Law Offices of
TOSDAL, SMITH, STEINER & WAX
401 West A Street, Suite 320
San Diego, CA 92101
website: tosdalsmith.com

Thomas L. Tosdal
Ann M. Smith
Fern M. Steiner
Michael K. Wax
Jon Y. Vanderpool
James M. Stern*
Angela M. Jae
Georgiana D'Alessandro

*Certified Specialist Workers' Compensation Law
State Bar of California Board of Legal Specialization

Telephone: (619) 239-7200
Facsimile: (619) 239-6048
Email: asmith@tosdalsmith.com

January 21, 2011

Mayor Jerry Sanders
Council President Tony Young
Council President Pro Tem Kevin Faulconer
Councilmember Sherri Lightner
Councilmember Todd Gloria
Councilmember Carl DeMaio
Councilmember Lorie Zapf
Councilmember Marti Emerald
Councilmember David Alvarez
City of San Diego
202 C Street
San Diego, CA 92101

Re: Joint Proposal By MEA and AFSCME Local 127 Re Purchase of Service Credit Issues; Confidential Settlement Proposal Under California Evidence Code § 1152

Dear Mayor and Councilmembers:

As you know, SDCERS has designed a "correction" process and a set of "options" related to "window period" purchase of service credit contracts which reflect SDCERS' understanding of its obligations in the wake of the Fourth District Court of Appeal's decision in *City of San Diego v. SDCERS*. As you also know, based on SDCERS' presentation to the Council on November 29, 2010, it remains for the City, as plan sponsor:

(1) to clarify which plan participants were "retirees" as of November 20, 2007, when the City filed its Writ Petition;

(2) to determine whether it is in the City's best interest to direct SDCERS to exclude any plan participants from the "correction process;" and/or,

(3) to determine whether it is in the City's best interest to direct SDCERS to add an option which would be available to any active employee/plan participant who is willing to sign a release of all legal claims.

This letter outlines the actions which MEA and Local 127 believe the City should take for the reasons explained.

1. Objectives To Be Achieved

The point of this letter is to identify an outcome which (1) lessens, if not eliminates, the likelihood of meritorious legal claims being filed and thereby (2) achieve a more certain fiscal outcome for the City and its pension plan. Our proposal is also intended to resolve the fundamental concern addressed by the courts regarding the "old" versus "new" pricing of service credits being purchased during the "window period," and to be fair to employees and retirees who did not know that any legal defect lurked in the contracts they signed and on which they relied in making career and financial planning decisions.

Indeed, it cannot be denied that the City's own representatives on the SDCERS Board approved the adoption of a "window period" along with Mayoral appointees Dick Vortmann and Diann Shipione. And employees themselves may have rejected the invitation to enter into a "window period" contract *if* the City Council or City Attorney had at least informed them that the City disagreed with the SDCERS Board's decision to make the "old" purchase rates available during a "window period." Yet, just the opposite occurred – the City itself promoted the purchase of service credits during the "window period," and the City Council, with the advice of the City Attorney, made a conscious decision to accept the unfunded liabilities associated with these "window period" contracts while using this circumstance to gain leverage in settling the *Gleason* Class Action litigation in 2004.

By acting *now* to eliminate or reduce the number of potential damage claims arising from SDCERS' proposed "correction" process, the City has the opportunity to secure actual gains for the pension system while assuring that these gains are not later diminished or eliminated altogether by litigation expenses and/or damage awards.

2. A Compromise To Settle Colorable Legal Claims Does Not Involve An Illegal "Gift of Public Funds"

At the outset, it is important to be clear that the City *can* lawfully take action to limit or reduce the adverse effects of the Court's decision where these effects will otherwise give rise to colorable claims for damages by individual retirees or active employees.

To re-acquaint you with the factual and legal issues which expose SDCERS and the City to a variety of legal outcomes – or to refresh your recollection regarding them – we have attached a copy of a letter dated August 11, 2010, which was authored by attorney Ann M. Smith and addressed to SDCERS' PSC Ad Hoc Committee. (Tab A)

Without belaboring or repeating these points here, suffice to say that the Court of Appeal's decision gives rise to a number of legal, financial, fiduciary, and administrative complications which remain unresolved by the decision. When the SDCERS' "correction" process, as currently designed, is implemented, affected employees and retirees will have potential individual claims against SDCERS *and*, both independently and through the City's obligation to indemnify SDCERS Board members, against the City. In fact, as a result of our own well-attended meetings, we can assure you

that very compelling factual scenarios abound which will lead to a host of individual damage claims and/or to a potential class action involving several discrete sub-classes. I and others who addressed you on November 29, 2010, described some of these issues and the likely litigation scenarios to follow.[1] Others conveyed in the most heartfelt and earnest terms the distress and upset which this proposed "correction" process has caused to those who have service retired, signed irrevocable DROP contracts, or made other career or financial decisions in reasonable reliance on *contracts* they believed were lawful, final and binding.

It is well-established that funds expended to settle a colorable legal claim are expended for a public purpose, and therefore are not an unconstitutional gift of public funds. Section 6 of article XVI of the California Constitution prohibits the state and its subdivisions from making gifts of public money to an individual or corporation. In determining whether an appropriation of public funds is to be considered a gift, the primary question is whether the funds are to be used for a public or private purpose; if they are to be used for a public purpose, they are not a gift within the meaning of the constitutional prohibition. *Sturgeon v. County of Los Angeles* (2008) 167 Cal.App.4th 630, 637-38 (internal quotations omitted). Money spent to settle a colorable legal claim is spent for a public purpose, and is thus not an unconstitutional gift. "The settlement of a good faith dispute . . . . is an appropriate use of public funds and not a gift because the relinquishment of a colorable legal claim in return for settlement funds is good consideration and establishes a valid public purpose." *Jordan v. California Dep't of Motor Vehicles* (2002) 100 Cal.App.4th 431, 450 (citing *Orange County v. Irvine Co.* (1983) 139 Cal.App.3d 195, 200).

3. MEA's and Local 127's Proposals

While MEA and Local 127 recognize that the "window period" purchase of service credit contracts implicated here are contracts signed by individual plan participants, MEA and Local 127 are, nevertheless, interested advocates regarding the outcome for these individuals. These contracts arose under the negotiated Purchase of Service Credit Program which is a provision of the City's pension plan and a term and condition of employment. The currently proposed "correction" process threatens the rights and economic well-being of current or former represented employees such that MEA and Local 127 are both motivated and committed to assuring a fair and proper outcome. With this goal in mind, we urge the City Council to take the following actions:

a. Clarify That Those Who Were in DROP When the City Filed its Writ Petition Were "Retired"

282 plan participants had already signed irrevocable DROP contracts *before* the City filed its Writ Petition on November 20, 2007. SDCERS *and the City* were signatories on these DROP contracts. These plan participants had "retired" under the plan because their eligible service credits were finalized, their pension benefit accruals ceased, and – as the DROP contract expressly states,

---

[1] Because Councilmembers Alvarez and Zapf had not yet been sworn into office and thus were not present for this Council session, we respectfully urge you to listen to the videotape of the entire session to hear these presentations.

their pension allowances were not thereafter subject to change. Since the City *excluded* "retirees" from the relief it sought by its Writ Petition, this relief necessarily excluded those plan participants who were "retired" because they were already in DROP.

Accordingly, the City Council should simply clarify that SDCERS must not include in the "correction process" any plan participant who had already retired on or before November 20, 2007, by virtue of his/her having signed an irrevocable DROP contract on or before that date.

b. Exclude Those Who Entered DROP After the City Filed Its Writ Petition Because the City Signed Off on Their DROP Contracts

187 plan participants signed irrevocable DROP contracts *after* the City filed its writ petition on November 20, 2007. They should be excluded from the "correction" process based on two distinct grounds relevant to an appropriate risk/benefit analysis.

First, the City failed to provide any notice to its employees that a legal challenge was underway which might affect "window period" purchase of service credit contracts. Without such notice, employees reasonably relied on the finality of these contracts and the service credits they had purchased at the price set by the SDCERS Board. Since the City had, in fact, encouraged these "window period" purchases throughout the workplace, employees had no means to know that the City was attacking the validity of these contracts years after the fact.

Moreover, the City *waived* its right to challenge these employees' purchased service credits when the *City signed off* on these irrevocable DROP contracts. The City's independent action in waiving any alleged defects in the service credits being used to calculate these employees' final pension allowances is not excused by the Court of Appeal's decision. Had the City informed the DROP applicant that the City was reserving its right to challenge service credits being used in the calculation of his/her pension allowance, the applicant may have decided to forego or delay entry into DROP until the matter was resolved.

Finally, the City will ultimately be liable (directly or indirectly) for SDCERS' failure to disclose to employees who were preparing to enter DROP after November 20, 2007, that there was a material risk their "window period" service credits might be lost or reduced as a result of contentions the City was making in ongoing litigation.

Accordingly, the City should authorize SDCERS to exclude these plan participants from the "correction" process because any benefit from including them is outweighed by a substantial risk that their meritorious legal claims will succeed and impose a greater cost burden on the City by increasing the pension plan's unfunded liability.

///

///

c. Exclude Those Who Service Retired After the City Filed Its Writ Petition Because Neither SDCERS Nor the City Disclosed To Them That the Service Credits On Which They Relied When Retiring Were Subject to Loss or Reduction Due to Pending Litigation

53 plan participants service retired *after* the City filed its writ petition on November 20, 2007. The City, of course, saw the logic in excluding retirees from the relief it sought by its Writ Petition because they had retired in reliance on any "window period" service credits.

Yet, those who retired *after* the Writ Petition was filed – just as was true for those who retired *before* that date – reasonably relied on these "window period" service credits and had no forewarning or notice from SDCERS *or the City* that they were at any risk of losing or having their service credits reduced due to pending litigation.

Had SDCERS or the City informed these employees of such a risk, most, if not all, would have delayed their retirement until the matter was resolved. Having made a good faith decision to retire based on the pensions they had earned – which they reasonably believed to be guaranteed for the remainder of their life of expectancy – they forfeited the right to work longer and thereby accrue additional service credits. The City has not offered to rescind these employees' retirements and restore them to the positions they were in prior to retirement. Most, if not all, now live on a fixed income; they do not receive Social Security benefits for their City service. The damage claims of these retirees if the proposed "correction" process proceeds against them will be among the most compelling and sympathetic.

Accordingly, the City should authorize SDCERS to exclude these plan participants from the "correction" process because any benefit from including them is outweighed by a substantial risk that their meritorious legal claims will succeed and impose a greater cost burden on the City by increasing the pension plan's unfunded liability.

d. Direct SDCERS To Add A Compromise or Settlement Option For Active Employees Designed To Make the Plan "Whole" Without Punitive Interest Charges Being Added

1,536 active employee/plan participants now face limited "correction" options – each of which has adverse consequences depending on the employee's circumstances. However, there is *no option* which permits the employee to preserve the contract he/she signed in good faith during the "window period" by paying the difference between the "old rates" charged and the "new rates" which the City argued, and the Court agreed, should have been charged for any contracts after August 15, 2003. Allowing an employee to pay *now* what the City argues should have been paid *then* – but *no more than that* – would put the City, the plan, and the innocent employees in the position they would have been in if the "window period" had not been adopted.

Currently, the "correction" option which SDCERS intends to offer affected plan participants – who want to preserve the "window period" purchase of service credit contracts they signed – only

permits them to "true up" the cost of these contracts by paying the difference between the "old rates" and the "new rates" with 8% interest added for the multi-year period involved. These interest charges are not only burdensome, they are punitive in their effect because these employees would not have paid any interest if the "new rates" had simply been charged in the first place. And the only reason they didn't do so at that time is because the SDCERS Board adopted a "window period" to which the City agreed.

Putting it another way, the fundamental argument which the City made and the Court accepted was that the SDCERS Board's decision to offer a "window period" was a violation of the San Diego Municipal Code (albeit with the City's agreement at the time). Had this alleged violation not occurred, no "window period" would have been adopted and all service credits purchased *after* August 15, 2003, would have been priced at the "new rates." By permitting employees to pay *now* what they would have paid *then* is a fair result which is consistent with the Court's ruling. Adding 8% interest to the bill is unfair because it is SDCERS' and the City's fault – not employees' fault – that "window period" was made available to them in the first place.

If the City, as plan sponsor, directs SDCERS to *add* this "true-up-without-interest" option to the "correction" options SDCERS otherwise intends to make available, the City will be presenting employees with *another option* which may, in fact, reduce the likelihood and/or number of potential costly individual legal claims. In fact, to assure that the City would be more likely to achieve this outcome, we propose that the City direct SDCERS to make this "true-up-without-interest" option available to those employees who *voluntarily* sign a release of all claims in exchange.

By offering employees this "trade-off," the City will make it more likely that the plan's unfunded liability associated with these "window period" purchase of service contracts will be reduced without the offsetting disadvantage of litigation expenses and potential costly damage awards. By accepting this "trade-off," an affected plan participant must pay additional hard-earned money for service credits he/she reasonably believed had been bought and paid for already, yet, by doing so, he/she can take some small comfort in knowing that the uncertainty surrounding this issue has been removed and that the punitive burden of interest charges has been avoided. Of course, as with the other options already identified by SDCERS, it would be the plan participant's decision whether to select this option and sign the release. Needless to say, neither MEA nor Local 127 has the power to guarantee that *any* plan participant would do so. But the compromise with regard to interest charges will be a significant inducement.

Accordingly, the City should authorize SDCERS to *add* this "true-up-without-interest" option to the options SDCERS has already identified, and to make this particular option available only to those plan participants who sign a release of claims form acceptable to the City.

4. Conclusion

We believe that the proposals we have outlined in this letter fulfill the objectives we identified above and are within the City's power to adopt. Moreover, if adopted, the City will thereby protect the City's best interests while achieving a fair outcome for the retirees and employees who have become the victims of circumstances for which they are not responsible.

In deference to the time-line SDCERS has described for implementing the proposed "correction" process, we welcome any opportunity to discuss this proposal with you on an expedited basis.

Dated: January 21, 2011

TOSDAL, SMITH, STEINER & WAX

By: Ann M. Smith

Ann M. Smith
Attorneys for SAN DIEGO MUNICIPAL EMPLOYEES ASSOCIATION

Dated: January 21, 2011

ROTHNER, SEGALL & GREENSTONE

By: Ellen Greenstone /amS

Ellen Greenstone
510 South Marengo Avenue
Pasadena, CA 91101
Telephone: (626) 796-7555
Fax: (626) 577-0124
egreenstone@rsglabor.com
Attorneys for AFSCME, Local 127

Encl.: Ltr 8/11/10 from Ann M. Smith to SDCERS/PSC Ad Hoc Committee

cc: Jan I. Goldsmith, City Attorney
Jay Goldstone, Chief Operating Officer
Scott Chadwick, Human Resources Director
Andrea Tevlin, Independent Budget Analyst
Mark Hovey, SDCERS CEO
Elaine Reagan, SDCERS General Counsel
Mike Zucchet, MEA General Manager
Joan Raymond, President, AFSCME Local 127

TAB A

Law Offices of
TOSDAL, SMITH, STEINER & WAX
401 West A Street, Suite 320
San Diego, CA 92101
website: tosdalsmith.com

Thomas L. Tosdal
Ann M. Smith
Fern M. Steiner
Michael K. Wax
Jon Y. Vanderpool
James M. Stern*
Angela M. Jae
Georgiana D'Alessandro

*Certified Specialist Workers' Compensation Law
State Bar of California Board of Legal Specialization

Telephone: (619) 239-7200
Facsimile: (619) 239-6048
Email: asmith@tosdalsmith.com

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.