

**The California State Municipal Finance Officers
CSMFO**

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**The Latest and Greatest on Pensions,
OPEB, Bankruptcies, Local Initiatives, and
the Future of the Defined Benefit Plan.**

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PRJ

THE PUBLIC RETIREMENT JOURNAL
The Inside Stories on Retirement in California



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EMPLOYEE BENEFITS LAWYERS

What Will Be Covered Today:



- The Lay of the Land – Did the PEPPRA solve the world's problems?
- Municipal Bankruptcy
- When the Governor Steps In
- Retiree Health Care
- News Shorts
- What's on the horizon for 2015 and beyond

Was AB 340 Enough?!?



Was the PEPRA enough to control costs?

- Most voters do not know about AB 340
- Contribution rates are creeping upwards
- Health care costs are on the rise
- The haves vs. the have-nots (DB vs. DC)
- An 18 percent in investment returns – no rate relief

Rate Trends and PEPRA Interpretations



- Benefit formula modifications
- Interpretations/Clean Up
- Transit workers, the court has spoken
- Intent vs. implementation
- Early retirement incentives?
- Cost sharing as we approach 2018

Bankruptcy & Public Pensions: A Tale of Four Cities



- Vallejo, Detroit, Stockton and San Bernardino
- What's at stake? “Vested” pension rights vs. the right of a bankrupt city to relief from its debts (including pension obligations)
- Put another way, is the state-sponsored retirement system (i.e., CalPERS) just another general creditor of the city?

Bankruptcy & Public Pensions: Vallejo



- First major California city to file for bankruptcy in 2008. Two largest debts: \$135 million for retiree health and \$84 million for pensions
- Under heavy pressure not to touch pension benefits. Made tactical decision not to battle CalPERS
- City's bankruptcy resulted in a negotiated reduction of retiree health obligations of roughly \$100 million
- Did it accomplish enough? Pension costs have increased by 40% over the last two years! Moody's - large continuing pension costs could force Vallejo into bankruptcy again

Bankruptcy & Public Pensions: Detroit



- The largest municipal bankruptcy in U.S. history – so far
- Debts of \$18 billion; \$3.5 billion in unfunded pensions
- On 12/03/13, Judge Rhodes allowed Detroit to enter bankruptcy and stated: **pensions for actives and retirees should be treated like any other contract**
- On 11/7/14, Judge Rhodes approved the City's bankruptcy plan. Key part of plan was agreement by City employees and retirees of 4.5% cuts in pensions and the elimination of COLAs. City's operations subject to outside review for 18 mos.

Bankruptcy & Public Pensions: San Bernardino



- Third California city to file for bankruptcy (2012). Operational deficit of roughly \$50 million
- Annual contribution to PERS had grown from \$5 million in 2000 to \$26 million in 2012
- Unlike Stockton, San Bernardino stopped contributions to PERS. Fearing a “Detroit-type” result, PERS has resisted the bankruptcy
- Recently, City and PERS negotiated a settlement: City will pay most of unpaid contributions and will continue its payments. Reorg plan due 5/15. What will other creditors do?

Bankruptcy & Public Pensions: Stockton (Super Bowl, again)



- Largest Cal. city to file for bankruptcy (in 2012), with operational deficit of \$26M and \$1B in long-term debt
- Apart from PERS, one of largest creditors is Franklin–Templeton (owed \$35M). City continued paying PERS.
- Franklin: not fair for it to get only \$350K (1%) while the PERS obligation (\$29M per year) would remain untouched
- **On 10/01/14, Klein ruled that pensions could be cut**
- Despite ruling, City sought/obtained approval of a reorg plan leaving pensions intact
- Franklin has challenged implementation of the reorg plan; should know more by mid/late Feb

Bankruptcy & Public Pensions: A Tale of Four Cities



- **Vallejo** – If pension costs/obligations are a driver of bankruptcy, you need to deal with it. Round 2?
- **Detroit** – Where pensions can be reduced, exit from bankruptcy may well include pension cuts and new plan
- **San Bernardino** –PERS is formidable. Did S.B. miss a golden opportunity?
- **Stockton** – Bondholders may have won the battle, but lost the war. Are cities willing and able to take on CalPERS?
- Who will be next? And how will they handle CalPERS?

When The Gov Gets Ticked...



- Governor got ticked at PERS twice
 - Mortality rates
 - Pensionable Comp (temporary upgrade or out of class pay)
 - PERS new regs. – included temporary upgrade pay
 - SB 13 didn't address this in 2013
 - Similar issue with 37 Act
 - Termination pay – courts ruled AB 197 could apply to legacy employees
 - Appeals in 4 counties

The Governor & State Employee Retiree Health Benefits



- Governor's proposed 2015-16 budget
 - Includes prefunding retiree health benefits for state emps
 - \$72 billion in OPEB liabilities (1.6% of GF)
 - A part of bargaining? Three State BUs already prefund
 - i.e. CHP: under Schwarzenegger – set to receive 1% raise
 - Set aside that 1% to an OPEB account, asked Gov to help
 - 2% set aside
 - 2013: Brown Administration to match 3.9%
 - 2014: 7.8% going towards OPEB, close to fully funded
 - **How do negotiations go with the rest of state's BUs?**

Retiree Health Vesting



- Unfunded retiree health is becoming a bigger problem than unfunded pensions (\$65 billion vs. \$50 billion for State)
- Although law is still evolving, REOC case has helped to clarify the analysis
- What was REOC?
 - Litigation in federal and state courts spanning 5+ years over whether O.C. was obligated to continue its earlier practice of “pooling” retirees with actives to calculate health care premiums

Retiree Health Vesting



Ninth Circuit with help from Cal. Supreme Ct. determined:

- A Cal. County and its employees can form an implied contract that confers vested rights to health benefits on retired county employees, but:
 - Compensation and benefits are set by governing body
 - “Vested rights” determination is a “contractual analysis”
 - Both U.S. and State constitutions prohibit impairment of government’s contracts

Retiree Health Vesting



Judicial determinations (continued):

- Focus on legislative acts (resolutions, ordinances, approved MOUs) and intent to create contractual rights
- If intent to confer contractual right not explicit, persons asserting right have heavy burden to overcome
- To find binding obligation to provide permanent retiree health benefits, look for resolutions or approved MOUs that:
 - Explicitly provide for health benefits in perpetuity
 - Guarantee that the level of benefits will continue
 - Indicate that benefit is a continuing obligation
- Long-term practice of providing a benefit is not enough

Retiree Health Vesting

Result of REOC Case



- Based on the Cal. Supreme Court’s guidance, U.S. District Court, on remand, found “no contractual right to vested pooling exists” and entered summary judgment for County
- This was again appealed to Ninth Circuit. In a February 2014 decision, the Ninth Circuit upheld lower court’s finding for county. REOC, it held, failed to prove the existence of statutory language or related circumstances “clearly evincing a legislative intent to create rights of a contractual nature enforceable against the county”

Retiree Health Vesting: The Evolving Case Law



- However, in first post-REOC case (IBEW v. City of Redding, 11/02/12), Cal. Court of Appeal:
 - Upheld union’s challenge to Redding’s attempt to scale back its retiree health insurance commitment
 - Ruled that promise of permanent retiree health could survive and extend beyond expiration of MOU
- Case differed in that MOU contained explicit language providing such benefits to: “each retiree and dependent... currently enrolled and for each retiree in the future”
- Appeal to California Supreme Court denied in 2013

Retiree Health Vesting: The Evolving Case Law



Dailey v. City of San Diego:

- In 2009, police officers failed to reach agreement with City. City imposed its last, best and final offer, which included a freeze on the maximum annual retiree health subsidy
- Dailey’s case was later appealed to the federal Ninth Circuit Court of Appeals which ruled that Dailey’s retiree health benefit was an “employment benefit” not a vested contractual right
- Plaintiffs attempted to re-litigate issues in state courts
- In May 2014, following unsuccessful appeal to Cal. Supreme Ct., case was resolved in favor of City – resulting in a renegotiation of retiree health, saving an estimated \$700M

Retiree Health Vesting: The Evolving Case Law



Sonoma County Assn. of Retired Employees v. Sonoma County:

- Ongoing extensive litigation (since 2009) over whether County had made an implied contract with employees to provide permanent retiree health insurance subsidies
- Because plaintiff/retirees initially could not show an express contract to provided retiree benefits – case dismissed
- Due to decision in REOC while case pending, 9th Circuit (2013) gave retirees another opportunity – to argue implied contract
- Case has devolved into several procedural skirmishes over scope and proof of any implied contract – stay tuned

Retiree Health Vesting: The Evolving Case Law

Retiree Support Group v. Contra Costa County:

- Another post-REOC case involving a county's alleged promises to provide retiree health benefits
- February 2012 complaint alleged that workers gave wage concessions in exchange for lifetime health benefits
- Although originally dismissed, RSG was allowed to amend its complaint to bring its action within scope of REOC's implied contract analysis
- Parties have been sparring over procedural and discovery issues – due to passage of time the case is coming to a head

Retiree Health Vesting: The Evolving Case Law



M&G Polymers USA v. Tackett:

- On 01/26/15, US Supreme Court made an important ruling regarding employee benefits
- Held that prior 6th Circuit holding (in Yardman) that retiree health benefits may vest upon retirement is not correct
- Held that “vesting” of retiree health benefits must be analyzed based on ordinary contract principles (i.e., was there an explicit agreement to provide ongoing benefits?)
- “When a contract is silent as to the duration of retiree benefits, a court may not infer that the parties intended those benefits to vest for life”

Retiree Health Vesting - Lessons Learned



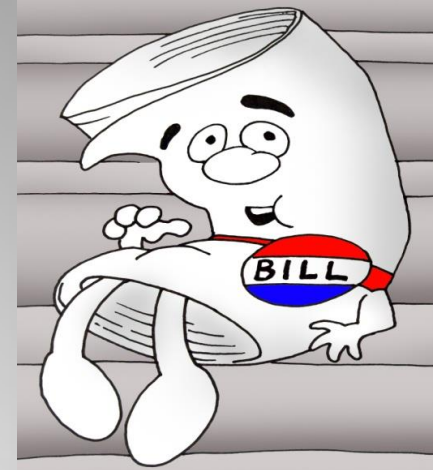
- Although it's possible to have “vested” rights to retiree health benefits, California courts are much less likely to find this – city must have “clearly intended to create a vested benefit”
- Many municipalities and local governments, without the type of MOU found in Redding, have a fair amount of latitude to modify “practices” regarding health and retiree health benefits
- In light of the outcome in Redding, take care in negotiating and documenting MOUs
- Think about the “contractual” nature of vested rights
- Do you have a reservation of rights? How does it work?

Retiree Health Vesting - (more) Lessons Learned



- A PEMHCA “equal contribution” resolution does not appear to create a vested right to retiree benefits that cannot be changed
- Even if you are in PEMHCA, there are a number of tools to control and mitigate health costs: 125/HRA; classifications
- Immediately analyze benefits of pre-funding retiree health – can make financial look much better
- If prefunding retiree health, think about the best way to do that – is one trust enough?
- Retiree health obligations are routinely being (almost) eliminated through the municipal bankruptcy process

News Shorts~ Snippets You Should Know



- November election produced 33 new members
- Same ASSY PER&SS Chair – Bonta
- Bonta Also Chair Of Health Committee
- Senator Dr. Richard Pan Chair of PE&R
- Only housekeeping bills
- Judges suing over PEPRA
 - AB 837 failed – elected vs. took office
- PERS divestments
 - Apartheid, tobacco, violent video games, automatic weapons, Sudanese genocide
 - Now proposal to divest in coal – Senate Prez De Leon

New Leaders



Speaker of the Assembly
Toni Atkins (D-78)



Senate President pro Tem
Kevin de León (D-22)

Federal Cuts to Pension Benefits



- Plan hidden away in a \$1.01 trillion fed bill
- Allows certain ERISA multi-employer pension plans to reduce benefits to retirees
- Pension Benefit Guaranty Corp (PBGC) insurance program:
 - Federal agency bails out private sector employee plans
 - PBGC deficit is \$42.4 billion, up from \$8 billion last year
 - Provides benefits to more than 10 million actives and retirees
 - Mostly in building trades, retail manufacturing, trucking
 - 80 year olds w/disability pension can't have benefits cut
 - Retirees 75-79: can cut, but will be smaller than under 75

SB 1234 – An Update



Secure Choice Retirement Savings Trust

- 47% of Californians projected to retire with income below poverty
- Concept: 3 percent of salary into a State run trust account
- Still in concept phase – Investment Board to conduct feasibility
 - Look at practical conditions – can it be done?
 - Funding for market & feasibility study comes from private entities
 - Received \$1 million
 - Received 20+ RFPs – results from equity firms: YES!
 - Once study is complete, next steps:
 - Final legislative approval
 - Board convened by Governor Brown

Initiatives to Blow Up Vested Benefits



“Sustainable Retirement System Initiative”

- Received requisite # of signatures for November, 2014
- 401(k) for all new employees (including public safety)
- 5-year freeze on pay
- Limits 11% of pay for those not in SS
- Limits 4% of pay for those in SS
- Judge denied ballot designation
 - Needs legislative authorization
 - Retirement benes are delegated to BOS
 - Doesn't ensure vested rights were protected

Reed's Rerun



A 2016 Run on the November Ballot

- Seed money from John Arnold
- SB 1253 – Signed by Governor, effective 1/1/15
 - Legislative review after 25% of signatures gathered
 - Policy committees to hold hearing 131 days before election
 - Proponents can modify or shelve proposal
 - Clear transparency of \$ support
 - What will this do to Reed's attempt?

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