MEMORANDUM OF LAW

DATE: June 1, 1994

TO: Lawrence B. Grissom, Retirement Administrator

FROM: City Attorney

SUBJECT: Disability Retirement Income Offset

San Diego Municipal Code ("SDMC") section 24.0514 requires the Retirement Board to offset disability retirement benefits by the amount that the benefit plus outside income exceeds the current salary for the position which the retiree formerly held. The Board has not been testing for outside income or offsetting benefits for at least six (6) years.

The City Attorney strongly advises the Board to act on this issue as soon as possible, by directing the Administrator to either: (1) implement the offset program immediately; or (2) prepare an ordinance for the City Council explaining the drawbacks and costs of offsetting outside earnings, and seeking a change in the Municipal Code.

ANALYSIS

The City Council Determines Benefit Levels

SDMC sections 24.0514 and 24.0516 are clear and mandatory. For members who receive a disability retirement, the Board shall reduce disability income if outside earnings, combined with the disability benefit, exceed the current compensation for the retiree's position. SDMC section 24.0514. Any employee hired on or after October 1, 1978, who is subsequently granted a disability retirement must provide a quarterly statement of all compensation plus a copy of annual federal income tax returns. SDMC section 24.0516.

The Board must follow these rules. It is the City Council which creates benefit levels for its employees, and the Board of Administration which determines how best to deliver the benefits to its members. Grimm v. City of San Diego, 94 Cal. App. 3d 33, 39 (1979). Under the City Charter, the City Council is vested with the exclusive power to define the level of retirement benefits payable, and the terms and conditions for those benefits.

The City Council, representing the will of the people of

San Diego, decided that the Retirement System should remunerate disabled people up to the current level of earnings of the position they held, but should not grant a windfall to persons who rehabilitate themselves into higher paying jobs. This outside earnings offset has been a condition of receiving a disability benefit since disability benefits were first granted in 1927. This condition is proper and lawful under the City Charter and under the law, and it is the duty of the Board of Administration to administer this benefit requirement by examining individual cases to determine which disability retirees under retirement age are earning outside money, and how much. Indeed, the City Council has given guidance to the Board in how to administer this benefit requirement, by mandating that all employees hired on and after October 1, 1978, provide the Board with quarterly statements of all compensation plus a copy of annual federal income tax returns.

The California Pension Protection Act of 1992 (commonly known as "Proposition 162") maintains the basic division in responsibilities established by the City Charter and existing case law. The Board of Administration has "plenary authority and fiduciary responsibility for investment of moneys and administration of the system . . . ." Cal. Const., Article XVI, Section 17 (emphasis added). The City Council retains the power and authority to define the terms and conditions of benefits, within the broad outlines drawn by the Charter; the Board has exclusive control over the investment of funds and administration of the system.

Similar Offsets Have Been Upheld in Court

Some Board members have questioned whether an offset would stand up in court. It would. An almost identical disability offset program was upheld in Atchley v. City of Fresno, 151 Cal. App. 3d 635 (1984). There, the City of Fresno offset disability benefits when retirees received outside income which exceeded the current pay for the same job classification. The retirement board implemented this offset by requiring disability retirees to submit quarterly statements of earnings. If the quarterly reports were not filed, the board would either compel an audit or withhold the pension checks. This offset plan was challenged in court by a group of retirees.

The Court of Appeal upheld the disability offset because it was part of the pension plan described in municipal ordinances since 1955, and was well within the City's authority in prescribing the terms and conditions for retirement. Atchley at 644. In creating a retirement plan, the City could dictate any limitations or restrictions on the retirement benefits it chose

to offer. The City is free to offer whatever sort of retirement system benefits it wishes to offer. Once retirement benefits are determined and described, and employees accept employment or continue employment in reliance on those benefits, the employees obtain rights to the vested benefits which existed when they accepted employment. The City may not reduce or withdraw promised benefits. But in the inception, the City can offer any level of benefits it deems appropriate.

The Atchley court also condoned the methods used by the Fresno Retirement Board to enforce the offset. The Court found that the Retirement Board had acted properly in requiring quarterly reporting of income, withholding of benefits, and audits to implement the offset. The Retirement Board, as administrator of the City's policies, had the latitude to decide how to administer the program. It was reasonable for the Board to require quarterly reporting of income, and to withhold payment of benefits to those who did not comply. Withholding income was not an improper reduction of benefits, but a proper method of enforcing the rules regarding benefits.F

It appears that the City considered and approved the methods used by Fresno to enforce the offset when it enacted changes to the disability offset code sections in 1978. See Exhibit A.

The Court also noted that similar offsets were upheld in Brophy v. Employees Retirement System, 71 Cal. App. 2d 455 (1945) and Burger v. Employees' Retirement System, 101 Cal. App. 2d 700 (1951). Those two cases both involved offsets for outside income similar to ours. If a member retired on a service retirement before age 62, and had outside income from gainful employment, the member's pension was reduced so that the pension, combined with outside income, did not exceed the current pay of the retiree's former position.

Other systems, including the California State Public Employees' Retirement System ("PERS") have similar offsets. See Govt. Code section 21300.

An offset due to outside income was upheld in the state Judges' Retirement System. In re Marriage of Alarcon, 149 Cal. App. 3d 544, 552-554 (1983). In that case, a state court judge who accepted a federal judgeship contested two provisions of the Judges' Retirement Law which would diminish his state retirement benefits by virtue of his federal salary. One provision, Government Code section 75033, was enacted seven years after Alarcon became a state court judge, and provided that any state judge who left office after 1972 to accept a lucrative office with the federal government would not be eligible for a deferred retirement. The Court held this diminution did not apply to

Alarcon, because his right to a retirement benefit became vested upon his assuming office in 1964.

However, in 1974, the Legislature enacted a new provision, Government Code section 75033.5, providing for early retirement and increased benefits, with an offset for outside earnings. The Court ruled that if Alarcon wished to take advantage of the increased benefits, he also would have to accept the burdens attached to those benefits. Alarcon challenged the offset as a violation of equal protection, but the Court upheld the offset. The retirement plan provides the comforts of income for the retired judge; the retired judge can choose to receive income from his retirement allowance or from employment.

Similarly, the San Diego Retirement System ensures that members disabled from the performance of duty will receive income. That income may come from the Retirement System, or from outside earnings, or from some combination of the two. But the City does not want the Retirement System to contribute to a windfall for the member no longer able to work for the City.

Case law and the Constitution permit the City Council to enact this offset for outside earnings. It is a valid term and condition of receiving a pension. The City Council can set whatever level of benefits it wishes, short of reducing vested benefits without replacing them with equal benefits. The offset has always been part and parcel of the award of a disability retirement allowance. The offset is valid, and the Board is bound to administer the terms and conditions set by the City Council.

The Board Can Recommend to City Council That the Offset Be Discontinued

With its perspective of overseeing the Retirement System, the Board of Administration is uniquely situated to evaluate the effect of the earnings offset on its administration of benefits and on the beneficiaries themselves. The Board can share its experience and concerns with the City Council, and recommend to the City Council that it modify or discontinue the offset.

If the Board reimplements the offset and discovers flaws and difficulties in administering it, then it is the Board's obligation to advise the City Council of those difficulties. The Board should bring to the Council's attention empirical evidence which shows that the offset program costs more than it saves, if such evidence develops.

As the offsets have not been processed for so long, there is no recent data to suggest how much would be recouped and how much the collection effort would cost. Implementing the offsets would provide a data base of information with which to evaluate

the program.

The Offset Should Be Implemented Prospectively Only

To implement the offset, we recommend that the Board promptly notify all disability retirees who are still under service retirement age that the Board will start to collect information about outside earnings and will offset outside earnings where appropriate at a date in the future. Because outside earnings have not been reported and offset in such a long time, disability retirees should be notified in advance that the Board will start administering the offset again.

We advise that the Board not seek to recover payments from the past, but revive the offset prospectively, only. In addition to the difficulties of collecting all of that old information, it would be an extra burden on the System to sift through all of the data and match the earnings to past pay rates. Further, the retirees, acting in good faith, have probably spent the money which the System gave them, and it would be difficult to collect it. The overpayments in the past were caused by the Retirement System, rather than by the retirees, so the Retirement System should bear the cost of the past overpayments.

CONCLUSION

It is imperative that the Board take action to correct this situation. The Board has two alternatives.

The Board could direct you, the Administrator, to take all steps necessary to implement the offset program required by the Municipal Code. At your direction, we would prepare a notice to send to the disability retirees who are under service retirement age, advising them that their disability pensions will be offset if their outside earnings combined with their pension exceed the amount of current pay for their positions.

In the alternative, the Board could direct you to prepare and present to City Council a proposal to amend these provisions of the Municipal Code. If this alternative is selected, your report should be prepared as soon as possible.

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