

MEMORANDUM

DATE: June 23, 2010

TO: Little Hoover Commission

FROM: Jeff Chang and Ken Ruthenberg

RE: Observations and a Few Recommendations Concerning California Public Pensions

This memorandum sets forth several broad observations and a few recommendations that we would like to share with the Commission and the legal experts interested in this subject.

Observations

1. There is a great deal of disagreement and uncertainty about the extent to which California's public agencies can change or reduce pension and retiree health programs. As a result, many public employers may not be making the types of changes that will prove to be sustainable over the long term.
2. We believe that California public employers have greater latitude under existing law to make necessary changes and reductions than most realize and that it is essential to inform and educate them about these options. In particular, we would like to see more discussion and clarification of:
 - a. What was meant by the California Supreme Court in the Kern case when it stated that: "pension systems must be kept flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system and carry out its beneficent policy" and "the employee does not have a right to any fixed or definite benefits, but only to a substantial and reasonable pension."
 - b. How and when a reservation of the right to amend or terminate a plan will prevent an impermissible impairment and whether the

statutory right to terminate CalPERS participation can be viewed as a reservation of rights.

- c. Whether the "comparable new advantages" concept raised in the Allen case really only comes into play when a change would reduce already earned benefits.
3. We know from experience that many local governments and agencies are being frustrated in their efforts to control benefits costs due to the relative inflexibility and considerable bureaucracy of large, one size fits all systems such as CalPERS. For example, one of our clients, a CalPERS employer, recently made inquiry to CalPERS asking if it could obtain an estimate of its unfunded pension liability to help it analysis whether it could afford to leave the CalPERS system. It has been told that such an estimate may take up to a year to generate.
4. We generally think it is a mistake for the complex specifics of agencies employee benefits programs to be determined by voter initiatives. Instead, we are in favor of changes to the laws that give each and every public employer more flexibility to change or reduce benefits, if necessary and justified.
5. We believe that California, its agencies and it public employees would be better served by a legal framework that clarifies employees' rights to benefits as well as employer rights to make changes by reference to rules similar to those found in the Employee Retirement Income Security Act of 1974, as amended (ERISA). For example, the rules applicable to private employers under ERISA would allow an employer to freeze its defined benefit pension plan (continuing to provide for and guarantee benefits that had already been earned) while providing for reduced (or even zero) future benefit accruals, depending upon the employer's financial health and pressure to remain competitive in terms of recruiting and retaining employees.

Recommendations

1. Study and analyze the various ways in which the law in this area can be clarified (e.g., state-wide legislation, local legislation, new case law, attorney general opinion) and weigh the cost-benefits (as well as the likely results) of each approach.

2. Institute mechanisms to enable California public employers to learn more about their options under current law to make benefit changes. At the same time, work with public employee unions to educate them as to the need for benefit modifications that can be sustained.
3. Examine the feasibility of changing the law and/or rules applicable to CalPERS with an eye towards providing participating employers with greater flexibility change and modify benefits, as well as to leave the system altogether.
4. Discuss and analyze the pros and cons moving to a legal construct for dealing with these issues that is similar to that contained in ERISA.