PERS - PUBLIC AGENCY COALITION (PAC)
(A Member-Based Organization, Est. 1989)

THE ALERT

JUNE 15, 2015

The Great Public Pension Assault

We knew it was coming: the details behind the plan by San Jose's ex-mayor Chuck Reed and his sidekick, ex-council member of San Diego Carl DeMaio, to slash defined benefit plans for public employees. There are four other city officials who signed on as official backers, but Reed and DeMaio will likely be the face of the initiative proponents. We will get to the details, but a quick refresher is in order.

Quickie on Background ~

Reed's previous proposal from 2013 would have cut pensions for current and future public employees and would have set up a framework requiring local agencies to show how they would pay off their pension and other post employment benefit (OPEB) unfunded liabilities in 15 years.

Reed was dealt a blow by Attorney General Kamala Harris who issued her official description called the Title and Summary before Reed and his supporters could begin the expensive and arduous process of collecting signatures. Her statement lambasted Reed's proposal by indicating that it would **eliminate** benefits for police officers, firefighters, teachers, nurses.

Reed took offense to her "biased" overview and filed a lawsuit which was later thrown out by a Sacramento court because, well, that's exactly what Reed set out to do and AG Harris called 'em like she saw 'em.

Now, Reed believes that with a little tinkering and a lot of fundraising, he may be able to not only qualify his proposal for the November 2016 ballot, but get it passed by the voters.

He is teaming up with former San Diego City Council Member Carl DeMaio to take another crack at it and to build "a bipartisan coalition of civic, community and local elected officials."[1] Both Reed and DeMaio championed local initiatives in their respective cities to cut pensions and retiree health benefits for existing workers and drastically overhaul the current system for new hires. DeMaio supported a plan in San Diego to have all new hires provided only a 401(k)-style plan. Reed aimed to unilaterally require employees to pay the lion's share of the employer obligations for the city's defined benefit plan; if they didn't want to cough up the dough, they could opt into a lower tier called the Voluntary Election Program (VEP). New hires would be placed in a Tier 2 which would essentially look like a hybrid plan: part Social Security, part defined benefit, part defined contribution.

In the case of San Jose, the Court ruled that the local initiative violated vested rights and collective bargaining laws and the Court threw out most of the initiative's major provisions. In San Diego, the Public Employee Relations Board (PERB) said the initiative violated the collective bargaining rights of San Diego workers and invalidated the measure. Reed and DeMaio used these local defeats as reason for pursuing a statewide approach to pension reform.

Now for the Details ~

Earlier this month, Reed and company unveiled what they are calling the "Voter Empowerment Act of 2016." The proposal will need the signatures of 585,407 voters, down sharply from 807,615 needed signatures last year due to low voter turnout in November. The measure, although not lengthy, is a far reaching and full scale assault on the salary, benefits, pension and OPEBs of ALL current and future public employees. And by "government employers" they mean the state, or a political subdivision of the state, counties, cities, charter counties and cities, school dis-

tricts, special districts, boards, commissions, the UC Regents, Cal State universities and agencies…so in other words, every public employer you can think of.

No More DB Plans ~

If this proposed initiative is approved, all new employees hired on or after January 1, 2019 will have a 401(k)-style plan as the default retirement plan. Specifically, new employees may not enroll in a defined benefit pension plan unless the voters of that jurisdiction approve it. This puts the onus on the local government to sponsor an initiative to allow you to keep doing what you're doing – offering the lower PEPRA benefits that your new employees are probably still grumbling about.

You know how this turns out, people. All of you in a defined benefit plan have faced pension envy over the last decade with your 401(k) neighbors licking their wounds after the Great Recession. You think they would vote to have new employees have a defined benefit plan instead of what they have? Don't bet on it.

And to clarify – "new employee" doesn't mean the same thing as the PEPRA. The PEPRA says a new employee is a person who is new to the retirement system, so if you're a local government in CalPERS, many of your new hires may be coming from other PERS-covered agencies or agencies with reciprocity like the '37 Act. In contrast, this initiative says a new hire means anyone new to your agency. You can guess as to the impact this will have on your recruitment of experienced personnel.

No More Enhancements ~

The proposal also aims to prevent any enhancement of pension benefits of any employee in a defined benefit plan unless the voters of that jurisdiction vote to pass that enhancement. Some jurisdictions, including the City and County of San Francisco, already have such measures which backers hope will dramatically reduce the frequency and scope of any benefit enhancements.

Aside from the dangerous task of putting these complex decisions to voters who are not aware of the details of public financing or the history of benefits given to public employees, running an initiative is costly. Proponents and opponents would have to pay to get their messages out, in addition to the time delays and administrative costs of having an election.

Perhaps the biggest issue of all is the legal liability this provision creates for employers participating in statewide pension plans with their limited control over the administration of those systems. The initiative says an employer must receive voter approval of a benefit enhancement, specifically citing "expanding the categories of pay included in pension calculations" or any other changes otherwise providing an economic advantage for government employees. For agencies in CalPERS, this clearly encompasses decisions that are within the parameters of the pension fund's regulatory power. How does that work?

No More Than 50 Percent ~

The proposal also would prevent government employers from paying more than 50 percent of total retirement benefits costs without voter approval. The PEPRA requires employers and employees to share the normal cost right down the middle, but employers retain the responsibility for unfunded liabilities. This provision would require employees to pick up half of the cost of unfunded liabilities as well.

Under current law, the employer is the guarantor of pension benefits and is responsible for any unfunded liabilities, whether they occur by investment losses or actuarial changes. Instead, future employees would be required to pay half of the cost of any unfunded liability. This means employees would have an obligation to pay unfunded liabilities even though they have no influence over the management of those liabilities.

This would also lead to dramatic shifts in employees' required contributions from year to year leading to unpredictable paychecks along with the fallout that would create at the bargaining table. Oh, and the 50 percent limit on employer

contributions also applies to retiree health care.

Override Collective Bargaining on All Compensation?

As we read the proposal, it appears as though its reach is far beyond just pension and OPEBs. In the initiative's "Findings and Purpose" section, it expresses an intent to affect compensation, stating that "state and local governments face a severe financial crisis due to unsustainable compensation." As we translate this, there's a lot more that goes into compensation than just pension benefits and OPEBs. The term "compensation" is used in several substantive places.

Both Reed and DeMaio have been vociferous critics of public employee compensation and claim public employee unions wholly own the politicians who negotiate benefits: "the taxpayer is not in the room" is the oft heard cry. By initiative, voters would be allowed to direct the scope of negotiations, which negates the process altogether. It could, for example, instruct employers not to offer pay raises unless pension deficits were eliminated. A local initiative could also order the employer to negotiate a freeze on salary for a period of years ---or any other provision of an employees' compensation package.

The proposal seeks to override the protections afforded by the eight collective bargaining statutes covering California public employees, including the Meyers-Milias-Brown Act (MMBA). Section 23 of the proposed initiative reads:

> *Notwithstanding any other provision of this Constitution or any other law:*
>
> *A) Voters have the right to use the power of initiative or referendum provided in Article II, to determine the amount of and manner in which compensation and retirement benefits are provided to employees of a government employer.*

Challenges to the legality or application of any local initiative could only be brought in the courts of California exercising judicial power, which specifically eliminates the jurisdiction of the Public Employee Relations Board (PERB) and its role in ensuring the state's collective bargaining laws are upheld.

The proposal also requires government agencies and retirement boards to fully and faithfully implement voter approved initiatives, whether placed on the ballot by a government agency or by voters. Since most such measures that we've seen are often poorly written debacles, it's not clear whether this would create a legal liability for pension funds charged with implementing unclear and possibly illegal voter-approved initiatives.

While the initiative itself says it cannot alter any provisions of a current collective bargaining agreement, once that agreement expires, it's fair game. But whether a local voter initiative can legally override a labor contract is left to the courts to mediate. Since the proposal creates a constitutional right for a voter initiative to override all state collective bargaining laws, it's only the constitutional protections afforded contracts in general that would protect public labor agreements. And since Reed's initiative says the voters' right to determine compensation overrides any other provision of the State Constitution, it seems MOU agreements would only be protected by federal contract law. Granted we're not attorneys (which is why we're happy to give you this free legal advice), but that's the way this scenario appears to us.

And employers, lest you think this is only a problem for labor, let us remind you that there is little to prevent a voter-backed initiative from overriding your agreements. And there's nothing to stop labor groups from sponsoring initiatives year after year after year. Ballot box negotiations would likely go in both directions if the pension landscape is reshaped per Chuck Reed.

Benefit Promises No Longer Vested ~

The proposal also attempts to eliminate vested benefit rights for future and current employees. Section 23 of the proposed initiative also reads:

> *Notwithstanding any other provision of this Constitution or any other law:*

a) Voters have the right to use the power of initiative or referendum provided in Article II, to determine the amount of and manner in which compensation and retirement benefits are provided to ***employees of a government employer****.*

j) Nothing in this section shall be interpreted to reduce the retirement benefits earned by ***government employees*** *for work performed. (****emphasis added for dramatic effect)***

The proposal does not restrict itself to "future government employees," but allows a local initiative or referendum to determine the compensation and retirement benefits of all government employees.

And referring to benefits already earned has a purpose—it changes the "vested rights" rule to only apply to benefits earned, as opposed to the current California rule which states that an employee has the right to continue accruing benefits according to the promises made upon accepting employment.

In the case of retiree health benefits, it's not clear how the courts would apply the "already earned" litmus test. It's not clear whether an individual could lose retiree health benefits after 20 years of service if the individual isn't yet retired and laid claim to those benefits. An individual working under a vesting schedule could presumably lose accumulated credits if he has not yet earned the minimum number of years to qualify. So, for example, a state employee with 8 years of service may lose retiree health benefits if the 10 year minimum threshold hasn't yet been met. Or would the court recognize that the promise of retiree health benefits is part of the reason why many government employees come to work each day?

The immediate effect would be that any future accrual of pension or retiree healthcare benefits could be changed at any time by voters, via initiative or referendum at the local level. In other words, local measures such as San Diego's, San Jose's or Ventura County's could all be valid in the eyes of the court. The removal of vested rights could be done by a local initiative and could do all of the following:

- End accrual of future pension/retiree healthcare benefits
- Require employees to pay a larger share of pension/retiree healthcare costs
- Reduce the accrual rate of such benefits
- Increase the age of retirement for such benefits earned in future years
- Reduce the COLA for benefits earned in future years of service

Death/Disability Benefits Not Impacted, sort of ~

It appears as though this proposal aims to address a problem with a previous attempt that was derailed due to a glitch in drafting. Then Governor Schwarzenegger along with previous Assembly Member Keith Richman tried back in 2009 to qualify an initiative to cut pensions. In describing that initiative, then Attorney General Bill Lockyer penned a Title and Summary saying their plan would cut death and disability benefits for police and fire. Even years after 9/11, there was no voter stomach for stripping these benefits for public safety officers and the initiative quickly fizzed out.

Reed's proposal reads: *"Nothing in this section shall be interpreted to modify or limit any disability benefits provided for government employees or death benefits for families of government employees, even if those benefits are provided as part of a retirement benefits system. Nothing in this section shall be interpreted to require voter approval for death or disability benefits."*

This is a simplistic way of addressing a complex problem. Most local agencies currently provide death and disability benefits to safety employees through their pension system. The costs of those benefits are included in the annual cost of the system. While this initiative bars future employees from a pension system, it seems to suggest that employers may continue participating in a pension system solely with respect to the provision of death and disability benefits.

We haven't yet seen a cost analysis, but we're guessing the cost of providing safety employees an alternative 401(k) style benefit, the possible addition of Social Security benefits, along with the cost of maintaining death and disability benefits are likely to cost more than the current DB system. But rather than someone doing this cost analysis before sponsoring this initiative, the backers will require each jurisdiction to perform this analysis and incur the cost of convincing voters that the current system may actually be cheaper. Go ahead… try to explain.

That's not to mention the impact this would have on disability applications. Currently, for many seasoned employees, the only advantage to filing a disability claim is the tax advantage afforded to disability income compared to regular service retirement income. But imagine under Reed's proposal where a safety employee could either retire for service retirement with a 401k plan or retire for disability with the added benefit of a traditional pension benefit, and guess what's going to happen to the number of disability applications.

To the best of our knowledge, there is no private sector alternative to the public pension funds for providing or funding death and disability benefits so the hands of local governments are largely tied in this matter.

Closing A Plan ~

When you want out of a retirement plan, it's going to cost ya. That's because when you close a plan, you still have your current liabilities – your employees and retirees pensions. For instance, CalPERS applies a lower discount rate to make up for the new members being hired by your agency who **won't** be paying into the system. CalPERS needs the funding to ensure payment of the pensions promised to members who remain in the closed plan so it forecasts what is required and lowers the discount rate from the current rate of 7.5 percent to a low risk rate of return. If a closed plan does not have enough assets to pay pensions, CalPERS has the authority under current law to cut pensions to the level covered by the assets.

The proposal eliminates the ability for pension funds to apply termination fees, accelerate payments on existing debt or impose other financial conditions against a government employer that's terminating its DB plan. This hand tie would either prompt pensions to be cut for existing employees that reflect the level of plan assets or (more likely) embroil the agency and local initiative backers in a lengthy legal battle.

Here's how the language reads:

> *Retirement boards shall not impose termination fees, accelerate payments on existing debt, or impose other financial conditions against a government employer that proposes to close a defined benefit pension plan to new members, unless voters of that jurisdiction or the sponsoring government employer approve the fees, accelerated payment or financial conditions.*

The anecdote that prompted this amendment came from the City of Pacific Grove. Mayor Bill Kampe, who is a backer of the Reed/DeMaio proposal, was very vocal about his City's interest in pulling out of CalPERS, but the price tag was too high. CalPERS, for one, would likely argue that the actuarial assumptions used in the terminated agency pool are not penalties and therefore would not be considered a "financial condition" against the employer. However, CalPERS does require employers leaving the system to fund their accrued liabilities. As the initiative conceives it, pension funds may be at risk of violating their fiduciary duties or be forced to cut member pensions.

There is a far simpler legislative solution to this particular problem. Rather than employers terminating their contact with CalPERS – and along with it CalPERS' legal right to collect from the employer, a statutory change would allow an employer contract to remain active with CalPERS while members no longer accrue service under the system. Simple. Fair. Too easy?

A Couple of Case Studies ~

Let's take a look at San Jose and San Diego's pension reform measures as examples if this statewide proposal were to pass.The portion of San Jose's Measure B which was struck down as violation of vesting rights gave all current em-

ployees the option of switching to a lower pension formula for future service or staying in the current plan and paying off pension debt with annual contribution increases of 4 percent of pay, capped at 16 percent or half the debt. It aimed to unilaterally require employees to pay the lion's share of the employer obligations; if they didn't want to cough up the dough, they could opt into a lower tier called the Voluntary Election Program (VEP). New hires would be placed in a Tier 2 which would essentially look like a hybrid plan: part Social Security, part defined benefit, part defined contribution. The San Jose POA estimated that if an officer desired to stay in the current pension system, her annual salary deduction for pension/healthcare benefits would increase by 24 percent over the current 17 percent officers were paying. In short, an officer would have 41 percent of their annual salary deducted for pension and retiree health benefits.

DeMaio championed Proposition B in San Diego, a plan to have all new hires after a certain date be subject to a 401 (k)-style plan. Prop B carved out police officers. Prop B also aimed to limit compensation used to calculate city employee pension benefits, required substantially equal pension contributions from the City and employees; and eliminated the right of employees/retirees to vote to change their benefits. Proposition B was approved by San Diego voters by a 2-to-1 margin on June 5, 2012.

A pay freeze was a key component of Prop B. News stories have highlighted that the closing of the pension system to new employees did not save any money and in fact led to higher costs—the only savings came from a five year pay freeze. Likewise, in San Jose Reed's initiative imposed a 10 percent pay cut if the pension cuts were reversed by the courts.

Reed/DeMaio intend to preclude courts from striking down a future measure based on pesky collective bargaining laws or vested rights. In addition, they want to preclude courts from removing from the ballot pension initiatives on grounds they violate vested rights or are not authorized by statute, as occurred in 2014 in Ventura County and the City of Pacific Grove. In other words, these local initiatives would be constitutional and law if "Voter Empowerment Act of 2016" passes in November of next year.

The Proponents ~

The hurdle opponents will have to jump through is with the proponents' one liner: Voters should have a say before state and local officials grant benefits. Reed and DiMaio are teaming up with a handful of other elected officials to promote the proposal: Pacific Grove Mayor Bill Kampe, Anaheim Mayor Tom Tait and former Vallejo Vice Mayor Stephanie Gomes and former San Bernardino Mayor Pat Morris.

They are being funded by various out-of-state hedge fund investors like the Koch brothers and John Arnold. And they're also likely to benefit from the complexity of their proposal as pundits try to break it down into simple buzz words. Already a conservative think tank, the Reason Foundation, has posted a review of the initiative beginning with the caveat: "While not impacting current employees or retirees…"[2] Hmmm. Wonder how they figured that.

The Opponents ~

Most all public employees are against the measure. An official group called Californians for Retirement Security is comprised of many labor groups: the State Employees International Union (SEIU), the California School Employees Association (CSEA), the American Federation of State County and Municipal Employees (AFSCME), the Peace Officer Research Association of California (PORAC), the California Professional Firefighters (CPF) and many others. They are waging a very expensive assault against the proposal and have already issued the following statement:

Statement on Reed/DeMaio Pension Measure from Dave Low,
Chairman, Californians for Retirement Security

"This is yet another destined-to-fail attempt to eliminate the retirement security of teachers, firefighters, school bus drivers and other public employees they have earned and agreed to in good faith at the bargaining table.

"Polling and the most recent high-profile election on this issue in Phoenix, Arizona where voters rejected a similar effort, shows that voters consistently say they don't want the complex issue of retirement security decided with 30-second political sound bites. Divisive political campaigns, funded by out-of-state special interests like Texas Enron

billionaire John Arnold, won't make anything better and will ultimately be tied up in the courts for years.

"Governor Brown and the Legislature enacted a package with bipartisan backing that will save $55 billion in PERS savings and billions of dollars more in state and local jurisdictions. Pensions have been capped and public employees are paying 50 percent of normal costs. Californians want those changes to work, and won't fall for this political stunt from a failed Mayor and an extreme, right-wing radio talk show host.

CalPERS Weighs In ~

CalPERS is not taking Reed's proposal lying down either. They issued a statement the same day it was released for public review:

"Public employee pensions are deferred compensation, a key part of the compensation of public employees, and a valuable tool for those employers who choose to use them. Public employees work hard during their careers to serve their fellow Californians and virtually all contribute toward their retirement each month. Secure and reliable pensions benefit the California and local economies, aid in recruiting and retaining employees, improve workforce stability and ensure the quality of life for retirees in our communities.

The retirement benefits promised to employees, and guaranteed by the federal and State constitutions, are determined by the employers and the employees, not by CalPERS. The courts have clearly established that California public employees have a vested right to the level of benefits promised to them when they are first employed. This prevents not only a reduction in the benefits that have already been earned, but it also prevents a reduction in the benefits that an employee has been promised for their future service. CalPERS is bound by fiduciary duty to deliver the promised pension benefits according to the U.S. and California Constitutions, statutory law and case law. The California voters placed these protections and duties in our Constitution to ensure that employees' pensions would be protected by CalPERS as their fiduciary and trustee. CalPERS will continue to support and defend our members' vested rights, in accordance with the laws of the land and our obligations under the federal and State constitutions.

All Californians deserve a secure retirement. A better solution would be to help those without pensions find ways to save for retirement, not to reduce the pensions of those who already have them. Changes to pension benefit levels should be determined by the employer and the employees, and not at the ballot box. If this initiative were to pass, then all contractual rights in California could be in jeopardy. Fairness and the rule of law are the foundations of a society that honors and respects the promises made by that society to its public servants."

Now What?

The proponents have filed their proposal with the Secretary of State. It then goes to the Attorney General for a Title & Summary. With any luck, the official description will mirror last year's description of Reed's original attempt. From there, proponents will need $2.5 to $3.5 million for a signature gathering effort. They will need 585,407 signatures to get it qualified which is based on voter turnout in the last election, which was dismally low. The proponents will also need tens of millions of dollars if they expect to win at the ballot box.

Labor is already gearing up to spend as much money as possible to defeat this sucker. By way of reference, they spent $75 million to kill Prop 32 in 2012, the initiative that attempted to eliminate their ability to collect union dues from employee paychecks.

Soap box alert before we sign off: the employer community should come together with labor to help fund, editorialize, talk, take positions of strong opposition to kill this proposal before it even gets qualified. Hopefully, with enough momentum, it won't.

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1. Oside News, Reed and DeMaio Team Up on Pension Reform, www.osidenews.com/2015/03/13/reed-and-demaio-team-up-on-pension-reform/
2. http://reason.org/blog/show/the-voter-empowerment-act-of-2016

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