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August 11, 2010

Mr. Alan J. Arrollado
Mr. Raymond G. Ellis
Mr. David A. Hall
PSC Ad Hoc Committee Members
c/o Elaine Reagan, General Counsel
401 West A Street, 4th Floor
San Diego, CA 92101

Re: Legal and Ethical Obstacles to Any Proposed PSC "Corrections" Adversely Affecting Employees and Retirees

Dear Messrs. Arrollado, Ellis, Hall:

I write on behalf of those MEA-represented active and retired employees who are threatened with adverse action related to certain purchase of service contracts ("PSCs") as a consequence of the SDCERS Board's operational decisions (and votes) on August 15, 2003, and again on November 16, 2007, which have led to the published opinion filed on June 7, 2010, by the Fourth District Court of Appeal ("4th DCA") in *City of San Diego v. SDCERS*, D054688 (Super. Ct. No. 37-2007-00081912-CU-WM-CTL).

The 4th DCA concluded that SDCERS may not recover any underfunding associated with certain PSC contracts through the Unfunded Accrued Liability ("UAL") portion of its annual bill to the City because (1) the SDCERS Board's decision on August 15, 2003, to allow additional service credits to be purchased at the *old* rates during a 60-day "window period" was *unlawful*, and (2) the SDCERS Board's decision and vote on November 16, 2007, to charge the City for the funding shortfall – which triggered the City's timely writ petition – was also *unlawful*.

As to the Board's vote on November 16, 2007, "to charge the City for the underfunding," the court noted that SDCERS' own fiduciary counsel (Harvey L. Leiderman of Reed Smith LLP) had publicly stated that the Board's alternative was to "charge the employees" (instead of the City) by "voiding contracts, collecting arrears payments, offering rewritten contracts, spreading out additional payments or reducing benefit levels." The fact

that Mr. Leiderman's advice was clearly wrong (based on well-established legal and equitable principles, as well as the **undisputed outcome of past litigation and rulings which were clearly binding on the City and SDCERS**) – and likely constituted legal malpractice (as described below in detail) – went unmentioned in the 4th DCA's decision.

With Board Members Sullivan, Meyers, Lamberth and Thompson having recused themselves, the remainder of the Board followed Mr. Leiderman's advice and, in doing so, they – and he – ignored my express plea to take *no further action* for the reasons detailed in an 18-page Memorandum which I distributed to the Board on *October 19, 2007,* and, thereafter, buttressed in my follow-up e-mail communications.

Thus, regrettably, it was these *two Board actions* which have led directly to the heartache and threatened economic hardship to which certain plan participants are being subjected despite the unequivocal fact that they are innocent victims. During your first public hearing on this issue on August 6, 2010, you began to hear their personal stories and their undeniable anguish, disbelief, fear and confusion over the unwelcome news you have delivered to them in your recent communications. As one speaker correctly noted, neither the Union Tribune nor any other media outlet was present to hear these stories – another sign of the bias which informs all "news-making" in the City of San Diego.

In my presentation to you, I attempted to sum up the depth of this anguish based on the fact that employees and retirees have consistently viewed SDCERS, in its role as a *fiduciary*, to be a *trusted* protector of their legitimate interests in a City, and at a time, when they have been repeatedly victimized by hostile public opinion and by highly political decision-making which affects their employment in every respect from morale to take-home pay. They relied in good faith on the finality and enforceability of the *contracts* which SDCERS invited and prepared; they signed and performed these contracts to their detriment; they made irreversible career, financial, family and retirement decisions without ever doubting that SDCERS' (and the City's) promises to them were likewise *irreversible*.

It must also be emphasized that, in most cases, those employees who made a decision to apply to purchase service credits during the "window period" in 2003, did so as a result of the deliberate efforts and publicity generated by both SDCERS *and the City*. After the SDCERS Board's vote on August 15, 2003, SDCERS staff sent a notification to all City employees alerting them that PSC purchase applications received by SDCERS prior to November 1, 2003, would be priced under the *old* rates. The "PSC request form" which SDCERS provided to employees "reassured" them that SDCERS was in compliance with the laws governing this PSC purchase opportunity; the form stated: "The San Diego Municipal Code and Retirement Board Rules govern the PSC benefit; therefore, SDCERS must adhere to all regulations and rules pertaining to each PSC."

And the City's authorized managerial agents *promoted* this PSC "opportunity" in meetings held throughout the workplace. Thus, not only did the *City* approve the "window period" by and through its representatives on the SDCERS Board who voted in favor of it, but also the *City*, through its authorized managerial agents, induced employees to rely on the lawfulness of this PSC opportunity in making their critical decisions to use their savings, other assets, or even a portion of each paycheck, to purchase service credits at the price SDCERS set – a price which they neither influenced nor negotiated. Finally, if the City had disagreed with SDCERS' interpretation of the Charter, Municipal Code and/or its fiduciary duty when establishing the "window period" on August 15, 2003, the City could have and should have – but did not – bring a timely legal challenge to the Board's action (by writ of mandate). Instead, the City took *no action* to challenge SDCERS' right to offer, and employees' right to accept, irrevocable contracts to purchase service credits at the non-negotiable price SDCERS set.

THE "CORRECTION" OPTIONS

Based on SDCERS' communications to date to the potentially affected plan participants, it appears that SDCERS has concluded – albeit tentatively – that, if SDCERS may not permissibly include the unfunded liability associated with the service credit contracts arising from the "window period" in its calculation of the City's annual UAL payment, then the only viable solution to make the trust fund "whole" is to collect the underfunding from affected plan participants. **This is wrong**.

1. As Indemnitor of the SDCERS Board, The City Itself Is Liable To Affected Plan Participants For Their Economic and Non-Economic *Damages* Resulting From the SDCERS Board's Unlawful Ministerial Decision on August 15, 2003

While SDCERS may not charge the City *directly* for the PSC underfunding at issue here by adding it to the City's annual UAL cost, **the City – *not employees or retirees* – nevertheless remains *indirectly* liable to make SDCERS "whole" for this underfunding** as follows:

(A) The City's legal argument before the Superior Court and the Court of Appeal was, in essence, that the SDCERS Board acted *unlawfully* on August 15, 2003, in establishing a "window period" for additional PSCs contracts to be executed at the *old rates*. The City persuaded the courts that this Board decision – though motivated by a desire to fulfill its fiduciary duty to plan participants – was not a proper exercise of discretion deserving of judicial deference but was, instead, an unlawful ministerial or operational decision in direct violation of the plan documents as set forth in the City Charter and in the Municipal Code. While SDCERS argued to the contrary in defending the Board's action, the City's view prevailed. Accordingly, it follows from the City's argument that the SDCERS

Board breached its fiduciary duty to plan participants by allowing (indeed inducing) contracts to be signed, relied upon, and performed, when the Board (and its advisors) knew or, in the exercise of reasonable care, should have known that the plan document did or arguably could be interpreted to prohibit these transactions – thus, potentially subjecting plan participants to subsequent adverse action (as is now threatened). Nor did SDCERS disclose to employees *before* they signed and relied on the finality and enforceability of these "window period" PSCs that there was any risk these contracts might be found to violate the City Charter or the San Diego Municipal Code.

(B) At the time of its operational decision to establish a "window period" on August 15, 2003, the SDCERS Board had thirteen Members in office and in attendance at the meeting when they **voted twelve to one** in favor of implementing the new rates developed by the system's actuary for purchased service credits *and* in favor of allowing a "window period" for purchases to be accomplished at the *old rates*. The twelve Board Members who voted in favor of this "window period" included three appointed Members **Dick Vortmann, Diane Shipione, and Franklin Pierce; City Manager-designee Cathy Lexin, City Treasurer Mary Vattimo, City Auditor-designee Terry Webster**, and all six Members elected by Retirees (1), General Members (3), Fire Safety Members (1) and Police Safety Members (1). The only "no" vote was cast by appointee Ray Garnica.

(C) At the time the SDCERS Board took action to establish the PSC "window period" on August 15, 2003, Resolution R-297335 was in effect which the City Council had adopted on November 18, 2002, in recognition of the fact that Board Members "may, from time to time be subjected to claims and suits for actions taken in their capacity as such;" and that "there is a need to protect and encourage individuals who volunteer their time and their talent to serve in the public interest." By this broad indemnification Resolution – which included indemnification for punitive or exemplary damages under certain conditions – the City agreed that it:

> "shall defend, indemnify and hold harmless all past, present and future members of the Retirement Board against all expenses, judgments, settlements, liability and other amounts actually and reasonably incurred by them in connection with any claim or lawsuit arising from any act or omission in the scope of the performance of their duties as Board Members under the Charter."

(D) By Resolution R-301414, adopted on May 10, 2006, the City Council repealed its Indemnification Resolution R-297335, "for any acts or omissions by Board Members occurring *after April 18, 2006*. The repealing Resolution states on its face that notice of this repeal was given on April 20, 2006, to the SDCERS Board Members in office at that time.

(E) While Resolution R-301414 effectively ended the broad and automatic obligations established by Resolution R-297335, it did *not* end the City's obligation to defend and indemnify SDCERS Board Members for acts and omissions after April 18, 2006. Resolution R-301414 simply stated that "any determination of whether to provide a defense and indemnification would be governed by the provisions of Government Code sections 825 and 995."

(F) On July 25, 2007, the 4th DCA upheld the Superior Court's enforcement of Resolution R-297335 by ordering the City to pay both (1) the costs and attorneys fees incurred by Board Members in defending against the civil litigation filed against them by San Diego City Attorney Mike Aguirre, and (2) the costs and attorneys' fees they incurred in suing the City to enforce the obligations of Resolution R-297335. *Torres, et al. v. City of San Diego* (2007) 154 Cal.App.4th 214.

Accordingly, if SDCERS takes adverse action against employees or retirees on the PSCs at issue here, the following cascading events are surely to follow as night follows day:

- Such adverse action will give rise to meritorious damage claims against the SDCERS Board Members whose acts or omissions on August 15, 2003, constituted a breach of fiduciary duty;

- These Board Members will, in turn, look to the City to defend *and indemnify* them;

- The City will be obligated to do so based on binding appellate authority in *Torres, et al. v. City of San Diego* (2007) 154 Cal.App.4th 214;

- These Board Members will likely be forced to concede that their decision on August 15, 2003, *was a breach of fiduciary duty* based on the successful argument the City already made and the Court of Appeal accepted in *City of San Diego v. SDCERS*, D054688 (Super. Ct. No. 37-2007-00081912-CU-WM-CTL);

- Damage awards would likely follow in the amount of each employee's and retiree's harm – which would include both economic and non-economic damages since the measure of damages for a breach of fiduciary duty is the traditional tort recovery per Civil Code section 3333 – i.e., "the amount which will compensate for all the detriment proximately caused thereby, whether it could have been anticipated or not." (See also Civil Jury Instruction 4101; *Michelson v. Hamada* (1994) 29 Cal.App.4th 1566, 1582.)

- As indemnitor, the City, not SDCERS, will be required to indemnify these Board Members for these damages awards.

Accordingly, by pursuing the aggressive arguments it did and by procuring a determination that the Board's 8/15/03 operational decision was *unlawful,* the City itself has essentially *proven* that a breach of fiduciary duty occurred – a breach for which the City is the express indemnitor.[1]

While the City undoubtedly expected that employees/retirees would bear the brunt of its litigation strategy, the opposite is true because the *City itself must pay for all of the harm caused to plan participants by the SDCERS Board's acts or omissions on August 15, 2003.* In calculating the likely amount of these damages, SDCERS may reasonably assume that the *minimum* amount of the economic harm to employees and retirees would be the full value of the "underfunded" purchase price of the PSC contracts at issue; yet, if SDCERS proceeds with adverse action against employees and retirees, the economic damages will undoubtedly be greater than this amount because each individual employee's and retiree's particular circumstances and hardships must be taken into account when measuring damages. Moreover, if SDCERS proceeds, each employee's and retiree's non-economic damages in the form of emotional and mental distress, fear, anxiety, worry, and anger (as previewed by the individual stories presented on August 6, 2010) must be added to the total damage calculation *for which the City is ultimately liable.*

Thus, the City's seeming "victory" in this litigation is a hollow one. In its gleeful rush to judgment in this case (initiated by former City Attorney Mike Aguirre without City Council's authorization and pursued without careful scrutiny by City Attorney Goldsmith), the City has failed to assess and appreciate the risk it ultimately faced if it succeeded – whereby it would become obligated to pay *in tort damages* an amount which is equal to or greater than the amount SDCERS had added to the UAL for these "window period" PSCs. The result is that the City's annual budget will be further strained because a judgment for tort damages would be permissibly spread over a maximum of ten (10) years (under certain conditions) rather than amortized over twenty years as this portion of the UAL would be.

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[1] This result is also consistent with the legal doctrine of vicarious liability whereby a principal (i.e., the City as pension plan sponsor) is liable for the negligence of its agent (i.e., SDCERS as pension plan administrator). And, as a practical matter, all expenses incurred by SDCERS to defend itself against legal claims and/or to pay damage claims against it are ultimately borne entirely by the City in any event.

2. <u>The City, SDCERS, and/or Its Former Fiduciary Counsel Must Make The Plan "Whole" for Any Window Period PSC Underfunding – Not Employees Or Retirees – Due to the Board's Ill-Advised And Careless Operational Decision on November 16, 2007, Which Put Plan Participants Directly In Harm's Way</u>

When the SDCERS' fiduciary counsel Harvey Leiderman of Reed Smith LLP made a Power Point presentation to the Board on "Pricing of Additional Service Credit Purchases" on October 19, 2007, he noted that the City Attorney had "threatened litigation" and that he, as SDCERS' fiduciary counsel, had "commenced his legal analysis" in March 2007, leading to three closed sessions of the Board in July, August and September 2007, "to address pricing issues," with the affected Board Members having recused themselves (Mark Sullivan, Franklin Lamberth, Steven Meyer and John Thomson).

Mr. Leiderman suggested that the Board could take any one of *six* potential actions related to *all* PSC contracts; *five* of those actions were adverse to plan participants who had signed and performed PSC contracts – i.e., "voiding contracts, collecting arrears payments, offering rewritten contracts, spreading out additional payments or reducing benefit levels." Only *one* of the *six* proposed actions maintained the status quo – i.e., "continuing to collect the shortfall through the amortization of the system's unfunded liability."

Although Mr. Leiderman's Power Point presentation itemized "issues for consideration" which included queries suggestive of legal or equitable barriers to the Board's actually taking any of the *five* adverse actions, he did *not* qualify the Board's alleged *discretion* to do so in any respect – leaving the impression, as the Court of Appeal noted, that there would have been no legal or equitable barriers to the Board's having voted to take any one of those *five* actions instead of the one it did.[2] He described the Board's fiduciary duties in considering the appropriate action to take as (1) the duty to preserve and protect the fund; to pay benefits that are promised and earned and collect sufficient contributions to support the benefits; (2) the duty to correct errors when appropriate and not perpetuate erroneous interpretations of the plan; (3) the duty to act fairly and equitably to members and their beneficiaries; and (4) a subordinate duty to minimize employer contributions, consistent with fiduciary duties.

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[2] For example, Mr. Leiderman's Power Point asked: "Did members reasonably rely on the PSC pricing? Could members be returned to their pre-purchase positions? Could members be rehired to their old positions? Is it practical for the Board to collect arrears payments? May the Board adjust any PSC contracts, and if so, how? Is there a likelihood of litigation arising, and if so, at what cost?"

Although Mr. Leiderman's Power Point presentation on October 19, 2007, noted that the goal of the planned public sessions on October 19 and November 16, 2007, was to "(1) offer a forum to all stakeholders, (2) gather additional relevant evidence and data, (3) obtain useful perspective on the issues under consideration and potential actions, and (4) assure the public that the Board (was) acting fairly, openly, responsibly and prudently," my very detailed presentation analyzing *why* it was imperative that the Board take ***no** further action* went unheeded. (See attached 18-page Memorandum dated 10/19/07 entitled "Purchased Service Credits: What Should SDCERS Do?")

Although Mr. Leiderman's Power Point presentation had identified as an "issue for consideration" whether "the Board should file a declaratory relief action to get direction from the courts," I spelled out in painstaking detail that **SDCERS had already done so on July 26, 2005** (*SDCERS v. City of San Diego*, GIC 851286; consolidated with *SDCERS v. Aguirre, et al.* GIC 841845), using plan assets, **and had procured an Order from the Court** on SDCERS' Motion for Summary Judgment/Adjudication (which the City opposed) **"that SDCERS may properly and legally pay all City Retirement Benefits, including, but not limited to, the *Contested Benefits*."** SDCERS' declaratory relief complaint itself **defined** what these *Contested Benefits* were by reference to former City Attorney Mike Aguirre's Memorandum dated June 17, 2005, directed to City Auditor and Comptroller John Torell, and copied to SDCERS' Retirement Administrator and General Counsel, demanding that certain "illegal" retirement benefits not be paid; the list included, among others:

> **"Any retirement benefit based on a Purchase of Service Credit that was purchased by a member at a rate that was not actuarially neutral."**

In seeking a declaration from the Court "that SDCERS may properly and legally pay all City Retirement Benefits, including, but not limited to, *the Contested Benefits*," SDCERS explained in its Complaint why its action was appropriate and necessary as follows:

> ¶ 24: Pursuant to its duties under the California Constitution and the Charter, the Board has a fiduciary duty to seek a judicial determination of the legality of retirement benefits to its members upon reasonable notice that the legality of such benefits is disputed. Therefore, the Board has filed this declaratory relief action for the express purpose of discharging its fiduciary duty to all of its members and their beneficiaries to determine the legality of the **Contested Benefits**.[3]

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[3] This is apparently the concept which Mr. Leiderman had in mind when he presented the issues to the Board on October 19, 2007; though he did not inform the Board that SDCERS had already procured a declaration related to these PSCs.

Thus, when the Court granted SDCERS' motion on October 16, 2006, SDCERS had the final ruling it sought "for the express purpose of discharging its fiduciary duty to all of its members and their beneficiaries." That ruling clearly and unequivocally confirmed **"that SDCERS may properly and legally pay all City Retirement Benefits, including, but not limited to, the *Contested Benefits*."** In addition to this definitive ruling, as I detailed in my 18-page Memorandum, other litigation-related events *before* and *following* this ruling had established an ironclad roadblock against the City's misguided efforts to force the undoing of the PSC *contracts* which SDCERS had prepared and on which employees had relied in planning their work and personal *lives*.

Accordingly, the SDCERS Board's public meetings on PSC contracts in October and November 2007, were entirely unnecessary. SDCERS' fiduciary counsel was inexcusably unaware – or misunderstood – what had already occurred and been achieved during costly prior litigation, including the declaratory relief SDCERS itself had already sought and achieved.

As a result, Mr. Leiderman guided the Board down a path which subjected hundreds of plan participants to unnecessary stress, anxiety and anguish (see tapes of meetings on October 19, 2007, and November 16, 2007). Even though the Board *intended* to act in a manner which did *not* alter SDCERS' contractual liability to plan participants based on their signed PSC contracts but, instead, to preserve the *status quo* by including the unfunded liability associated with all PSC contracts in the UAL, the Board was advised to *take action* – albeit an unnecessary one – which ultimately undermined SDCERS' *contracts* with plan participants.

Thus, as reported in the Board's Summary, on November 16, 2007, after a closed session from 9:30 a.m. to 10:26 a.m., "the Board returned to open session at 10:50 a.m., and Board President Thomas Hebrank announced that in closed session the Board had determined, by a unanimous vote of 8 to 0, to allow the existing purchased service contracts to remain as formulated and to *continue* to amortize the shortfall through the existing unfunded actuarial liability." Because the Board conducted its discussions on this issue in a *closed* session on November 16, 2007, it is not known whether Board members understood the *effect* of *taking a vote* as opposed to *taking no further action* as I had urged on October 19, 2007, when presenting my 18-page Memorandum.

Moreover, I also do not know whether Mr. Leiderman had considered the potential effect of *taking this action* as opposed to *taking no further action.* While I do not claim to know today what Mr. Leiderman's thought process or motivations may have been in this regard – and I am not asserting that he acted deliberately rather than negligently in handling this issue – I am informed by a reliable source (which would undoubtedly be confirmed during any litigation-related discovery process) that Mr. Leiderman's first telephone call after

his professional services were terminated by SDCERS soon after the November 16, 2007, Board meeting, was to Executive Assistant City Attorney Don McGrath who was City Attorney Mike Aguirre's second-in-command in the effort to reduce employees' and retirees' vested pension benefits and one of the attorneys of record on the City's writ petition.

Although the Board's decision on November 16, 2007, was to maintain the *status quo* by (1) not attempting to alter its contractual obligations with plan participants, and (2) continuing to include PSC underfunding in the plan's UAL as had been its practice, this unanimous vote on November 16, 2007, gave rise to the City's timely writ of mandate (filed four days later without City Council approval) challenging the Board's ministerial action to "charge the City for this shortfall" as unlawful. Moreover, the City argued, and the courts agreed, that the Board's action did not involve a basic policy decision such that judicial deference was warranted; its action was, instead, an unlawful ministerial decision in direct violation of the City Charter and San Diego Municipal Code.

Thus, despite the ironclad record of prior litigation barring a legal challenge to these PSCs – and despite other available defenses to any attempt to unwind or "rewrite" these contracts (i.e., *res judicata*, the statute of limitations, and detrimental reliance, among others), the SDCERS Board's *action* deprived plan participants of these legitimate legal and equitable defenses and exposed them to the harm **which SDCERS itself is now threatening to take against them**.

Accordingly, if SDCERS proceeds with adverse action against employees and retirees on these PSC contracts, these employees and retirees will, in turn, have a meritorious claim against the SDCERS Board for its action on November 16, 2007, which, under all the circumstances, constituted a breach of fiduciary duty entitling them to a tort measure of damages as explained above in relation to the Board's action on August 15, 2003. The Board may, in turn, have a viable claim for malpractice against Mr. Leiderman and Reed Smith LLP as a result of the advice which induced their action constituting a breach of fiduciary duty.

I do not know whether SDCERS had a policy of insurance in effect on November 16, 2007, which would provide a defense and indemnification of Board Members for any such claims if employees and retirees file them. Nor do I know what malpractice insurance Reed Smith LLP had in effect during the relevant period which might be available to cover the damages arising from the Board's negligent ministerial action November 16, 2007. However, I do know that both potential insurance sources must be looked to as a proper and viable means of making the SDCERS trust fund "whole" for any losses associated with the PSC contracts at issue in this case – *instead of looking to employees and retirees to do so.*

Finally, apart from any potential insurance coverage which may be available to the SDCERS Board and/or to Harvey Leiderman/Reed Smith LLP to defend and indemnify them

against the damage claims which will inevitably arise if SDCERS takes adverse action against employees and retirees, the **City itself will also remain as an indemnitor** of the individual Board Members who participated in the decision on November 16, 2007.

Even though the broad indemnity Resolution R-297335 had been repealed by the City Council on May 10, 2006, "for any acts or omissions by Board Members occurring *after April 18, 2006*, the City Council's new Resolution R-301414 affirmed that "any determination of whether to provide a defense and indemnification (for acts or omissions after April 18, 2006) would be governed by the provisions of Government Code sections 825 and 995." These code sections require a public entity to defend an employee or former employee who is sued in his or her official or individual capacity on account of an act or omission in the scope of his or her employment, and to pay any resulting judgment, compromise or settlement. And section 117 of the City Charter provides that members of the city's Boards and Commissions are deemed to be unclassified employees of the City. Accordingly, sections 825 and 995 apply to SDCERS Board members who are not otherwise employed by the City.

Thus, the City remains the indemnitor of the Board's actions *after* April 18, 2006, including but not limited to its action taken on November 16, 2007. To the extent that SDCERS pursues adverse actions against plan participants on PSC contracts which SDCERS induced them to sign and on which these plan participants thereafter relied when making life-altering decisions, these adverse actions will be a direct consequence of the Board's breach of its fiduciary duty when it took an unnecessary, gratuitous and negligent ministerial action on November 16, 2007, thereby putting at risk PSCs on which plan participants had detrimentally relied. As noted above, those plan participants who are adversely affected, will have meritorious claims for a tort measure of damages against these SDCERS' Board members who, in turn, will have an absolute right to seek both a defense and indemnification from the City of San Diego.

3. SDCERS May Not Unilaterally "Void" or "Re-Write" These PSCs and Any Legal Action Seeking to Modify These Contracts Will Require Individualized Proof of "Cost Neutrality" And Will Trigger Individual Defenses And Cross-Claims

SDCERS' communications to employees and retirees to date suggest that SDCERS may and will unilaterally "undo" or "re-write" the affected PSCs because the 4th DCA's decision leaves it no other alternative. **This is wrong**.[4]

[4] Nor may SDCERS side-step its fiduciary duties under the circumstances by proposing a rescission/correction plan to the IRS in any *ex parte* VCP proceeding which undermines the state law rights of plan participants or deprives them of their state law remedies.

As noted above, the Court of Appeal's ruling was quite narrow in concluding *only* that SDCERS may not "lawfully" include the "window period" PSC underfunding in the UAL to be paid by the City. Alternative means to make the trust fund "whole" as identified above were not considered by the Court nor were employees or retirees "heard" at all in the proceedings which led to this decision.

Well-established state law principles related to *contracts* and *vested* pension benefits prevent any such unilateral actions.[5] Instead, SDCERS may only *propose* a PSC "re-write" to each affected plan participant, together with a full disclosure of the economic consequences of the proposed "re-written" contract and the plan participant's rights in the matter, and, after such a full disclosure, invite the plan participant's *voluntary* agreement to rescind the prior PSC and accept SDCERS' proposed modification.

In the absence of such a *voluntary* contract modification, SDCERS' only recourse would be to take legal action against each individual employee or retiree (or other beneficiary whose rights derive from an employee or retiree), such that SDCERS would be required to prove, by a preponderance of the evidence, why a timely modification of this contract can or should occur under the law. In response, each employee or retiree will have the right and the opportunity to raise any and all defenses against SDCERS' claim based on law and equity; and, in addition, may cross-claim against the City based on the relevant facts in his or her case. **A sampling of the issues likely to be raised includes:**

(A) Legal Actions Against Retirees and Active DROP Members:

(1) Those employees who made decisions to *retire* or to sign *irrevocable DROP contracts* after the City's writ of mandate had been filed against SDCERS on November 20, 2007, were not given any warning or other form of written disclosure by SDCERS (or the City) that their prior PSCs were being challenged or might be subject to rescission/correction as a result of this litigation.

- Accordingly, their decisions to *retire* and/or to enter *DROP* after November 20, 2007, were not based on a knowing and intelligent waiver of their rights under the pension plan and/or of their rights to continued employment with the City.

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[5] After retirement, pension benefits vest *absolutely* and the power to modify contractual pension rights is non-existent. *Terry v. City of Berkeley* (1953) 41 Cal.2d 698, 702-703. Moreover, San Diego Municipal Code section 24.1404, subsection (b), establishes that "all amounts credited to a Member's DROP Participation Account are fully vested." This, of course, includes all monthly pension allowances credited to the DROP account based on the amount of the service retirement awarded by the Board.

▸ However, as plan administrator, SDCERS does not have the power, by itself, to make them "whole" for the harm which would flow from the rescission or modification of their PSCs because (1) SDCERS cannot rehire them into the positions from which they retired, and/or (2) SDCERS cannot agree to rescind their irrevocable DROP contracts because the City is also a signatory to these contracts.

▸ The detrimental reliance and irreparable harm these plan participants would suffer from any rescission or modification of their PSCs are **insurmountable obstacles/defenses** which SDCERS cannot overcome in any court of law or equity, and, in the proper exercise of its fiduciary duty, SDCERS should take no further action against them.

(2) SDCERS may not unilaterally change the amount of any retiree's or active DROP member's retirement allowance; this amount became final and binding upon **SDCERS and the member** at the time the Board approved the employee's retirement and/or change in status to "active DROP."

▸ If SDCERS now claims that any retiree or active DROP member owes additional contributions to SDCERS – *and* SDCERS makes an informed determination as a fiduciary that it is in the best interest of the plan to pursue a legal claim against a retiree or active DROP member to recover these additional contributions, SDCERS will be obligated to prove this claim to the satisfaction of a court of law or equity and, in doing so, to overcome all defenses raised by the retiree or active DROP member before procuring a money judgment against the retiree or active DROP member. These defenses will include, but not be limited to:

- the bar of the statute of limitations,
- the equitable doctrine of laches,
- the Board's breach of fiduciary duty,
- the doctrines of promissory and equitable estoppel,
- the bar of a fully-performed contract,
- the vested rights doctrine under the state and federal constitutions).

▸ As noted above, in any such legal action which SDCERS initiates, any retiree or active DROP member will also be entitled to file a cross-claim against the City for the City's direct culpability in approving the "window period" in August 2003, and for thereafter inducing the retiree or active DROP member to rely to his/her detriment on the finality and enforceability of these PSCs – as well as for the City's vicarious liability for the negligence of its plan administrator.

- Pursuant to San Diego Municipal Code section 24.1008, even if SDCERS procures a money judgment against a retiree or active DROP member, SDCERS will become a simple judgment creditor and will have *no right* to subject the retiree's or active DROP member's retirement allowance to execution, garnishment, attachment or any other process of any court except to the extent permitted by California Code of Civil Procedure section 704.110 (limited to judgments for child, family or spousal support).

(B) Legal Actions Against Active Employees:

(1) For the same reasons described above, SDCERS may ***not*** unilaterally rescind or alter the irrevocable "window period" PSCs which became final and binding upon each plan participant who remains an active employee of the City. Many of these contracts have been fully performed by the employees who fully paid for the purchase *years ago* – at the non-negotiable price SDCERS set – in justifiable reliance on the finality and enforceability of these contracts. With the City's express approval of this "window period," these employees drew upon limited assets or otherwise found the means to raise the funds needed to complete these purchases and the purchased service was added to their "creditable service" balances. Other employees have paid and continue to pay for their PSCs by pre-tax and post-tax payroll deductions – thus *diminishing* their bi-weekly take-home pay available to support themselves and their families – also in justifiable reliance on the finality and enforceability of these contracts.

(2) If SDCERS does not get an employee's *informed* and *voluntary* agreement to rescind or modify his/her prior "window period" PSC, SDCERS will be required to take legal action against each individual employee precisely in the manner described above with regard to retirees and active DROP members – and with the same defenses being available and the same potential cross-claim being asserted against the City.

(C) In Any Such Legal Actions, SDCERS Will Have the Burden to Prove What Specific Amount of "Underfunding" Occurred With Each PSC

The City's Purchase of Service Credit program under its pension plan is set forth in Division 13 of Article 4 ("CERS") of the San Diego Municipal Code. Division 13 establishes the types of service credit which may be purchased. For example, Section 24.1302 establishes a plan member's right to purchase service credit covering his/her probationary period if a *prescribed* amount is paid into the system; section 24.1306 establishes a member's right, upon re-employment with the City, "to repay any refunded contributions with interest at the actuarial interest rate under terms and conditions prescribed by the Board."

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Other sections of Division 13 establish additional types of service which may be purchased but offer no specificity regarding the cost to be charged. See, for example, section 24.1303 (previous City service); section 24.1304 (part-time or hourly service); section 24.1305 (purchase of service credit upon reinstatement); section 24.1308 (service by officer or employee not previously included within the field of membership); and section 24.1309 (military service). Although these sections do not specify what must be paid for the service being purchased, section 24.1310 provides the following "catch-all" provision:

> To purchase Creditable Service, a Member must elect to pay and thereafter pay, in accordance with such election before retirement, into the Retirement Fund **an amount, including interest, determined by the Board.** No Member will receive Creditable Service under this Division for any service for which payment has not been completed pursuant to this Division before the effective date of the Member's retirement.

However, two other sections under Division 13 offer greater specificity related to the cost for *certain* service credits:

- for a purchase of an approved leave of absence, section 24.1307 requires payment of an amount "determined by the Board to be the equivalent of the employee cost of that service" if the absence was less than one year; and requires payment of an amount "determined by the Board to be the equivalent of the employee and employer cost of that service" if the absence exceeds one year.

- for a "five-year" purchase option (commonly known as an "air-time" purchase), section 24.1312 requires payment of an "amount the Board determines to be the employee and employer cost of that Creditable Service."

Thus, while SDCERS has used both "flat rates" (1997 through 2008) and "age/service-based" rates (since 12/19/08) for pricing service credits when performing its ministerial duty under the plan, if SDCERS initiates legal action against any plan participant based on the theory that he or she did not pay the amount "required by the San Diego Municipal Code" – albeit he or she paid the amount the Board had determined to be the correct amount at the time the purchase price was established by contract – SDCERS will be required to prove the *actual cost which should have been paid at that time by that employee based on the actual requirements of the San Diego Municipal Code and all relevant actuarial considerations*. The "old" or "new" flat rates will be irrelevant in this process as they were adopted for the administrative convenience of SDCERS and did not necessarily reflect the actual cost for each employee executing a PSC. Indeed, this point is borne out by the numbers Cheiron presented to the Board on October 19, 2007, which showed, in pertinent part, that:

- as of the June 30, 2006, actuarial valuation, General Members who purchased service credits during the "window period" had "underpaid" (as a group) by a total of $22,049,867 [and some of these General Members retired *before* November 20, 2007, and are not impacted by the City's Writ Petition];

- as of the June 30, 2006, actuarial valuation, Safety Members who purchased service credits during the "window period" had "overpaid" (as a group) by a total of $1,047,024 [and some of these Safety Members retired *before* November 20, 2007, and are not impacted by the City's Writ Petition].[6]

As Cheiron emphasized to the Board on December 19, 2008, the "single rate for all members is not an approach widely used elsewhere, is unnecessarily simplistic and undercharges a few members at the expense of overcharging most members."

Accordingly, once each individual General or Safety Member's *actual* cost is determined by SDCERS as part of its required proof in any legal action to collect additional contributions from the employee (on the theory that SDCERS did not charge the amount "required by the San Diego Municipal Code"), it will become clear whether that individual employee paid too much (and is owed a refund by SDCERS) or paid too little and owes additional contributions to SDCERS – subject to the defenses and cross-claims otherwise available to defeat SDCERS' claim for such additional contributions as described above. In that context, among other potential issues, the impact of investment gains and losses over the life expectancy of each individual employee who purchased service credits must also be considered because Cheiron did not include investment gains in excess of the assumed interest rate when calculating the alleged "underfunding" as of the 6/30/06 valuation date – and the 4th DCA specifically observed that the underfunding at issue in the case before it "may have been avoided entirely if, for example, the retirement fund experienced better than expected investment returns."

4. What Should the PSC Ad Hoc Committee Do With the Information Presented in This Letter?

- **Post this letter on the SDCERS' website.**

First, in the interest of full disclosure to employees and retirees who received SDCERS' prior communications on this issue, it is imperative that the information contained

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[6] Cheiron also noted in its 8/14/07 letter to SDCERS that a portion of the unfunded liabilities associated with all PSCs were *not* part of the UAL as of June 30, 2006, because these amounts represented benefits in excess of IRS section 415 limitations and were, in any event, a direct obligation of the City.

in this letter be made available to them and it is incumbent upon SDCERS, acting in its fiduciary capacity, to make it available – even if SDCERS does not agree with its contents. Only in this manner will all retirees and employees be able to make a more informed judgment about how to protect their rights and defend their vested pension benefits without incurring the burdensome and prohibitive costs of seeking individual counsel.

Because SDCERS is using its website as the medium to disseminate information on this issue in a timely manner, and this website is funded by plan assets belonging to *all* plan participants, it would be most appropriate for this letter to be posted on the SDCERS website as an item of interest to members who are or may be impacted by the work being done by the PSC Ad Hoc Committee – together with any disclaimer that SDCERS does not endorse or agree with its contents (if this is the case).

- **Reconsider the list of "correction" options tentatively identified.**

Next, the PSC Ad Hoc Committee and, thereafter, the full Board, must make a full and complete evaluation of the issues raised in this letter before proceeding with any proposed "corrections" of the "window period" PSCs. As fiduciaries, SDCERS must not continue to subject plan participants to the anguish and worry they are currently experiencing as a result of SDCERS' recent communications when, in the exercise of due care, SDCERS has other lawful and proper means to make the trust fund "whole" for these underfunded PSCs without looking to retirees and employees to do so. Those means are outlined in detail in this letter and each must be evaluated and acted upon – or, if rejected, a sound rationale for the rejection (based on fact and law) must be offered to those affected. In view of the City's ultimate liability in the matter, it would be unconscionable for SDCERS to use trust fund assets to subject retirees and employees to adverse consequences and thereby transfer to them the obligation to cross-claim against the City and/or to counterclaim against SDCERS and the relevant Board Members in order to trigger the City's obligation to defend and indemnify those Board Members. Nor, frankly, is there any logical reason to subject these Board Members to such an ordeal.

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In short, SDCERS has the power and the duty to see that a thorough analysis is done and that decisions are made in keeping with its fiduciary duties and, thus, unencumbered by "political" considerations. On behalf of all affected employees and retirees, as well as MEA, I urge you to do just that and I look forward to additional opportunities to work with you in achieving this outcome.

Sincerely,

Ann M. Smith

cc: Mayor Jerry Sanders
COO Jay Goldstone
City Attorney Jan Goldsmith
Deputy City Attorney Walter Chung
MEA President Tony Ruiz
MEA General Manager Mike Zucchet
Firefighters Local 145 President Frank DeClercq
SDPOA President Brian Marvel
AFSCME Local 127 President Joan Raymond
DCAA Representative George Schaefer
San Diego Alliance of Unrepresented Employees (AUE)
Retired Employees Association
SDCERS Board Members (August 15, 2003)
SDCERS Board Members (November 16, 2007)

ATTACHMENT

PURCHASED SERVICE CREDITS
WHAT SHOULD SDCERS DO?

Take No *Further* Action Because SDCERS Already Won – and the City Already Lost – This Legal Battle

❑ **SDCERS** already filed a declaratory relief action and procured the precise relief it sought – using plan assets to do so – an order declaring: "That SDCERS may properly and legally pay all City Retirement Benefits, including, but not limited to, **the Contested Benefits**. . . ." How were these **"Contested Benefits"** defined?

✓ City Attorney Michael J. Aguirre's Memorandum to City Auditor with copy to SDCERS' Retirement Administrator and General Counsel dated 6/17/05 (included instruction not to pay "any retirement benefit based on a Purchase of Service Credit that was purchased by a member at a rate that was not actuarially neutral.")

☞ *SDCERS v. City of San* Diego, GIC 851286, filed 7/26/05 [consolidated with SDCERS *v. Aguirre, et al.*, GIC 841845]:

> ¶ 22.: On or about June 17, 2005, Aguirre issued a Memorandum to City Auditor and Comptroller John Torell ("Torell"), copied to SDCERS' Retirement Administrator and General Counsel, ("the June 17 Memo") directing Torell to "instruct" SDCERS not to pay the following retirement benefits which Aguirre asserted are illegal (**collectively: "the Contested Benefits"**):

Presented to SDCERS on 10/19/07 on behalf of
the San Diego Municipal Employees Association
by Ann M. Smith, Esq.,
Tosdal, Smith, Steiner & Wax

(a) - (e) . . .

(f) "Any retirement benefit based on a Purchase of Service Credit that was purchased by a member at a rate that was not actuarially neutral";

(g) - (I) . . .

¶ 23.: Aguirre has publicly declared that in taking the actions described in paragraphs 21 and 22, supra, he has acted in his capacity as an authorized agent of the City of San Diego pursuant to Charter, Article V, section 40.

¶ 24.: Pursuant to its duties under the California Constitution and the Charter, the Board has a fiduciary duty to seek a judicial determination of the legality of payment of retirement benefits to its members upon reasonable notice that the legality of such benefits is disputed. Therefore, the Board has filed this declaratory relief action for the express purpose of discharging its fiduciary duty to all of its members and their beneficiaries to determine the legality of the Contested Benefits.

☞ SDCERS' Declaratory Relief Action included a single Cause of Action seeking a declaration from the Court: "That SDCERS may properly and legally pay all City Retirement Benefits, including, but not limited to, **the Contested Benefits**. . . ."

❑ City filed its Answer on 8/30/05, signed by Executive Assistant City Attorney Don McGrath, with *no affirmative* defense raised or cross claim asserted related to the alleged underpricing of purchased service credits.

❑ SDCERS filed – and the City opposed – a Motion for Summary Adjudication/Judgment of its only Cause of Action.

♡ **SDCERS' Motion was granted** by Final Ruling filed 10/16/06.

❑ **City** already took action challenging pension benefits in SDCERS *v. Aguirre, et al.*, GIC 841845 and lost by entry of a Judgment of Dismissal on its Sixth Amended Cross Complaint on 9/17/07 **and SDCERS agreed to be bound by the Court's rulings. Any action taken by SDCERS which is contrary to that Judgment would be a contempt of Court, a misuse of trust funds, and a breach of your fiduciary duties**.

❑ This Judgment, unless reversed on appeal, bars the City from taking legal action to challenge pension benefits on the grounds alleged in its various cross complaints from July 8, 2005, through May 10, 2007 – *as well as on any other grounds which could have been alleged but were not.*

❑ It is indisputable that the City (and the City Attorney) *knew* during the entire pendency of its action challenging pension benefits that certain purchased service credits had been allegedly underpriced.

✓ The City Attorney told the UT Editorial Board in an interview published on **3/13/05** that service credits had been purchased at a "$120 million discount."
✓ The City Attorney issued his Interim Report No. 3 dated **4/8/05** related to alleged "illegal" pension benefits.
✓ The City Attorney issued a Memorandum dated **6/17/05** to the City Auditor with a copy to the SDCERS' Retirement Administrator and General Counsel, directing the City Auditor to "instruct" SDCERS, among other things, that no pension benefit allowance be paid "based on a Purchase of Service Credit that was purchased by a member at a rate that was not actuarially neutral."
✓ On **7/8/05**, the City Attorney filed a Cross Complaint against SDCERS and numerous individually-named other defendants in GIC841845 challenging pension benefits in nine separate causes of action, including alleged breach of trust, breach of fiduciary duty, fraud/negligent misrepresentation, fraud/intentional misrepresentation, fraud/concealment, negligence, conspiracy, and seeking a writ of mandate directing SDCERS and its Trustees to "recalculate proper pension benefit amounts," and directing City Auditor Torell to comply with the directive to refrain from making further payments of the challenged benefits. The City alleged that SDCERS and the individually-named cross-defendants had violated both the common law and various statutes in connection with the subject matter of the cross complaint, including California Constitution, Art. XVI, §§ 17 and 18, Government Code § 1090, the Political Reform Act, Government Code § 87100, Probate Code §§ 16004, 16401, and 16403, City Charter §§ 99 and 143, the San

Diego Municipal Code §§ 24.1111 and 27.3560, and former San Diego Municipal Code § 24.0801.[1]

✓ On **7/26/05**, SDCERS filed its separate Declaratory Relief Action seeking to establish that SDCERS could lawfully and properly pay all **Contested Benefits** described therein by reference to the City Attorney's **6/17/05** Memorandum, including the directive related to purchases of service credit by a member "at a rate that was not actuarially neutral."

✓ The City Attorney issued A Press Release dated **3/7/06**: "City Employees Can Now Direct SDCERS to Transfer Funds Used to Buy Future Pension Service Credits Back to Their Savings Plans," with "Informational Statement Regarding Rescission of Purchase of Prospective Service Credit Agreement" and "Request to Rescind Purchase of Prospective Service Credit Agreement."

✓ On **3/24/06**, SDCERS filed a "Compulsory Cross Complaint" in response to the City's Fourth Amended Cross Complaint filed on **2/8/06** in GIC841845 challenging various pension benefits. In its cross-complaint, SDCERS sought damages for the City's alleged breach of its obligations to fund the pension plan under Charter § 143, alleged aiding and abetting of a breach of fiduciary duty by SDCERS, and alleged violation of Government Code § 1090 in connection

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[1] It should be noted that this original cross complaint was subsequently amended multiple times on 8/3/05 (2ACC/twelve causes of action), 9/30/05 (3ACC/three causes of action), 2/8/06 (4ACC/three causes of action), 5/3/06 (5ACC/nine causes of action) up to and including the Sixth Amended Cross Complaint (6ACC) filed on 5/10/07, and that the determination of what claims to include was made exclusively by the City Attorney's Office acting in the *name of the City* but on behalf of the "people of the City of San Diego" – and not by or with the participation of the Mayor or City Council.

with the adoption of MP1 and MP2.

✓ On **5/1/06**, the City Attorney filed an Answer to the SDCERS Compulsory Cross Complaint on behalf of the City denying the allegations, and asserting twenty affirmative defenses.

✓ Also on **5/1/06**, the City Attorney's Office filed a Motion for Leave to file a cross-complaint in the *McGuigan* case – belatedly attempting to challenge pension benefits which the alleged *McGuigan* class of plaintiffs otherwise claimed were "vested" and Constitutionally-protected; the Motion was denied.

✓ On **5/3/06**, the City Attorney filed a Fifth Amended Cross Complaint (5ACC) on behalf of the City challenging pension benefits in GIC841845. As did its predecessors, this 5ACC alleged that the City was suing "on behalf of the citizens of San Diego, and other governmental interests." The City's 5ACC stated nine causes of action against SDCERS and seven individual cross-defendants/former trustees Saathoff, Torres, Vattimo, Lexin, Webster, Wilkinson, and included a writ of mandate sought against City Auditor Torell.

✓ On **6/14/06**, the City Attorney personally signed a request for entry of dismissal of all claims against Saathoff, Torres, Vattimo, Lexin, Webster, Wilkinson, and City Auditor Torell. The Clerk of the Superior Court entered the dismissal on the same date.

✓ On **7/12/06**, SDCERS filed an Answer to the City's 5ACC.

✓ The City Attorney issued his Interim Report No. 12 dated **9/18/06** related to the Pricing of POS Credits.

✓ On **10/20/06**, the City and SDCERS filed a Stipulation with the Court in GIC841845 whereby SDCERS agreed to

dismiss the Fourth Cause of Action against the City in its Compulsory Cross Complaint alleging a violation of Government Code § 1090 by the City in connection with the adoption of MP1 and MP2; the City agreed to dismiss the Third Cause of Action in its 5ACC seeking a Writ of Mandate against SDCERS directing that certain pension benefits be recalculated; and SDCERS agreed that it would be bound by any and all orders of the Court related to the legality and enforceability of the pension benefits being challenged in the 5ACC and to take no role in litigating their legality.

✓ The City Attorney presented the testimony of Mr. Esuchanko on behalf of the *City* on **November 13 and 14, 2006**, during Phase One of the pension benefit litigation, to the effect that **employees/plan participants were not at fault for any underpricing of service credits they had purchased** and that the estimated actuarial loss from this alleged underpricing was approximately $110.8 million

✓ The City Attorney issued a press release dated **1/4/07** re "Pension Credits Purchased In Lieu of Actual Work Performed Has Created $110 Million Deficit; City Attorney Proposes Immediate Changes."

✓ The City Attorney sent a letter dated **3/6/07** to SDMEA President Howard Guess, over the signature of DCA Vincent P. Floyd, expressing the "City's willingness to discuss" changes "being considered" to SDMC section 24.1312, including a change to "rectify the miscalculation of the cost of purchase of service credits."

✓ By and through counsel Ann M. Smith, SDMEA responded to Mr. Floyd by letter dated **3/12/07**.

✓ In **April 2007**, the City reached a new labor agreement with the SDPOA and imposed its "last, best and final offers" (LBFO) on San Diego City Firefighters Local 145 and the DCAA following impasse hearings; neither the agreement reached nor the LBFO included any diminishment of benefits or impairment of the vested rights of employees related to service credits purchased.

✓ The City Attorney filed a Sixth Amended Cross Complaint in GIC841845 on behalf of the City on **May 10, 2007** – naming for the first time as defendants all City employees, retirees and their beneficiaries – and seeking to have various pension benefits declared null and void based on the same allegations of breach of fiduciary duty and other wrongdoing by SDCERS, with no specific mention of or claim made based on any alleged underpricing of purchased service credits by SDCERS.

✓ A Judgment of Dismissal on the City's 6ACC was entered on **9/17/07**, following the Court's Order filed on **8/3/07**, sustaining Intervenors' demurrer to the City's 6ACC without leave to amend. On **9/25/07**, the City Attorney filed a Notice of Appeal.

Doctrine of *Res Judicata*

Judge Barton: "A party against whom a complaint is filed and served must assert in a cross-complaint any related cause of action he or she has against the plaintiff at the time of filing the Answer or be precluded from asserting the related cause of action in any other action against the plaintiff. (Code Civ. Proc., § 426.30(a).) A related cause of action for

purposes of the compulsory cross-complaint rule is one which arises out of the same transaction, occurrence, or series of transactions or occurrences. (Code Civ. Proc., § 426.10(a).) The bar arising from the failure to assert a compulsory cross-complaint applies to related causes of action regardless of whether such causes of action were actually litigated or decided in a prior action between the parties."

Layperson's terms: The law provides for an orderly and timely resolution of disputes and brings finality to those disputes. A litigant gets only ONE bite at the apple and no litigant – whether it is the City of San Diego or SDCERS – has a right to take multiple "bites" just because someone has a new legal theory or a political agenda to advance.

Other prior actions also bar any legal claims:

- ***Gleason* Class Action**: three consolidated cases; first one filed 1/16/03; settled with Judgment entered 7/26/04.

  ❑ Doctrine of *Res Judicata* bars any *new* claims challenging the pension benefits of any members of the class because those claims were required by law to have been raised as a compulsory cross-complaint to that action which asserted that the City and SDCERS had violated their duties to fund the pension plan and had, thereby, rendered the plan actuarially unsound, threatening the Constitutionally-protected vested benefits of the Plaintiffs' Class.

The Alleged Underpricing of Purchased Service Credits Was Expressly Addressed by the Parties in *Gleason*

❑ The *City,* **SDCERS**, and the *Gleason* Plaintiffs knew, during the pendency of the *Gleason* Action, that underpricing of purchased service credits had allegedly occurred. Thus, the parties specifically addressed the pricing issue in the settlement on which Judgment was entered:

❑ The *Gleason* Settlement Class expressly released the City, SDCERS, their employees, agents, trustees, administrators and representatives from any and all claims, actual or potential, that arise from the facts alleged in the complaints in the Actions, any existing or potential claims relating to the City's past annual contributions to SDCERS, **or to actions by SDCERS or the City concerning the purchase of service credits by members of SDCERS.**"

The PSC Pricing Issue Apparently Influenced Both SDCERS and the City during Settlement Discussions

☞ A glimpse into the litigation history leading to this release is provided in the formerly privileged attorney-client memoranda prepared by Luce Forward Hamilton & Scripps, LLP for its client the City of San Diego during the pendency of the *Gleason* litigation. All of these Memoranda were admitted into evidence during the trial of the pension benefits case before Judge Barton in October and November 2006 – nearly a year ago. These memoranda indicate that, at some point during the pendency of the case, Plaintiffs' counsel

made a settlement proposal on terms generally acceptable to the City but which SDCERS rejected as inadequate. The City interpreted this as a decision by SDCERS to become "adverse" to the City rather than allied with the City in defeating the Plaintiffs' claims. This change in attitude prompted the City to raise the issue of SDCERS' having allegedly underpriced purchased service credits in an amount *estimated to be as high as $180 million* – which the City noted would be, if accurate, an amount in excess of any alleged underfunding associated with MP1 and MP 2. This allegation was apparently used by the City to gain some bargaining leverage when settling the case – which, as you know, involved prospective contribution terms only and included no lump sum payment designed to reimburse SDCERS for past underfunding permitted under the terms of MP1 and MP2.

SDCERS Had Multiple Professional Advisors During *Gleason*

✓ Litigation counsel Seltzer Caplan McMahon & Vitek
✓ Independent Litigation Representative Nell Hennessy
✓ Outside Fiduciary Counsel Pillsbury Winthrop, LLP

- ***McGuigan* Class Action**: filed 6/28/05; amended 9/6/05; settled 6/8/06, with Judgment entered 12/12/06 resolving *all "Pension Underfunding Claims" arising between 1996 and 2006.*

  ❑ With the *Gleason* play book already in hand – and full knowledge of the alleged underpricing of purchased service credits – the City – represented by Mr. Aguirre –

nevertheless failed to file any compulsory cross complaint in response to the *McGuigan* case. After the City Attorney's Office bungled the defense of the case and $20,000 in sanctions had been imposed on the City as a result, the City turned to outside counsel Latham & Watkins for help. Latham & Watkins then presided over a settlement which applied to a class defined as *every single plan participant, retired or active* – on which Judgment has been entered. At no time during the pendency of this case – did the City raise any cross claim against the Plaintiffs' Class related to alleged underpricing of service credits they had purchased even though the Plaintiffs' claims arose from the City's alleged violation of the Charter and SDMC in funding the pension plan and those claims included an allegation that the City's conduct vis-a-vis the underfunding of the pension plan had allegedly caused the plan to become actuarially unsound.

❑ The *McGuigan* Settlement took advantage of the $100 million generated from the sale of tobacco securitization bonds with the annual revenue lost to the City as a result of that bond sale being back-filled by the funds being generated from employee concessions during the 2005 bargaining.

❑ Although the City reserved its right to continue to challenge "Disputed Benefits" in the *SDCERS* case before Judge Barton despite its agreement to pay the "Special Additional Contribution" to SDCERS – that case has now been lost at the trial court and, unless reversed on appeal, ends ***all attacks on pension benefits that were made or could have been made.***

❑ The City's "reservation" regarding litigation over so-called "Disputed Benefits" did not revive claims which could have been but were not made as compulsory cross claims to the *McGuigan* action. The Judgment entered in the *McGuigan* case acts as a double *res judicata* bar to any new claims related to alleged underpricing of purchase of service credits.

- ***Corbett* Class Action**: filed 7/16/98; a Judgment was entered approving settlement on May 17, 2000.

❑ When the City Answered the *Corbett* Complaint on 2/3/99, the City filed a Cross Complaint asserting that, if additional items of compensation were required to be considered when calculating the amount of any retired or active member's retirement allowance, these plan participants would owe SDCERS a larger contribution than they had previously paid into the system.

❑ In GIC841845, Judge Barton has held that all pension benefits in effect pre-*Corbett* – including the so-called "MP1" benefits (and purchased service credits) – cannot now be challenged because these benefits were merged into the *Corbett* Judgment. ["The settlement also affected the benefits for DROP participants, those who had purchased service credits, as well as disability pension recipients. . . .The *Corbett* Judgment would also affect past and future purchase of service credit since that was a component in determining the years of service portion of the retirement benefit calculation both before and after June 30/July 1, 2000." (Statement of Decision, 12:18-19; 17: 26-28.)]

[Note: The following additional comments are strictly "academic" in view of the above.]

No Viable Legal *Theory* Would Permit A Recovery Against Retirees/Employees

❑ Retirees/Employees signed contracts whereby SDCERS set the sticker price – not even a negotiated transaction – and SDCERS represented in doing so that the payment being demanded would constitute FULL PAYMENT with no reservation of right to send additional "payment due;"

❑ Payment Options (SDMC § 24.1310):

- ✓ Lump sum
- ✓ Installment Payments (pre or post-tax)
- ✓ Direct transfer from any defined contribution plan maintained by the City of San Diego (SPSP/401(k))
- ✓ Direct transfer from a qualified IRA

❑ SDCERS knew the offer to enter into a contract to purchase service credits would induce action and that SDCERS' representations as a fiduciary in the matter would be relied upon by plan participants to their detriment – making doctrine of promissory estoppel applicable even if it is contended that the consideration paid was inadequate; the promise will be enforced to avoid injustice;

❑ Retirees/Employees *are not* at fault [City's expert actuary Joseph Esuchanko testified under oath to this effect in November 2006 during the trial on the City's pension benefits case. He also

testified that he estimated the UAAL associated with the 5-year POS credit program to be $110.8 million.

❑ A party to a contract bears the risk of a mistake when (a) the risk is allocated to that party by agreement of the parties (as it was here); or (b) the party is aware at the time the contract is made – as SDCERS was aware here – that it had only limited knowledge with respect to the facts to which the mistake relates but treated its limited knowledge as sufficient." Rest. 2d, Contracts § 154.

❑ The equitable doctrines of estoppel and promissory estoppel – among other defenses – would apply to protect retirees/employees against the injustice of permitting the *at fault* party(ies) from attempting to renege on the contractual promises at issue.

Any Conceivable Claim Would Be Time-Barred

❑ If SDCERS or the City still had a viable claim against *anyone* related to the alleged underpricing of purchased service credits, it would be barred by the statute of limitations

✓ Breach of a fiduciary duty: 3-year statute of limitations

✓ Violations of California Constitution, State Statutes, City Charter or San Diego Municipal Code: 3-year statute of limitations – unless a forfeiture is involved (as here): **one-year statute of limitations**

✓ An action for relief on the ground of mistake: 3-year statute of limitations

The Burden Would Be on SDCERS or City to Sue Individuals and Prove Both Liability and Damages

❑ In addition to the burden of overcoming the bullet-proof legal defenses identified above, SDCERS or the City would also be required to bring suit against each individual employee, retiree or beneficiary claimed to have underpaid for purchased service credits (despite the unilateral price-setting by SDCERS) based on an individualized analysis of the price paid, the interest actually earned on monies accepted by the trust fund from date of receipt through anticipated pay-out of all benefits due – offset by damages caused to each individual (who is otherwise innocent) from any proposed change with regard to purchased service credits – including but not limited to:

✓ lost interest earnings on the monies paid to SDCERS (whether the system's assumed interest rate or the actual rate of return experienced by the system is used);
✓ adverse tax consequences from any rescission or refund;
✓ lost opportunities by the service credit purchaser to have invested the same monies in other retirement savings plan, real estate or other investment vehicles;[2]
✓ lost expectancy damages with regard to the contract signed and performed;

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[2] Obviously, not every plan participant was convinced that the opportunity to purchase service credits was a good investment decision or, otherwise, every single plan participant would have begged or borrowed to purchase service credits and they did not.

✓lost opportunities to have continued in active employment but for the decision to retire in reliance on the purchased service credits.

❑ The individual issues of fact and law would defeat any attempt by the City or SDCERS to address the issues by means of a reverse class action.

❑ As a fiduciary, if SDCERS were to take action to attempt to collect the alleged shortfall in payments from certain contracting parties (which resulted from its own unilateral price-setting), it would also be obligated to ascertain and refund any overpayments made by retirees or employees in connection with purchased service credits.

In Summary:

Should SDCERS take *further* action? No – it already did and the favorable ruling should not be undermined by the plan's fiduciaries' taking adverse action against plan participants.

Any potential claims are barred, are not supported by any viable legal theory, and would be time-barred.

It would be ethically and morally wrong for SDCERS to expend additional plan assets on a hopeless legal venture which will cause unwarranted additional worry and anxiety among plan participants to whom you owe a fiduciary duty..

Should SDCERS fear action against it by the City? No – any claim would be totally lacking in merit, is barred by more than one prior Judgment, and would be time-barred.

What should SDCERS do then? Continue to send the City the bill amortizing this piece of the UAAL, and continue to make the stellar investment returns you have managed to make through all the turmoil of the past few years.

> Be assured that City employees – who are hard-working taxpayers – already have made concrete sacrifices in their take-home pay to help the City pay down its debt to this pension system. They have families to feed, mortgages to pay, gas to buy – just like every other working person in this community.
>
> In fact, SDCERS got an extra $100 million lump sum in June 2006 as a result of those concrete concessions. Salary freezes in 05-06 and 06-07 will produce other actuarial gains – again thanks to the sacrifices of active employees. Other economic sacrifices continue to be demanded of them as the City turns repeatedly to the paychecks of its employees to offset the adverse effects of its own fiscal decision-making over the past two decades. Yet active City employees continue to serve the residents of San Diego each and every day without fail.

And . . . SDCERS should tell employees, retirees and their beneficiaries TODAY that SDCERS will take no further action on this issue. They do not deserve to be victimized by this City's politics any longer and SDCERS should not lend itself to such an unworthy and merit less cause.

Presented to SDCERS on 10/19/07 on behalf of
the San Diego Municipal Employees Association
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