Important Developments and Trends Affecting Public Sector Pensions, OPEB, and Other Benefits

A Presentation by:

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What Will Be Covered Today:

1. The 2017-2018 Governor’s Budget
2. Recent legislation & status of Secure Choice
3. Cal. Supreme Ct. takes on the “vested rights doctrine”
4. Pros and cons of a vested rights change
5. CalPERS lowers discount rate
6. Terminating your CalPERS contract: voluntarily and involuntarily
7. Q & As
The 2017-2018 Governor’s Budget

- $5.3 billion for state contributions to CalPERS
- Additional state contributions of approximately $172 million in 2017-18, increasing to $2 billion when the discount rate changes are fully implemented.
- Total state pension contributions are expected to reach $9.7 billion by 2023-24 due to:
  - changes in the discount rate,
  - scheduled contribution increases under existing funding policies,
  - payroll growth.
- “The PEPRA rolled back pensions significantly. Let it work.”
Legislative/Sacramento Update

- Deadline to introduce bills – February 17th
- Very little in pensions and OPEBs
- Seeking institutional knowledge – staffing changes
  - Assembly PER&SS Cmte – Freddie Rodriquez
  - Senate PE&R Cmte – Dr. Richard Pan
- Changes will occur in courts, on ballot, if any.
Secure Choice Retirement Savings Program

- Secure Choice - $15 million loan, start-up
- 3% deducted from employees’ paychecks
- Opt Out
- 3 year implementation
- > 100 employees – 1 year
- > 50 employees – 2 years
- > 5 employees – 3 years
- 70-90% compliance rate
- 6.8 million California workers
- Looking for an Executive Director:
Cal. Supreme Ct. takes on the “vested rights doctrine”

- What the “vested rights doctrine” is and how it came about
- The historical and ERISA context
- Recent case law involving “vested rights”
- The Marin case
- The Cal. Fire case
- The Alameda County case
What the “vested rights doctrine” is and how it came about

• Federal & State constitutions prohibit the State from impairing or rejecting its contracts.
• If a state’s law recognizes a pension right as a contractual right subject to this prohibition, that right generally cannot be taken away.
• In 1947, in Kern v. Long Beach, the Cal. Supreme Ct. established that the right of a public employee to a pension benefit was a right based on contract principles.
• The Cal. Supreme Ct. also established that “the right to a pension becomes a vested one upon acceptance of employment.”
What the “vested rights doctrine” is and how it came about (Cont.)

• Most of the controversy centers on “what the contractual right consists of.”
• On the one hand, the Cal. Supr. Ct. has said that prior to retirement, the employee does not obtain “any absolute right to fixed or specific benefits, but only to a substantial or reasonable pension.”
• On the other hand, the Ct. has held that a public employer may make unilateral changes to benefits: (a) if the change is reasonable and necessary to preserve the integrity of the system; and (b) provided that any negative changes affecting employees should be accompanied by comparable new advantages.
Vested Rights - the historical and ERISA context

• Was Kern correct in establishing a vested right? Yes.
• Did the Cal. Supr. Ct. go too far in requiring any unilateral change that would “disadvantage” employees be accompanied by a “comparable new advantage?” Yes.
• The Long Beach cases involved fairly draconian and dramatic eliminations of pension benefits involving numerous long-serviced police officers.
• These cases, when read together, created an immediate right to a pension formula that could almost never be reduced.
• How are the private sector ERISA rules different?
  – Establishes minimum vesting rules (which most public pensions now follow)
  – Prohibits the cutback or takeaway of any “vested accrued” benefits – explicitly recognizes that benefits are “earned” over time – not immediately
Recent case law involving “vested rights”

• The Orange County case
• The M&G Polymers case (USSC)
• The Marin case
• The Cal. Fire case
• The Alameda County case
Recent case law involving “vested rights” (Cont.)

• The Orange County case
  – Multi-year litigation cases filed over whether Orange County could unilaterally change the way in which retiree health insurance premiums had been determined for many years.
  – Cal. Supr. Ct. held that while a vested right to OPEB could be “implied” from a course of conduct, the party arguing for the implied contract carried an extremely heavy burden of proof.
  – On remand, the lower courts held that the county did not intend to create a contract right to certain OPEB benefits.
M&G Polymers USA v. Tackett (2015):

- USSC made an important ruling regarding employee benefits – in an ERISA case.
- Held that *Yardman* doctrine, that retiree health benefits may vest upon retirement, is not correct.
- “Vesting” of retiree health benefits must be analyzed based on ordinary contract principles (i.e., an explicit agreement to provide ongoing benefits?).
- “When a contract is silent, a court may not infer that the parties intended those benefits to vest for life.”
- This case has already been cited in a case involving a Michigan city’s retiree health obligations (Harper Woods).
Recent case law involving “vested rights” (Cont.)

Marin Assn. of Public Employees v. MCERA (8/17/16)

• Suit challenged “anti-spiking” changes made by PEPRA that restricted “pensionable compensation” for classic employees.
• Suit contains broad policy-based arguments for a change in the law.
• Court held that the Allen case, requiring provision of “comparable new advantages” was not mandatory.
• Court held that “in light of the unquestioned need for change, the change made by PEPRA was reasonable.”
Recent case law involving “vested rights” (Cont.)

Cal Fire Local 2881 v. CalPERS (12/30/16)

- Suit challenged changes made by PEPRA that restricted “airtime purchases” for many state employees.
- Plaintiffs sought to force CalPERS to continue airtime purchases; State intervened to defend PEPRA.
- Borrowing from REOC, ruling stated that plaintiffs had a heavy burden to demonstrate that legislation (i.e., the PERL) was intended to create enforceable private contract rights against the State.
- Appeals Ct. found nothing in statute or legislative history to establish a clear legislative intent to create a vested pension benefit with respect to airtime.
Recent case law involving “vested rights” (Cont.)

Alameda Cty. Dep. Sheriffs v. ACERA (5/12/14)

• Suit challenged changes made by PEPRA that removed “leave cash-outs”, “on-call”, “standby” and similar pay from “compensation earnable under the CERL.
• State intervened to defend PEPRA.
• Superior Ct. ruled that provisions were not unconstitutional.

On 11/22/16, Cal. Supr. Ct. issued an order delaying its consideration of the Marin case until the Alameda Cty. Case had been decided by the Court of Appeals. Appellate experts suggest that the Supr. Ct. may be looking to see how the Alameda Cty. court’s decision addresses the Marin ruling.
Pros and cons of a vested rights change

Arguments in favor of a change:
• Public employers need more flexibility to manage finances and change benefit programs.
• No need for public employees to have pension rights that are greater than in the private sector.
• Original cases “created” a right that no public employer would normally confer upon public employees.

Arguments against a change:
• The pension is “not an immutable entitlement to the most optimal formula of calculating the pension.”
CalPERS lowers discount rate

- 7.5% discount rate – CalPERS
- Governor Brown pushing 6.5%
- Previous recommendation:
  - Increases above 4% of target, discount rate goes down
- Due to:
  - Plan Maturity
  - Investment Environment
  - Mortality Increase
- Phase in:
  - FY 2017/18 – 7.375%
  - FY 2018/19 – 7.25%
  - FY 2019/2020 – 7%
In November 2016, CalPERS summarized its practices regarding voluntary (employer-initiated) and involuntary (CalPERS-initiated) contract terminations.

I. Voluntary Terminations (designed to improve “sustainability”)
• Termination liability determined with a “risk-free” discount rate – not described or stated.
• A “hypothetical” liability, based on 2.0% rate, included in annual report – note that this is not a final/binding number.
• CalPERS staff reluctant to discuss liability until termination resolution adopted.
• Takes 15 months from “resolution” to final payment.
• Told by staff that installments may not be available.
II. Involuntary Terminations (City of Loyalton)

• If participating employer fails to pay its required contributions, CalPERS has the option to involuntarily terminate its contract and reduce benefits to the funded level

• Can take anywhere from 8 – 17 months (Loyalton: over 3 years)

• Basically, it’s an issue of collectability

• When the next recession hits, will we see more of these?
Questions?

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