

**MEMORANDUM**

**TO:** Sandy Thiry, Administrator  
Charlotte Firefighters' Retirement System

**FROM:** Robert L. Gauss and Lisa Erb Harrison  
Ice Miller LLP

**DATE:** May 5, 2021

**RE:** Analysis of Application of Benefit Changes

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This Memorandum has been prepared in response to your request for an opinion on whether the Charlotte Firefighters' Retirement System ("CFRS") is legally required under Section 54 of the CFRS Act to change benefits for any Member who retired prior to October 25, 2013.<sup>1</sup>

**I. BACKGROUND**

The City of Charlotte is the sole sponsor of the CFRS and is responsible for providing the CFRS all demographic, payroll, and service information used in the calculation of pension benefits. The CFRS, a component unit of the City of Charlotte, is responsible for the calculation and distribution of benefit payments to its members and beneficiaries.

On October 25, 2016, Plaintiff Kurzel, a CFRS retiree, sued the City of Charlotte, alleging the City failed to pay him the entire amount owed for accrued leave on his termination. Ultimately, 67 plaintiffs became parties in the action ("Kurzel Plaintiffs"). The CFRS was never a party to this lawsuit. Below is a summary of the information provided to us regarding this action and subsequent steps taken by the City and the CFRS:

- On August 29, 2018, the City settled the case, paid the additional wages to the Kurzel Plaintiffs and provided the additional pensionable wage information to the CFRS. The settlement specified the "Increased Payout to be Reported to CFRS" and that the City would advise CFRS of its position that the increase in leave payout should trigger the re-calculation of monthly retirement benefits for each Plaintiff under Section 54 of the CFRS Act. The Settlement Agreement further provided that the City's attorneys were

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<sup>1</sup> We want to note that the authors of this Memorandum are not members of the North Carolina Bar and, therefore, are not opining on any interpretation of state law. Instead, our analysis is based on our knowledge of federal law applicable to qualified, governmental retirement plans (such as the CFRS) and a plain reading of the CFRS' plan terms.

of the opinion that the CFRS Board would be legally required to re-calculate the benefits and pay back benefit recalculations.<sup>2</sup>

- On December 20, 2018, pursuant to Section 54 of the CFRS Act, the CFRS Board of Trustees instructed the Administrator to recalculate the retirement benefits for the Kurzel Plaintiffs and to pay the additional benefits.
- On March 25, 2019, the City decided to treat all City of Charlotte firefighters who could have joined the Kurzel lawsuit, or who retired from the City under the CFRS since the August 29, 2018 settlement and before March 25, 2019, in the same manner as the Kurzel Plaintiffs. (This resulted in applying the Kurzel standard to firefighters who retired between and including the effective retirement dates of October 25, 2013 and March 24, 2019.) The City provided the additional pensionable wage information for this group of Members to the CFRS, and the CFRS Board of Trustees, pursuant to Section 54 of the CFRS Act, instructed the Administrator to recalculate and pay the additional benefits for the affected individuals.

The Charlotte City Council Resolution with respect to this group of individuals states in pertinent part as follows:

1. The City shall pay each firefighter or the firefighter's estate an amount equal to 7.692% of the vacation and sick leave payout made by the City upon the firefighter's retirement (the "Additional Payout");
2. The City shall withhold 12.65% of the Additional Payout, and will deposit that amount to the CFRS;
3. The City shall contribute to the CFRS a matching 12.65% of the Additional Payout;
4. The City shall report to the CFRS the corrected final vacation and sick leave payout for each firefighter, which will include the amount of leave payout originally paid to each firefighter, which will include the amount of leave payout originally paid to each firefighter plus the Additional Payout; and
5. The City shall inform the CFRS that it is the City's position this increase in payout constitutes an error in the original payout and that the Additional Payout should trigger the re-calculation of monthly retirement benefit amounts for each firefighter under Section 54 of the Retirement Act.

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<sup>2</sup> The Settlement had certain terms specific to the CFRS, including: "So long as the City takes steps that the CFRS agrees triggers its obligations under Section 54 of the Retirement Act, Plaintiffs will rely upon the CFRS and its Board to do a correct recalculation of the future monthly benefit amounts for each Plaintiff, based on the increased leave payout reported for each Plaintiff by the City." Settlement Agreement, Para. 8.

Thus, with respect to the group of retirees to whom the City extended the Kurzel leave payout treatment:

- The City paid the Additional Payout amounts to each firefighter (or their estate).
- The City remitted the employee and employer pension contributions for the Additional Payout amounts to the CFRS.
- The City reported to the CFRS the corrected record of each firefighter's leave payout amount for Compensation purposes.
- The City advised the CFRS of the City's position that, as a result of the above, the retirement benefits of each firefighter should be recalculated under Section 54 of the CFRS Act.

It is our understanding that, with respect to the pre-October 25, 2013 retirees:

- The City has not paid such retirees any additional leave payouts.
- The City has not remitted to the CFRS any additional employee or employer contributions with respect to any additional leave payout amounts.
- The City has not provided the CFRS with any updated records regarding leave payout compensation.
- The City has not advised the CFRS of any City position that this group of retirees should have their benefits recalculated under Section 54 of the CFRS Act.

## **II. QUESTION PRESENTED**

A CFRS retiree who retired prior to October 25, 2013 (and, thus, is outside the groups identified above) has requested that the CFRS increase his benefits, along with the benefits of all other retirees who retired prior to October 25, 2013, based on the same reasons the Kurzel Plaintiffs received an increase in benefits alleging that, pursuant to Section 54 of the CFRS Act, there was an error in the calculation of benefits that must be corrected.

## **III. RELEVANT PLAN PROVISIONS**

In our review, we have been provided the 2015 and 2017 CFRS Acts. With respect to our analysis, the following provisions are of particular note:

### **Sec. 2. Definitions**

#### **Compensation**

(9) 'Compensation' means the remuneration reportable on Form W-2 earned by a Member for services performed as an employee of the Charlotte Fire Department



prior to any reductions pursuant to Sections 125, 401(k), 402(e)(3), 414(h)(2), 403(b), 408(k)(6) and 457 of the Internal Revenue Code. Compensation shall include payments for unused sick and vacation days, longevity payments, bonus payments and merit increases. For the purpose of calculating a Member's Final Average Salary, (i) payments for unused sick and vacation days shall be included as Compensation to the extent the vacation and sick days, for which payments are made, could have accrued during two Plan Years of the Member's last five years of Membership Service, and (ii) payments for longevity shall be included as Compensation to the extent such payments were made during two Plan Years of the Member's last five years of Membership Service....[APPEARS UNCHANGED FROM 2015 TO 2017]

#### **Final Average Salary**

**2015 Act:** (11) 'Final Average Salary' means the monthly average Compensation received by a Member during any two consecutive Plan Years of Membership Serviced which produces the highest average and is contained within the Member's last five years of Membership Service. If a Member has less than two years of Membership Service, his Final Average Salary shall mean the monthly average Compensation for his total Membership Service. For the purpose of calculating a Member's Final Average Salary, (a) payments for unused sick and vacation days shall be included as Compensation to the extent the vacation and sick days, for which payments are made, could have accrued during two Plan Years of the Member's last five years of Membership service, and (b) payments for longevity shall be included as Compensation to the extent such payments were made during two Plan Years of the Member's last five years of Membership Service.

**2017 Act:** (11) 'Final Average Salary' means, effective with respect to Plan Years beginning on and after July 1, 2001, the higher amount of (i) the monthly average Compensation received during the two highest consecutive Plan Years of the Member's last five years of Membership Service or (ii) the monthly average Compensation received during the 104 weeks preceding the end of the member's Membership Service. If a Member has less than two years of Membership Service, his Final Average Salary shall mean the monthly average Compensation for his total Membership Service. For the purpose of calculating a Member's Final Average Salary, (i) payments for unused sick and vacation days shall be included as Compensation to the extent the vacation and sick days, for which payments are made, could have accrued during two Plan Years of the Member's last five years of Membership service, and (ii) payments for longevity shall be included as Compensation to the extent such payments were made during two Plan Years of the Member's last five years of Membership Service.

#### **Section 24. Member Contributions**

**Sec. 24. Member Contributions.** Each Member shall contribute to the Charlotte Firefighters' Retirement System and the City of Charlotte shall cause to be deducted

from each and every payroll of such Member, an amount equal to the Member's Compensation multiplied by 12.65%....[APPEARS UNCHANGED FROM 2015 TO 2017]

#### Section 25. City of Charlotte Contributions

**Sec. 25. City of Charlotte Contributions.** (a) The City of Charlotte shall contribute to the Charlotte Firefighters' Retirement System an amount equal to the Member's Compensation multiplied by 12.65%, for each and every payroll of such Member....[APPEARS UNCHANGED FROM 2015 TO 2017]

#### Section 54. Errors

**Sec. 54. Errors.** Should any change in the records result in any person receiving from the Retirement System more or less than he would have been entitled to receive had the records been correct, the Board of Trustees shall correct such error, and as far as practicable shall adjust the payment in such manner that the Actuarial Equivalent of the benefit to which the said person was correctly entitled shall be paid. [APPEARS UNCHANGED FROM 2015 TO 2017]

(Emphasis added). (We note that, while the definition of Final Average Salary was amended in the 2017 Act, the pertinent language relating to the treatment of payments for unused sick and vacation days as Compensation was not changed).<sup>3</sup>

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<sup>3</sup> The following red-line shows the changes in the definition of Final Average Salary from 2015 to 2017:

- (11) Final Average Salary' means ~~the monthly average Compensation received by a~~ effective with respect to Plan Years beginning on ~~Member~~ and after July 1, 2001, the higher amount of (i) the monthly average Compensation received during any ~~the~~ two highest consecutive Plan Years of ~~Membership Service which produces the highest average and is contained within the Member's~~ the Member's last five years of Membership Service or (ii) the monthly average Compensation received during the 104 weeks preceding the end of the Member's Membership Service. If a Member has less than two years of Membership Service, his Final Average Salary shall mean the monthly average Compensation for his total Membership Service. For the purpose of calculating a Member's Final Average Salary, ~~(a)~~ (i) payments for unused sick and vacation days shall be included as Compensation to the extent the vacation and sick days, for which payments are made, could have accrued during two Plan Years of the Member's last five years of Membership service, and ~~(b)~~ (ii) payments for longevity shall be included as Compensation to the extent such payments were made during two Plan Years of the Member's last five years of Membership Service.



#### IV. LEGAL REQUIREMENTS

##### A. Internal Revenue Code and IRS Employee Plans Compliance Resolution System.

A tax-qualified plan like the CFRS must follow the applicable requirements for governmental plans under the Internal Revenue Code ("Code") in order to maintain its tax-qualified status. It is critical that a qualified, governmental plan maintain its tax-qualified status in order to secure favorable tax benefits for members, which include the following:

- Employer contributions are not taxable to members as they are made (or even when vested); taxation only occurs at distribution.
- Earnings and income are not taxed to the trust or the members until distribution.
- Favorable tax treatment may be available to members when they receive plan distributions, *e.g.*, ability to rollover eligible distributions.
- Employers and members do not pay employment taxes on employer contributions (even if the positions are Social Security covered) when contributions are made or when benefits are paid.

In order for a plan to be qualified, it must constitute a pension, profit sharing or stock bonus plan. Code § 401(a). All governmental defined benefit plans must meet the definition of a pension plan as set forth in Treas. Reg. § 1.401-1(b)(1)(i). A pension plan is defined as "a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement." Treas. Reg. § 1.401-1(b)(1)(i).

Code § 401(a) requires that the plan of the employer be "for the exclusive benefit of [the employer's] employees or their beneficiaries ...." Therefore, the plan may not benefit a person other than the employees or their beneficiaries. Accordingly, the IRS has held that "funds accumulated under a qualified plan in trust are intended primarily for distribution to employee participants." Rev. Rul. 72-240, 1972-1 C.B. 108. *Compliance with this provision requires that benefits be provided in accordance with the terms of the plan document.*

The IRS has established the Employee Plans Compliance Resolution System ("EPCRS"), which is a program intended to allow plan sponsors to meet the applicable requirements of the Code and permit them to correct plan deficiencies. Rev. Proc. 2019-19. *A fundamental requirement under EPCRS is that a retirement plan must be operated in accordance with its terms.* An "Operational Failure" "means a Qualification Failure ... that arises solely from the failure to follow plan provisions." EPCRS, Section 5.01(2)(b) (emphasis added). A "Qualification Failure" "means any failure that adversely affects the qualification of a plan," and includes an Operational Failure. EPCRS, Section 5.01(2). Further, an "Overpayment" "means a Qualification Failure due to a payment being made to a participant or beneficiary that exceeds the amount payable to the participant or beneficiary under the terms of the plan or that exceeds a limitation provided in the Code or regulations." EPCRS, Section 5.01(3)(c) (emphasis added). Therefore,

under EPCRS the payment of benefits that are not authorized by the terms of the plan constitutes an Overpayment, which is an Operational Failure and a Qualification Failure.

### **B. Fiduciary Considerations.**

Under Restatement (Third) of Trusts, fiduciaries have a duty to administer the trust in accordance with its terms and applicable law. *See* Restatement Third, Trust, §76. As such, the fiduciaries have the duty to administer the trust diligently and in good faith, in accordance with the terms of the trust and applicable law. *Id.* Fiduciaries are responsible for ascertaining their duties and powers, collecting and protecting trust property and understanding the purposes of the trust with respect to the participants and their beneficiaries. *Id.* This places a burden on the fiduciaries to understand the governing documents of the plan and to operate in accordance with those governing documents.

## **V. ANALYSIS**

As described above, the CFRS Board has an obligation to ensure that the CFRS is administered in compliance with its terms, which includes paying benefits based on the actual terms of the CFRS Act.

Under Section 54 of the CFRS Act, "[s]hould any change in the records result in any person receiving from the Retirement System more or less than he would have been entitled to receive had the records been correct, the Board of Trustees shall correct such error, and as far as practicable shall adjust the payment in such manner that the Actuarial Equivalent of the benefit to which the said person was correctly entitled shall be paid." (Emphasis added.)

Additionally, the CFRS Act provides that Compensation and Final Average Salary include "payments for unused sick and vacation days ... to the extent the vacation and sick days, for which payments are made, could have accrued during two Plan Years of the Member's last five years of Membership Service ...." CFRS Act, Sections 2(9) and 2(11) (emphasis added). Importantly, the CFRS Act does not dictate how those payments are calculated, but rather only provides that the payments will be included to the extent they fall within the parameters of the definition of Compensation and Final Average Salary. Thus, absent a corresponding actual payment for the value of unused sick and vacation days, the Act would not include such as Compensation or Final Average Salary. Further, the CFRS Act provides that the City and the Member must both make required contributions on the Member's Compensation; absent actual payments for the value of unused sick and vacation days, such contributions will not have been paid to the CFRS.

In the other situations, where the CFRS re-calculated a retiree's benefits under Section 54 based upon a re-calculation of the payment for unused sick and vacation days (as described under Section I of this Memorandum), the City made recalculated, additional leave payments (either through the settlement process or in accordance with the Resolution adopted by the City). Importantly, these additional payments were then reported to the CFRS as corrected final vacation and sick leave payouts (*i.e.*, there was a "change in the records" of the CFRS for purposes of Section 54). Further, appropriate contributions on the corrected payouts were collected and remitted to the CFRS. Finally, the City directly informed the CFRS of the City's position that the



increase in payout constituted an error in the original payout and that the additional payout should trigger the re-calculation of monthly retirement.<sup>4</sup> **None of these circumstances have occurred for the pre-October 25, 2013 retiree group.**

Under the current circumstances for individuals who retired before October 25, 2013, we do not think that there has been a "change in the records" under Section 54 which would trigger an obligation for the Board to correct an error and recalculate retirement benefits. None of the retirees in this group have received an increased leave payout from the City, and the City has not reported any change in the Compensation and Final Average Salary records for this group of retirees. Further, the City has not remitted to the CFRS any additional contributions based upon any re-calculated leave payment. Absent these circumstances being met, we do not see a basis under the CFRS Act to conclude that the Board would be authorized to make a correction of benefit payments for this retiree group under Section 54 of the CFRS Act.

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<sup>4</sup> We do not express a direct opinion on whether this final condition is a requirement for the CFRS to re-calculate a retiree's benefits, but simply note that it is a circumstance that occurred in the other situations which has not occurred with respect to the pre-October 25, 2013 retiree group.