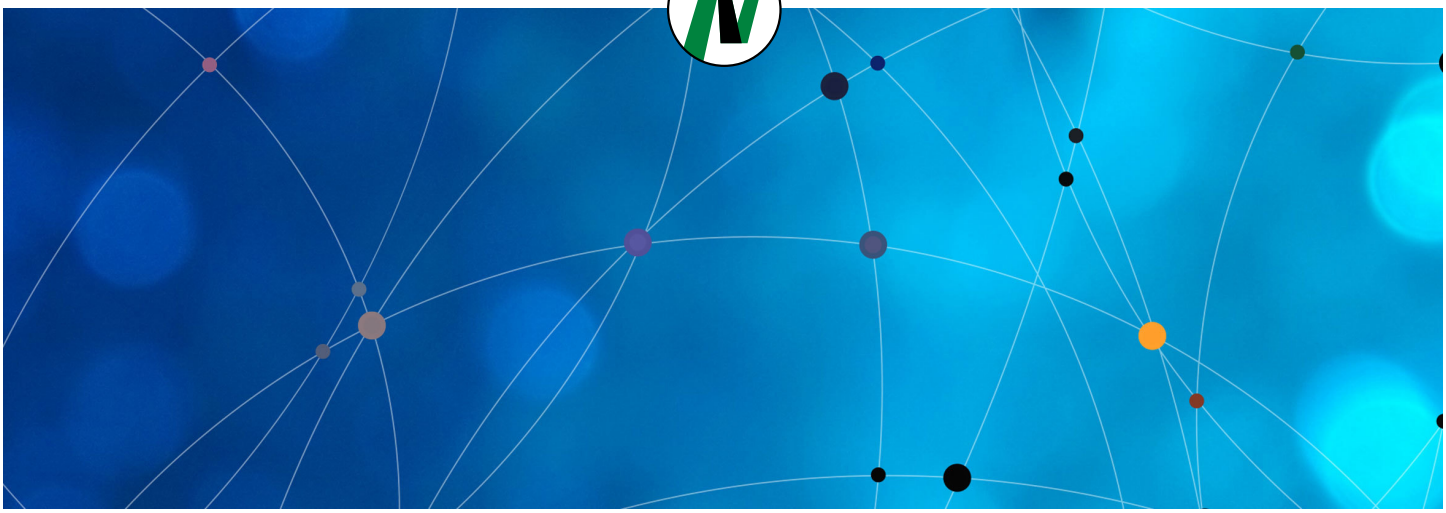

Court of Appeal Strikes Down 2011 S.F. Charter Requirement that SFERS Be "Fully Funded" before Vested Supplemental COLAs may be Granted

03.30.2015 | By Ashley K. Dunning, John T. Kennedy

In a March 27, 2015 opinion, the First District Court of Appeal unanimously declared a voter-approved amendment to the Charter of the City and County of San Francisco (City) to be unconstitutional as applied to current City employees and to City employees who retired after the subject supplemental cost of living adjustment (COLA) was granted on November 6, 1996.

In *Protect our Benefits v. City of San Francisco* (1st DCA Case No. A140095, March 27, 2015), the court considered Proposition C, an initiative that City voters passed in November 2011, amending the Charter to condition the payment of the supplemental COLA on the retirement fund being "fully funded" based on a market value of assets for the previous year. The court also held, however, that employees who retired prior to November 6, 1996 had no vested contractual right to the supplemental COLA that was initially adopted only after they had stopped working for the City, and therefore the 2011 amendment may be applied to their pensions.

City voters first granted a supplemental COLA to City retirees in an election held on November 5, 1996. The supplemental COLA was to be provided in addition to the basic COLA that previously had been granted to retirees. The 1996 Charter provision required "all earnings of the Retirement Fund in the previous fiscal year which are in excess of the expected earnings on the actuarial value of the assets to be placed in a reserve account and used to pay a supplemental COLA of up to three percent of current benefits, inclusive of the basic COLA." Originally, the supplemental COLA was not granted on a permanent basis. In another election on March 5, 2002, however, City voters passed an initiative making the supplemental COLA permanent, in

the sense that once it had been added to a retiree's retirement allowance, it could not be reduced. The 2002 Charter amendment also provided that the Reserve Account established to pay the supplemental COLA "shall be used to finance only the increase in the supplemental cost of living benefit adjustments for the next ensuing fiscal year... If there are insufficient funds in the Reserve Account to pay the increase in the supplemental cost of living benefit adjustments for the next ensuring fiscal year, then the increase in the supplemental cost of living benefit adjustments for that fiscal year shall not be paid. However, any excess earnings as defined in this section shall be accumulated until an amount sufficient to make one fiscal year's increase in the supplemental cost of living benefit adjustment is reached." The City voters passed another initiative in 2008, which, among other things, increased the supplemental COLA from 3 percent to 3.5 percent, less the amount of any basic COLA.

As reported in this decision, during the 2008-2009 Financial Crisis, the San Francisco Employees' Retirement System (SFERS) fund, measured by the market value of its assets, went from 103 percent funded as of July 1, 2008, to 72 percent funded as of July 1, 2009. On November 8, 2011, City voters adopted Proposition C. Proposition C made numerous changes to the financing and scope of SFERS pension benefits and retiree health care. With respect to the supplemental COLA, the initiative stated: "To clarify the intent of the voters when originally enacting this Section in 2008, beginning on July 1, 2012 and July 1 of each succeeding year, no supplemental cost of living benefit adjustment shall be payable unless the Retirement System was also fully funded based on the market value of its assets for the previous year." The amendment did not change the pre-existing accumulation provision that excess earnings must be reserved when insufficient to fund a supplemental COLA and accumulated until they were sufficient to fund one fiscal year's increase in the supplemental COLA (the accumulation cap). However, it suspended payouts of any supplemental COLA from that reserve until the system was fully funded.

The First DCA analyzed the general principles discussed in over 50 years of California vested pension right cases, including the seminal *California Supreme Court cases, Allen v. City of Long Beach* (1955) 45 Cal.2d 128, *Betts v Board of Administration* (1978) 21 Cal.3d 859 and *Allen v. Board of Administration* (1983) 34 Cal.3d 114. Those cases and others rely on both the federal and state constitutions as the source of vested contractual protection for public employees to the retirement benefits that were properly granted to them when they were first employed and throughout their employment. The cases permit the grantor of the benefits to make reasonable modifications to benefits granted during an individual's employment, provided that detrimental changes to benefits be accompanied by comparable new advantages to individuals whose vested benefits are thereby impaired.

Based on this law, including two cases that specifically involved COLAs -- *United Firefighters of Los Angeles City v. City of Los Angeles* (1989) 210 Cal. App. 3d 1095 and *Pasadena Police Officers Association v. City of Pasadena* (1983) 147 Cal. App. 3d 695 -- the court held that the 2011 amendment to the Charter regarding full funding impaired a vested pension right to the supplemental COLA. Specifically, the court held: "Before the enactment of [the Charter amendment], SFERS retirees were entitled to receive a supplemental COLA benefit when the Fund's actual earnings exceeded expected earnings, without regard to the Fund's market value or actuarial liabilities. [The amendment] conditions the payment of the supplemental COLA on the Fund being fully funded based on the market value of assets. Because there might be some years in which the Fund will earn more than projected, but will not be fully funded under a market value measurement, the full funding requirement results in a detriment to pensioners who would otherwise be entitled to receive the supplemental COLA. The diminution in the supplemental COLA cannot be sustained as reasonable because no comparable advantage was offered to pensioners or employees in return."

The court rejected the City's argument that the full funding requirement, in this context, was "reasonably to be expected" by City employees and pensioners, and discussed evidence establishing that the City Charter prior to 2011 could not reasonably be interpreted to include such a limitation.
On the other hand, the court also concluded that the 2011 full funding requirement may be applied constitutionally to employees who retired before November 6, 1996, because those individuals ended their City employment before the supplemental COLA was first granted.

The court also rejected the challenge to the Charter amendment that was based on an alleged defect in the actuarial report that accompanied the proposed Charter amendment in November 2011. The court noted that "[e]ven if we were to conclude the actuarial reports prepared by [the actuary] were not of the detail contemplated by [the Charter provision requiring the report], it does not follow that [the Charter amendment] should be invalidated on that basis. California courts have been most reluctant to overturn the results of an election based on a procedural defect in placing a measure on the ballot once the election has been held and the voters have spoken... [Appellant] has not identified any defect or omissions in the actuarial reports reviewed by the Board of Supervisors that even arguably resulted in an unfair election."

Our view
While the legal principles that protect vested pension benefits in California and other states recently have been critiqued in some other venues, including the bankruptcy court decision from Stockton discussed in our February 9, 2015 E-Alert entitled "Bankruptcy Court Decides That The Bankruptcy Code Preempts California State Pension Laws", this decision strongly affirms the basic and well-established principle of California constitutional law that pension benefit rights, once properly granted and vested, cannot lawfully be taken away under California law, either by voter initiative or action by the plan sponsor or legislative body, without granting a corresponding advantage to the thus impaired employees, retirees and/or other plan beneficiaries.

This case should not, however, be read too broadly either. The court's conclusions do not apply to benefits that were promised on a short-term, and/or otherwise non-vested, basis, as is the case for some supplemental COLAs in other plans. The court's conclusions also do not prevent authorized grantors of retirement benefits from clarifying the benefits they have, and have not, granted, so long as those clarifications do not impose new material restrictions that are not reasonably construed from existing plan provisions.