or wages paid (standard hours multiplied by the hourly rate) on a regular bi-weekly basis to an employee for his or her services in any given pay period, including (by way of example) but not limited to such items of compensation as: time during which the employee is excused from work for holidays, annual leave taken, sick leave taken, compensatory time off taken, industrial leave taken, discretionary or furlough leave taken, and pay for out-of-class assignments. . . . A complete listing of included and excluded items of compensation or remuneration is memorialized in a document entitled "Earnings Codes Included in Retirement Base Compensation" [the Earnings Codes Document], which is prepared annually . . . . The Earnings Code Document shall be amended annually, as necessary to reflect any changes or additions made during the City's budget adoption process.*

SDMC § 24.0103 (italics added).

The Plan expressly excludes items of compensation identified in the annual Earnings Codes Document:

*For purposes of calculating retirement benefits, "Base Compensation" shall not include any item of compensation or remuneration which is identified in the Earnings Codes Document as excluded from Base Compensation, including (by way of example) but not limited to: . . . payments made by the City to an employee for exceptional performance or pursuant to a "pay for performance" plan, unless such payments are expressly designated in the annual Salary Ordinance for inclusion in Base Compensation.*

SDMC § 24.0103 (italics added). Overtime is another form of compensation that is excluded from Base Compensation. *Id.*

Because Base Compensation consists of an employee's base salary or wages, a freeze on base salary or wages will also freeze Base Compensation.<sup>16</sup>

## **II. THE CITY CAN OFFER COMPENSATION INCREASES BASED ON PERFORMANCE THAT WOULD NOT INCREASE EMPLOYEES' PENSION BENEFITS.**

The Plan's definition of "Base Compensation," to the extent it includes "the base salary or wages" paid "on a regular bi-weekly basis," is a vested retirement benefit for current employees and can only be changed under very limited circumstances. But, the definition incorporates the Earnings Codes Document, which controls whether pay *in addition to* base salary or wages is included in Base Compensation. The Earnings Codes Document is adopted annually when the City Council approves the Salary Ordinance. Moreover, the Plan specifically provides that payments for exceptional merit or pursuant to a pay-for-performance plan *are not* included in Base Compensation, unless the Salary Ordinance specifically provides otherwise. Thus, employees do not have a vested right to have merit compensation or any type of special pay add-ons included in their pension calculations.

In addition, since changes to the Earnings Codes Document do not require an ordinance amending the Plan, a vote of the Retirement System membership is not required under Charter section 143.1. The City must, however, meet and confer with the recognized employee organizations before making changes to the Earnings Codes Document that will affect represented employees.

### **A. The Definition of "Base Compensation" Under the Plan is a Vested Benefit to the Extent it Includes Base Salary and Wages.**

As discussed earlier in this Opinion and as this Office has previously opined,<sup>17</sup> vested retirement benefits are protected by federal and state constitutional provisions that prohibit impairment of contracts. The California Supreme Court has held that a governmental employer cannot modify or eliminate the vested retirement benefits of current employees unless the employer can demonstrate that the change is reasonable and necessary to keep the retirement system flexible to permit adjustments in accord with changing conditions and, at the same time, maintain the integrity of the system. In order to be sustained as reasonable, any alteration of an employee's pension rights must bear some material relation to the theory of a pension system and its successful operation, and the city must provide the disadvantaged employees with "comparable new advantages." *Allen v. City of Long Beach*, 45 Cal. 2d 128, 131 (1955). *See also Betts*, 21 Cal. 3d at 863 (citing and quoting *Wallace v. City of Fresno*, 42 Cal. 2d 180, 183

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<sup>16</sup> The Municipal Code provides that Base Compensation "shall not be reduced *for* temporary salary adjustments necessitated by City budgetary reductions so long as the contributions to SDCERS as required by Charter section 143 are determined by the base salary before the temporary salary adjustment." SDMC § 24.0103 (*italics added*). This language was added by City Council ordinance in 2009 to apply to limited circumstances where, as a result of labor negotiations, employees' salaries are temporarily reduced by, as an example, a furlough, but contributions to the Retirement System are made based on the base salary before the furlough reduction. *See* San Diego Ordinance O-19874 (Jun. 25, 2009). This language does not serve as a limitation on the City's ability to implement a freeze on base salary or wages.

<sup>17</sup> Op. City Att'y 2010-1 (Jan. 21, 2010).

(1954), and *Kern*, 29 Cal. 2d at 852-853)); *Abbott v. City of Los Angeles*, 50 Cal. 2d 438, 449-453 (1958). It is for a reviewing court to determine what is a permissible modification of a vested right. *Betts*, 21 Cal. 3d at 864 (citing and quoting *Allen*, 45 Cal. 2d at 131; *Miller*, 18 Cal. 3d at 816).

In determining whether a benefit is vested and only subject to modification under limited circumstances, a reviewing court will 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 the collective bargaining 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 formula for determining an employee's pension is a core pension benefit, and has been held to be vested. *Betts*, 21 Cal. 3d at 863. Under the City's Plan, Base Compensation is an element of the pension formula, because retirement allowances are calculated as a percentage of employees' final compensation, which in turn is defined as an employee's highest Base Compensation over a specified time period. The City, therefore, cannot change the definition of "Base Compensation" in the Plan to exclude any portion of "base salary or wages" unless it can demonstrate that the change is reasonable and necessary and that "comparable new advantages" are being provided to employees disadvantaged by the change.

**B. Amending the Plan's Definition of "Base Compensation" to Exclude Any Portion of an Employee's Base Salary or Wages Would Also Require a Vote of the Retirement System Membership Under Charter Section 143.1.**

Charter section 143.1(a) addresses the circumstances under which a vote of the Retirement System membership is required:

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.

San Diego Charter § 143.1(a).

In interpreting this provision, the rules of statutory construction apply. In *California Teachers Association v. San Diego Community College District*, 28 Cal. 3d 692 (1981), the California Supreme Court recited the following basic rules of statutory construction:

In construing a statute, "we begin with the fundamental rule that a court 'should ascertain the intent of the Legislature so as to effectuate the purpose of the law.'" "An equally basic rule of statutory construction is, however, that courts are bound to give

effect to statutes according to the usual, ordinary import of the language employed in framing them.” Although a court may properly rely on extrinsic aids, it should first turn to the words of the statute to determine the intent of the Legislature. “If the words of the statute are clear, the court should not add to or alter them to accomplish a purpose that does not appear on the face of the statute or from its legislative history.”

*Id.* at 698 (citations omitted).

The phrase, “benefits of any employee under such retirement system,” as used in Charter section 143.1, is not specifically defined. However, “benefit” generally refers to “advantage; privilege” or “profit or gain; especially the consideration that moves to the promise.” Black’s Law Dictionary (9th ed. 2009). “Benefit” also means a “payment made or an entitlement available in accordance with a wage agreement.” American Heritage Dictionary (3rd ed. 1992). And, in the context of retirement and other employment benefits, “benefit” is generally defined as a form of pay for the performance of services.<sup>18</sup> The term “affect” means “to produce an effect on; to influence in some way.” Black’s Law Dictionary (9th ed. 2009).

“Retirement System,” as used in Charter section 143.1, refers to the Retirement System established under the authority of Charter section 141. “Retirement System” is defined, by ordinance, in the Plan as “the City Employees’ Retirement System as created by [Article 4].” SDMC § 24.0103. The term “member” is defined in the Plan as “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.” SDMC § 24.0103.

Applying the normal meaning of the words in Charter section 143.1, approval of a majority vote of the members of the Retirement System is required before the City Council may adopt an ordinance amending the Retirement System that affects (or changes) any City employee’s benefits (or payments) under the Plan.

The Plan defines “Base Compensation” as “the base salary or wages paid (standard hours multiplied by the hourly rate) on a regular bi-weekly basis to an employee for his or her services in any given pay period.” SDMC § 24.0103. Base Compensation is the basis for determining an employee’s final compensation, which is an element of the formula used to calculate an employee’s retirement allowance.

In order to exclude a portion of an employee’s bi-weekly wages from the calculation of his or her retirement allowance, Municipal Code section 24.0103 would have to be amended by ordinance to specifically set forth the limit to be applied. Such a limit would affect the formula used to determine retirement allowances and would ultimately change the benefit payments of one or more employees under the Retirement System. Therefore, before the City Council may

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<sup>18</sup> See I.R.S. Publication 15-B (2010), *Employer’s Tax Guide to Fringe Benefits*, p. 2.

adopt an ordinance limiting the amount of wages used to calculate retirement benefits, the amendment would have to be approved by a majority vote of the Retirement System members.

**C. The City May Exclude Future Pay Increases From Retirement Calculations, Without Amending the Plan and Without a Vote of the Membership, By Creating a New Pay Category and Identifying it as Excluded from the Calculation of Retirement Benefits in the Annual Earnings Codes Document.**

As discussed earlier in this Opinion, the City can freeze employees' Base Compensation under the Plan, subject to the MMBA and existing Civil Service provisions.

The City can also exclude future pay increases from Base Compensation by creating a new pay category for exceptional merit or pay-for-performance and identifying it in the annual Earnings Codes Document as excluded from retirement benefit calculations. SDMC § 24.0103.<sup>19</sup> The new pay category should be distinct from regular salary or wages, and should not be included in employees' regular bi-weekly pay checks. It should be paid separately and on a different schedule, in order to maintain the distinction between the new pay category and what is normally treated as Base Compensation. Also, this new pay category may not be a disguise for what should be "base salary or wages paid" under the definition of Base Compensation. As stated above, employees have a vested right to inclusion of "base salary or wages paid (standard hours multiplied by the hourly rate) on a regular bi-weekly basis . . . for his or her services in any given pay period" in retirement calculations.

Creating a new pay category that would not count towards employees' pension calculations would not require an ordinance amending the Plan, and therefore would not be subject to a vote of the Retirement System members under Charter section 143.1. It also would not impair vested pension benefits, as the Plan clearly contemplates that the pensionable status of certain types of pay, other than regular bi-weekly wages or salary, is subject to change annually by amending the Earnings Codes Document. *See San Bernardino*, 67 Cal. App. 4th at 1223 (citing *Valdes v Cory*, 139 Cal. App. 3d 773, 786 (1983)).

Moreover, the Plan provides that payments for "exceptional performance" or "pursuant to a pay for performance plan" are *not* included in Base Compensation absent an express designation to the contrary in the annual salary ordinance. SDMC § 24.0103. This language could be used to negotiate a policy to provide for increased compensation based on "exceptional performance" or "pay for performance" that is not pensionable.

The reference to the Earnings Codes Document for determining the pensionable status of specific pay categories was added to the Plan in 2000, as a result of the settlement of a class action lawsuit filed by active and retired City employees against the City and the Retirement

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<sup>19</sup> It is our view that the City could not change the pensionable status of pay for out-of-class assignments or certain types of paid leave, such as holiday pay, pay for annual leave taken, pay for sick leave taken, among others (which are listed in section 24.0103 as examples of Base Compensation), without amending the Municipal Code by ordinance, which would require a vote of the Retirement System membership under Charter section 143.1. In addition, these pay categories are arguably a vested retirement benefit, especially when the paid leave has already been taken or earned.

System.<sup>20</sup> The lawsuit, captioned *Corbett v. City Employees' Retirement System, City of San Diego, Real Party in Interest*, San Diego County Superior Court Case No. 722449 (*Corbett*), alleged that retirement benefits had been calculated incorrectly in light of the California Supreme Court's decision in *Ventura County Deputy Sheriff's Association v. Board of Retirement of Ventura County Employees' Retirement Association*, 16 Cal. 4th 483 (1997). In the *Ventura* decision, the Supreme Court ruled that the retirement board in that case was required to classify certain payments made by the County of Ventura to its employees, over and above their basic salaries, as "compensation earnable" and to include those payments in the "final compensation" used to calculate the amount of monthly pension benefits payable to retired employees. The plaintiffs in the *Corbett* case alleged that the same rationale should apply to certain categories of compensation paid by the City of San Diego.

The *Corbett* settlement agreement increased retirement benefits for retired employees and retirement factors for active employees in exchange for clarification of the types of compensation that would be used in retirement calculations going forward. The settlement agreement expressly provided that each member of the plaintiff class is "giving up all claims which could have been brought or pursued in this lawsuit concerning the definition of Compensation, [B]ase [C]ompensation, Compensation Earnable or Final Compensation under the Municipal Code for purposes of calculating retirement benefits payable by SDCERS."<sup>21</sup>

On August 7, 2000, the City Council adopted Ordinance O-18835, amending the Municipal Code to reflect the terms of the *Corbett* settlement. Among other things, the ordinance repealed the following definitions for "Compensation" and "Compensation Earnable" in the Plan:

"Compensation" means the remuneration paid in cash out of city funds controlled by the Council of the City of San Diego, plus the monetary value as determined by the [Retirement] Board of board, lodging, fuel, laundry and other advantages furnished to an employee in payment for the employee's services.

"Compensation Earnable" by a Member means the Base Compensation as determined by the Board for the period under consideration upon the basis of the normal number of days ordinarily worked by persons in the same grade or class of positions during the period at the same rate of pay. The computation for any absence shall be based on the compensation of the position held by such employee at the beginning of the absence.

San Diego Ordinance O-18835 (Aug. 7, 2000).

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<sup>20</sup> The San Diego Municipal Employees' Association; San Diego City Firefighters, International Association of Fire Fighters Local 145; Local 127, American Federation of State, County, and Municipal Employees, AFL-CIO; and the San Diego Police Officers Association all intervened in the lawsuit on behalf of their bargaining units.

<sup>21</sup> Notice of Proposed Settlement of Class Action, *Corbett*, filed April 4, 2000, at 2 (*Corbett* Order and Judgment Approving Settlement of Class Action, filed May 17, 2000).

The ordinance added the current definition for “Base Compensation” to replace the repealed definitions. Before the ordinance was adopted by the City Council, the Retirement System conducted separate elections of the active and retired members pursuant to Charter section 143.1. An election bulletin summarizing the changes included in Ordinance O-18835 was distributed to all retired and active members along with their ballots. It summarized the new definition of Base Compensation as follows:

“Base Compensation” means and includes only the base salary or wages paid to an employee in any given fiscal year, plus such other elements of compensation or remuneration which are expressly identified in the City of San Diego’s annual Salary Ordinance for inclusion in the calculation of Final Compensation.

SDCERS Benefits Election Report: Election #39, May 19, 2000. The retired employees and the active employees each approved the changes in the ordinance by a majority vote.<sup>22</sup>

The Plan, as amended, explicitly includes in Base Compensation regular bi-weekly wages and salary paid to an employee, including certain types of paid leave and out-of-class-assignment pay, which are identified in the Municipal Code as examples of pay included in Base Compensation. SDMC § 24.0103. All other types of pay are subject to change annually by amending the Earnings Codes Document. The employees, therefore, do not have a vested right in the pensionable status of compensation other than regular wages and salary.<sup>23</sup>

Before the City can change the pensionable status of pay categories listed in the Earnings Codes Document, it must negotiate with the City’s recognized employee organizations, pursuant to the MMBA.

## CONCLUSION

For General Member City employees hired before July 1, 2009, and Safety Members, retirement allowances are determined by multiplying Base Compensation, based on the highest one-year period during membership in the retirement system, by the years of service credit, by the appropriate retirement factor for the age at retirement. The calculation of retirement allowances for General Member employees hired on or after July 1, 2009, uses Base Compensation based on the average of the General Member’s three highest years at any time during membership in the Retirement System.

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<sup>22</sup> San Diego City Employees’ Retirement System Certification of the IVR Ballot Count for the Corbett Settlement Benefits Election, dated June 14, 2000.

<sup>23</sup> The Court of Appeal’s unpublished decision in *Sloan v. City of San Diego (Sloan)* supports this conclusion. *Sloan v. City of San Diego*, Case No. D049158 (San Diego County Superior Court Case No. GIC848641), unpublished decision filed January 29, 2008. In *Sloan*, three San Diego police officers brought a declaratory relief acting against the City, seeking an order requiring the City to include canine care pay in Base Compensation for purposes of determining retirement benefits. *Sloan*, at 1. Although the Court held that the City could not retroactively exclude police officer canine care from the definition of Base Compensation, it upheld the City’s exclusion of canine pay from Base Compensation by amending the Earnings Codes Document for fiscal year 2007, stating “it is within the scope of the City’s authority to prospectively change the types of pay classes that constitute retirement base compensation.” *Sloan*, at 18.

While the retirement calculation factors are vested, “base salary or wages paid” is an employment benefit that can be modified. Further, the pensionable status of certain items of compensation, such as specialty pay, can be changed on an annual basis through amendment of the Earnings Codes Document. Whether certain items of compensation, other than “base salary or wages paid,” are included in Base Compensation may be negotiated through the collective bargaining process.

If the City desires to reduce its Retirement System liability, it may prospectively modify employees’ salaries. This includes what items of special compensation, such as specialty pay, are to be included in the calculation of Base Compensation. Subject to the MMBA and existing Civil Service provisions, there are options the City Council may consider, including the following:

- The City may negotiate a policy freezing “base salary or wages paid” at current levels, with the exception that Classified Employees be permitted to progress to Step E if there is no change to the existing Civil Service structure. A freeze on base salaries or wages would result in a freeze on Base Compensation for purposes of calculating retirement allowances.<sup>24</sup>
  - The existing Civil Service structure is based, in part, on the principle of promotion, as set forth in Charter section 124. Consideration should be given as to how to treat employees who move between classifications, from lower paying classifications (with lower base salary ranges) to higher paying classifications (with higher base salary ranges), if the City implements a freeze on Base Compensation. An actuary may be able to provide assistance in reviewing this issue, from a policy perspective.
  - Because wages and future retirement benefits of current and future employees are mandatory subjects of bargaining pursuant to the MMBA, which is preemptive state law, the City would be required to meet and confer regarding the implementation of a policy freezing “base salary or wages paid.” The City would also be required to meet and confer regarding continuation of the policy, at the expiration of each MOU or upon the request of any recognized employee organization.
  - The City Council could propose a Charter amendment that sets forth such a policy. However, a City Council-proposed Charter amendment must be negotiated with the affected employee organizations prior to placement on the ballot. A City Council-proposed Charter amendment that results in a

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<sup>24</sup> The exclusion of a portion of employees’ overall compensation could, over time, result in some employees becoming subject to mandatory Social Security coverage. Under Internal Revenue Code section 3121(b)(7)(F), the wages of a state or local government employee are subject to Social Security after July 1, 1991, unless the employee is a “member of a retirement system” maintained by the governmental employer that provides at least a minimum level of retirement benefits. This issue should be reviewed further by an actuary. Also, consideration should be given to building into any policy a trigger that makes adjustments to satisfy the Social Security Safe Harbor requirements.

mechanism for setting wages is subject to mandatory bargaining to impasse. *City of Fresno v. People ex rel. Fresno Firefighters*, 71 Cal. App. 4th 82, 101 (1999).<sup>25</sup> Further, a Charter amendment regarding a freeze of Base Compensation must be drafted in a way that ensures that the City can comply with its duties under the MMBA to meet and confer on wages or retirement benefits in the future.<sup>26</sup> It is important to note that the MMBA sets forth procedural requirements regarding the City's labor relations with its employees. It does not mandate a certain form of compensation.<sup>27</sup>

- The City may negotiate a policy reducing the percentage between the “merit step increases” as defined under the Civil Service system, or reducing the current salaries for employees associated with the existing steps. Currently, the “merit step increases” are approximately five percent. This could be reduced to a lower percentage or lower amount, subject to any necessary review by the Civil Service Commission pursuant to Charter section 130 and any other applicable Charter provisions or Civil Service Rules. Employees are entitled to compensation already earned. Therefore, any change to the steps must be prospective. Again, the City would be required to meet and confer regarding the continuation of the policy at the expiration of each MOU or upon the request of an employee organization. Employees may argue that they have a vested right to the five percent Civil

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<sup>25</sup> The City's recognized employee organizations may argue that a Charter-established wage freeze is functionally equivalent to a Charter amendment prohibiting the City from meeting and conferring on wages. At least one court has rejected a similar argument. *United Public Employees v. City and County of San Francisco*, 190 Cal. App. 3d 419 (1987) upheld a San Francisco City Charter provision requiring a vote of the electorate to approve any “addition, deletion or modification” in employee benefits established by City Charter. *Id.* at 423. The court held that the MMBA's meet and confer process was not incompatible with the power of the electorate to reserve the right to grant or deny benefits of public employment. *Id.* at 425-426. *But see Voters for Responsible Retirement v. Board of Supervisors of Trinity County*, 8 Cal. 4th 765, 783-784 (1994) (concluding that voters could not through the referendum process rescind an agreement reached through bargaining under the MMBA). The *Voters for Responsible Retirement* case expressly declined to decide whether the result in the 1987 *United Public Employees* case was correct. *Id.* at 782.

<sup>26</sup> Said differently, should the City be unable to negotiate a Charter amendment with the affected employee organizations and decide to impose placement of a Charter amendment on the ballot, following impasse proceedings with the recognized employee organizations, the City must be mindful that the Charter amendment must harmonize with the MMBA. The MMBA addresses the “meet-and-confer process,” and it is preemptive state law. *Seal Beach*, 36 Cal. 3d at 602. The City's duties under the MMBA are mandatory. *Id.* See also *City of Fresno*, 71 Cal. App. 4th at 100 (1999) (citing *Seal Beach* for the rule that the duty to bargain in good faith established in the MMBA is “a matter of statewide concern and of overriding legislative policy, and nothing that is or is not in a city's charter can supersede that duty”); *San Leandro Police Officers Ass'n*, 55 Cal. App. 3d at 557. The City may not amend its Charter to conflict with or abrogate any duties the City has, as a public agency employer, to meet and confer with its recognized employee organizations over mandatory subjects of bargaining, including wages and retirement benefits.

<sup>27</sup> As an example, a Charter amendment could freeze Base Compensation, subject to existing Civil Service provisions and the MMBA, while negotiations could occur over the amount of money paid out in performance pay. There could be further negotiations over the terms and frequency of other forms of compensation. A Charter amendment could also change Civil Service provisions, which set forth the way the City compensates Classified Employees in the future, subject to vesting provisions and applicable Charter provisions. An alternative to an indefinite freeze could be to allow an increase to Base Compensation only if accompanied by an actuary's report as to the impact on the Retirement System's unfunded liability and annual required contributions. This would not bar negotiations, but would require that the negotiating teams work within Charter-mandated parameters.

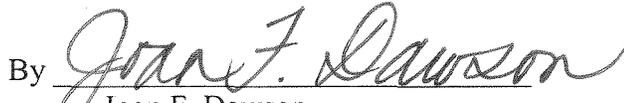
Service step increases. However, the better argument is that employees do not have a vested right to the step increases, and they may be negotiated. A City Council-proposed Charter amendment that changes the merit step increases must be negotiated with the affected employee organizations prior to placement on the ballot.

- To remain competitive with other employers, but avoid increasing employees' Base Compensation for purposes of calculating retirement allowances, the City could develop a new pay-for-performance plan for all City employees, which could include performance-based bonuses that could be paid annually, semi-annually, or quarterly based upon established criteria. These performance-based bonuses could be excluded from the calculation of retirement benefits as set forth in Municipal Code section 24.0103.
  - This policy would be subject to meet and confer under the MMBA as well as any necessary review by the Civil Service Commission under the Charter and applicable Civil Service Rules.
  - Further, the City cannot create a new pay-for-performance or exceptional merit plan that is merely a disguise for, or end-run around, "base salary or wages paid." As this Opinion states, the inclusion of "base salary or wages paid" in retirement allowance calculations is a vested right for employees, and may not be modified except under limited circumstances and accompanied by a comparable new advantage,
- In order to prospectively exclude a portion of an employee's bi-weekly "base salary or wages paid" from the calculation of his or her retirement allowance, Municipal Code section 24.0103 would have to be amended by ordinance to specifically set forth the limit to be applied.
  - Since such a limit would affect the formula used to determine retirement allowances, it would ultimately change the benefit payments of one or more employees under the Retirement System. Therefore, before the City Council may adopt an ordinance limiting the amount of wages used to calculate retirement benefits, the amendment would have to be approved by a majority vote of the Retirement System members.
  - There must also be consideration given to whether the proposed modification infringes upon a vested right. If it does, then the circumstances upon which modification can occur are limited and the City must also provide employees with a comparable new advantage.

Should the City Council desire any further analysis regarding any contemplated proposals, this Office would be happy to provide it.

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