

CITY OF SAN DIEGO RETIRED EMPLOYEES ASSOCIATION REPORT ON THE CORBETT SETTLEMENT

Submitted by SDREA Board Member Virginia Silverman

SUBJECT: CORBETT SETTLEMENT

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PURPOSE OF THE REPORT

This report has been prepared to inform the reader about the background and details of the May, 2000 Corbett settlement, and to discuss issues which are still unresolved in the administration of Corbett benefits.

BACKGROUND/HISTORY

Although the 2000 Corbett Settlement is recent history, the background and events leading up to Corbett go back nearly 70 years. In 1937, the California State Legislature passed the County Employees Retirement Law or CERL, which provided the legal basis for counties to establish their own defined benefit pension plans. Twenty California counties, including San Diego County, administer retirement plans under CERL. (Other counties, mostly smaller, are part of CALPERS).

CERL established the rules governing design and administration of the pension plans, including the method of calculating specific employee pensions - in general the familiar formula of highest salary times years of service times percentage per year at retirement age. Under CERL, the 'high salary' was (vaguely) defined as 'compensation earnable.'

For over 50 years most of the CERL counties construed 'compensation earnable' in narrow terms, limited to base pay for the class or grade, with no extra pay included in determining the amount of pension (e.g., bilingual pay was not included in pension determination, since all persons in the same class or grade did not receive it.). There was a challenge to this definition in 1983 (**Guelfi v. Marin County Employees Retirement Association**), but the appellate court upheld the narrow interpretation of 'compensation earnable,' and the issue was considered settled.

However, in the mid-1990's there was another challenge to the existing interpretation of compensation earnable. A lawsuit by the **Ventura County Deputy Sheriff's Association v. Board of Retirement of Ventura County Employees Retirement Association** sought to expand the definition of 'compensation earnable' to include bilingual, night shift and other special pay.

In 1997 the California Supreme Court ruled in favor of the Ventura County Deputy Sheriffs, rejecting the Guelfi decision. The Court defined 'compensation earnable' as all compensation paid in cash to an employee, excluding only overtime pay. The Court also rejected the argument that the ruling would be unfair to the other 19 counties that had also relied on Guelfi.

The Supreme Court did not address the issue of retroactivity -- whether or not its decision applied to already-retired workers. That issue was not settled until 2003, when the First District Court of Appeals ruled that the Supreme Court ruling did apply retroactively to retired employees.

Following the Supreme Court Ventura decision, lawsuits were initiated by county employees in 16 other CERL Counties (including San Diego County), seeking changes in pension calculations per the Ventura ruling, as well as on the issue of retroactivity.

In addition, lawsuits were initiated in various California cities to require City pension calculations to conform to the Supreme Court ruling. One of these was initiated in 1998 against the San Diego City Employees Retirement System by William Corbett, a retired San Diego City employee.

CORBETT SETTLEMENT

The lead plaintiff, William J. Corbett, a retired chief investigator in the City Attorney's office, was joined by City retirees Donald B. Allen, Leonard Moorhead and Gordon L. Wilson as plaintiffs in filing a complaint against the San Diego City Employees Retirement System on July 16, 1998 (and amended on October 28, 1998). The complaint alleged that the retirement benefits paid by SDCERS had not been properly calculated in light of the California Supreme Court's 1997 decision in the Ventura County case. Attorney Michael Conger represented the plaintiffs.

The City of San Diego and the four unions intervened, and the lawsuit was certified as a class action lawsuit because it could affect all SDCERS members, active and retired. In March, 2000, all parties participated in mediation with Retired Judge Harold W. Wiener, and reached an agreement in May to settle the case (the Settlement Agreement).

As required by the City Charter, an election was conducted by the SDCERS Board to approve the terms of the Settlement Agreement. Prior to the election, a 'SDCERS Benefit Election Report: Election #39' dated May 19, 2000 (**SDCERS Election Bulletin**) was sent to all active and retired members, providing specific information on the proposed changes for each of the four categories of members eligible for benefits under the Corbett Settlement: 1) Pre-July 2000 Retirees; 2) Vested Deferred Retirees; 3) Active members – General, Safety and Legislative and 4) Drop participants.

The member election was held between May 26 and June 9, 2000, and was certified by the SDCERS Board on June 16, 2000. The Settlement Agreement was then approved by the City Council on August 7, 2000 (Ordinance 0-18835 NS).

The Settlement Agreement did not strictly follow the 1997 Supreme Court decision in recalculating benefits. Instead, Corbett provided percentage increases, either per year of service or in final compensation, to increase pension benefits for each of the four eligible member categories. A summary of Corbett benefits follows, by category. Specific benefit details and additional information about the Settlement Agreement are in the attached SDCERS Election Bulletin.

1. Retired Member Benefits (employees who retired prior to July 1, 2000)

Retirees in this category included all former City employees who retired prior to July 1, 2000 on a service retirement or a non-service-eligible disability retirement.

These retirees received a one-time lump sum payment in November, 2000, which represented a 7% retroactive increase to the base pension paid between July 1, 1995 and June 30, 2000, a maximum of five years. The 7% payment included the 2% COLA, but not the 13th check or supplemental COLA.

Each year thereafter, these retirees receive a 7% increase to their retirement benefit if sufficient Surplus Undistributed Earnings, as described in the SDMC Sec. 24.1502 (the 'Waterfall'), are available to pay for the benefit.

The right to receive the 7% increase each year accrues monthly during the fiscal year. However, the increase is not paid until the following November, when the 13th check is normally paid.

The increase is paid, on a prorated basis, to the beneficiary or estate of any retiree who dies during the fiscal year but before the annual payment is made. (This language, in SDMC 24.1502, differs from the language in the SDCERS Election Bulletin and the August, 2000 Ordinance, O-18835 NS. It was inserted in April, 2002 by Ordinance 0-19043 NS as a technical amendment to clarify what happens to the accrued benefits when a retiree dies.)

If sufficient funds are not available to pay the Corbett benefit in one year, the liability is carried forward to the next year as a contingent liability. Liabilities are paid in the order incurred.

2. Vested Deferred Retiree Benefits

There are two categories of vested deferred retirees:

- a. Members who left City employment before July 1, 2000, who were vested and left their contributions on deposit, and then retired after July 1, 2000. These retirees receive a 7% increase to their pensions under the same rules and funding as the pre-July 2000 retirees (payments contingent on sufficient funds in the Waterfall).
- b. Members who left or will leave City employment after July 1, 2000, vested and with contributions on deposit, are eligible upon retirement to use the same calculations for their Corbett benefit as active members in their member category as of July 1, 2000.

3. Active Employee Benefits (General, Safety and Legislative Members employed by the City on or after July 1, 2000)

- a. General Members and Safety Members (police, fire and lifeguards): These employees are able to choose between two different methods to increase their pensions:
 - 1) An increase in the percentage applied to each year of service but with no change in base compensation (specific percentages are different for each member category): or
 - 2) A 10% increase to their base compensation for the purpose of calculating their pension (this method favors older workers).
- b. Legislative Members: Elected Officials receive a 10% increase to their base compensation in calculating their pension benefit.

Employee contribution rates for active employees were increased by varying rates to pay for the increased benefit. (See the SDCERS Election Bulletin for specific increases and contribution rates.)

4. Drop Participants

DROP participants were also divided into two categories:

- a. Employees who entered DROP prior to July 1, 2000 received a retroactive lump sum 7% increase on pension funds already deposited into their DROP accounts to that date. If still on DROP after July 1, 2000, future pension benefits increased by 10%.
- b. Employees who entered DROP after July 1, 2000 are able to choose between the two options offered to active general and safety members – an increase in the retirement calculation factor or a 10% boost to final salary to determine the pension amount.

5. Post-July 1, 2000 Non Service Eligible Disability Retirees

City Employees who retired after July 1, 2000 on a non-service-eligible disability benefit initially received a 10% increase to their disability retirement benefit, although this group was not specifically mentioned in the Corbett Settlement. However, payment of this 10% benefit was stopped in May, 2006 because it was determined to be a violation of IRS Rules for qualified retirement plans. (See additional comments under issues).

ISSUES/DISCUSSION

There are several unresolved issues in the administration of Corbett benefits: 1) the contingent nature of the funding for the annual Corbett payments to pre-July 2000 retirees; 2) Failure to include the costs of Corbett pre-July 2000 retiree payments in SDCERS Annual Actuarial Valuation as part of 'normal cost;' 3) Integration of Corbett payments into monthly pension checks; and 4) IRS issues regarding Corbett benefits for post-July 1, 2000 non-service-eligible disability retirees.

1. Contingent Funding for Retiree Corbett Payments

The right for the pre-July 2000 retirees to receive the annual 7% Corbett payments is incorporated in the settlement agreement. However, the actual payment each year is contingent upon sufficient funds being available in the Surplus Undistributed Reserve (the realized earnings from SDCERS investments) - the Waterfall. Corbett payments are near the bottom of the Waterfall (see SDCERS Election Bulletin, pages 5 and 8).

In most years since 2000 (when the pension fund was over 100% funded), sufficient funds have been available to pay the Corbett payments on time. However, in 2002 and 2003 the stock market was down and no Corbett payments were made. As provided for in the Settlement Agreement the liability was carried forward to future years. Therefore in 2004, with the stock market doing well, retirees received payments for three years (2002, 2003 and 2004). This accumulated payment had a negative tax impact on some retirees by moving them into a higher tax bracket.

Although grateful and relieved that the deferred payments were received, retirees have expressed concern about the uncertain funding source for their Corbett benefits. If a prolonged downturn occurs, Corbett payments to retirees could be delayed for many years, a particular hardship for older retirees whose pensions are much smaller than the current average. Some alternative source of funding should be identified to provide more stability for payments mandated by Corbett.

2. Corbett Retiree Payments should be Included in the SDCERS Annual Actuarial Valuation

Following the Corbett Settlement, the SDCERS Board directed the actuary not to include the annual Corbett retiree payments as an obligation in the SDCERS Annual Actuarial Valuation (AAL), because these benefits were considered 'contingent.'

Subsequent to that directive, recommendations were made by the SDCERS actuary, and by the Pension Reform Committee (PRC), to include the Corbett payments to retirees as a 'normal cost' in the Annual Actuarial Valuation (along with contingent benefits such as the 13th check), upon which the required annual City payment is made. This would eliminate the uncertainty for retirees, more accurately reflect the City's funding obligations, and reduce the underfunding.

In addition, City Manager Report No. 04-218 in September, 2004 discussed the PRC recommendations, and acknowledged the need to address Corbett retiree benefit costs as a City obligation.

The SDCERS Board did approve inclusion of the Corbett Settlement in the 2005 Annual Actuarial Valuation; however the 2005 Valuation was not produced. The final report on the 2006 Annual Actuarial Valuation is scheduled for completion in May, 2006. The total cost of payments for pre-July, 2000 Corbett retirees – a closed group -- has been estimated at approximately \$84 million.

3. Integration of Corbett Payments with Monthly Pension Benefits

Many retirees have expressed their wish to have the Corbett payments integrated into their regular pension checks. This would be especially beneficial to lower income pensioners. Until the Corbett payments authorized by the Court Settlement to retirees are removed from the Waterfall and incorporated into monthly pension checks, this matter will continue to create inequity, confusion, and accounting difficulties.

4. IRS Issues Regarding Post-July 1, 2000 Non-Service-Eligible Disability Retirees

The Corbett Settlement included disability retirees in the Plaintiff Class, stating that: “If the Settlement is approved, the PLAINTIFF CLASS will receive certain increased retirement benefits or disability retirement benefits..” Also, Corbett specifically included disability retirees as recipients of the pre-July 1, 2000 retiree benefit package.

Despite this, there was no reference about benefits for post-July 1, 2000 disability retirees in the Corbett Settlement, or in the implementing ordinance approved by the City Council (SDMC 24.0101 et seq.), which became part of the City’s written retirement Plan (the Plan). Considering this an oversight, the previous Retirement Administrator authorized a 10% increase in pension payments to the post-July 1, 2000 non-service-eligible disability retirees.

However, because there is no language in the Plan that authorizes SDCERS to add 10% to disability benefits, by doing so SDCERS violated the IRS ‘Exclusive Benefit Rule’. which requires SDCERS to use plan assets only to pay benefits clearly set forth in the Plan, along with reasonable administration costs.

This issue surfaced when the SDCERS tax counsel, Ice Miller, began a review of SDCERS compliance with IRS regulations. Upon the advice of Ice Miller, in May, 2006 the SDCERS Board voted to discontinue the 10% increase in pension payments to post-July 1, 2000 non-service-eligible disability retirees. The reduction became effective July 1, 2006, and affected approximately 120 disability retirees.

In addition, SDCERS submitted a Voluntary Correction filing to the IRS, seeking approval from the IRS to settle the issue on the following terms: that SDCERS will pay the correct benefits going forward; but that it will not seek repayment from the affected retirees of the benefits already paid in error.

If SDCERS had not taken these actions, IRS approval of SDCERS’ qualified plan status might be withdrawn, to the detriment of all active members and retirees.

After the SDCERS Board’s action, the Retirement Administrator wrote to the Mayor and Council explaining the issue and stating: “If the City Council agrees with the Board’s decision, then no further action is required. If, however, the intent of the City in the Corbett Settlement was to pay the 10%, then the City Council should amend the retirement plan by ordinance and clarify its intent.”

Whether or not the omission of this group from the Corbett Settlement beneficiaries was an oversight has not been resolved, and several groups and individuals, including CSDREA, have written or spoken to the City Council in support of restoring the 10% increase for post-2000 disability retirees.

However, the City Council has not taken action as of this writing. And with the recently-approved charter change requiring a public vote of any new pension benefits, reinstatement of this benefit does not seem likely, at least in the near future. The CSDREA Board will continue to monitor this issue, and update this paper as necessary.

ATTACHMENT: SDCERS Election Bulletin, May 19, 2000 [<Click here for attachment>](#)

FOR QUESTIONS

Contact SDCERS staff at (619) 525-3600 or Toll Free at (800) 774-4977

This information is provided as a service of the City of San Diego Retired Employees Association (CSDREA). The purpose of the above summary is to provide useful information about your Corbett benefits. The facts surrounding your eligibility for reimbursement and payments may change. Do not rely on the above information for decision making; instead contact the SDCERS staff for assistance.

Should you find erroneous information in any of the above statements, please contact an Officer or member of the Board of Directors of CSDREA with your comments. Your concerns will be researched and corrections or adjustments made, as needed.