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State of California
Little Hoover Commission
925 L Street, Suite 805
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California Public Employees' Pensions

Honorable Commissioners:

Thank you for inviting me to contribute to the work of the Commission as it examines the State's public employees' pensions. You are providing a timely and critical service to the People of California and I welcome the opportunity to assist you in that endeavor.

By way of brief introduction: I have practiced law in San Francisco for 38 years. I am a partner with the firm of Reed Smith LLP and head of the firm's Fiduciary Practices Group in California. For the past sixteen years, I have served the boards of multiple public employee pension funds in the State, as their fiduciary, litigation and investment counsel. These funds include CalPERS, CalSTRS, over a dozen county systems governed by the County Employees' Retirement Law of 1937, and charter city retirement systems including those for general and safety employees of the City of Los Angeles.

My practice over the years also has included representing financial institutions, corporations and investors in litigation, commercial, banking, antitrust and securities law. I have over twenty years' experience in bankruptcy and insolvency law, representing creditors and investors in corporate reorganizations and in municipal bankruptcies. I was counsel to the Orange County Employees' Retirement System during that county's Chapter 9 case. My firm represents the largest bondholder trustee in the City of Vallejo case. My bankruptcy experience affords me a unique perspective on the current financial pressures facing our municipal plan sponsors as they struggle to meet the pension promises they have made to their employees.

I understand that the Commission seeks to focus at its June 23, 2010 meeting on the legal constraints and avenues for modifying pension benefits for retirees, current employees and future workers – the "legal landscape for pension reform" described in the Executive Director's letter of May 20, 2010. In summary fashion, I respectfully offer the following observations to help guide our discussions. I will be prepared to address these points in greater detail on the 23rd.

Please note that the following written comments and any written or oral statements that I may make in the future are entirely my own personal, professional statements and are not reflective of or to be attributed to my law firm or any of our clients.

1. Generally speaking, public employees who are members of defined benefit pension plans in California have three contractual rights that are protected from impairment by the "contracts clauses" of the U.S. and California Constitutions:

    a. The right to the payment of promised benefits

    b. The obligation of the employer to make contributions to fund the benefits

    c. The obligation of the employer to provide an actuarially sound retirement fund

2. Not all members' expectations, however, are *vested pension rights*. Whether and to what extent they are is a complex question that must be addressed on a case-by-case, individual-by-individual basis.

3. The rights of retired, current and prospective new members of public employee pension funds can vary widely, and need to be analyzed separately.

4. California courts have a robust record of sustaining vested public employee pension rights over proposed legislative changes, absent a showing that the changes are (1) reasonable, (2) bear a material relationship to the theory of the pension system and (3) any resulting disadvantages to individual employees are accompanied by comparable new advantages. Saving a public employer money does bear a material relation to the theory of a pension system, but is insufficient alone to justify adversely affecting pension benefits. Further, a "comparable new advantage" does not include simply exchanging one of the three rights identified in #1 above for another one (e.g., improving the funded status of a plan by cutting benefits.)

5. California courts have recognized in theory that a public employer's fiscal emergency *might* justify vitiating vested pension rights, under the exercise of the State's broad police powers, but the courts have not actually found that any such declared "emergency" itself was sufficient grounds for reducing or deferring the payment of retirement benefits.

6. California's strong public policy favoring collective bargaining may conflict with the policy of protecting vested pension rights, which the courts describe as individual, not group, rights. The Commission should explore whether and to what extent collective bargaining over pensions may permissibly compromise the expected pension rights of individual, represented employees.

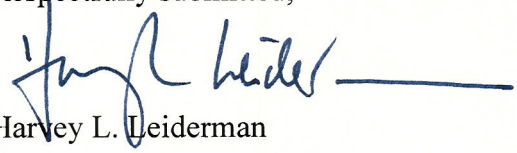
7. Following the 1997 California Supreme Court ruling in the *Ventura* case, many county retirement systems and their stakeholders entered into court-approved settlement agreements, enhancing retirement benefits for both active and retired members. Many of these settlement agreements recite that the benefit enhancements granted therein may not be affected by subsequent changes in statutory or case law. Any analysis of permissible changes to employees' vested pension rights should consider the extent to which these settlement agreements also may have created vested rights.

8. Instances of unlawful "pension spiking" continue to make headlines; however, these abuses appear to be more sporadic than systemic. While California law now provides pension trustees with adequate tools to curb such abuses, creative interpretations designed to produce fortuitous windfalls continue to challenge our boards. I encourage the Commission to consider recommending further legislation to clarify the existing state of the law and close unintended loopholes that result in costly and time-consuming litigation, and public mistrust.

9. Although to my knowledge no bankruptcy court has ever permitted a municipal debtor to reject its vested pension obligations, there are gaps in federal bankruptcy and California law that *might* allow a court to consider permitting a debtor to restructure its unfunded actuarial accrued liability ("UAAL") in a Chapter 9 Plan of Adjustment. The extent to which federal bankruptcy law might permit alternative treatment of California pension obligations under a Plan has yet to be fully explored. (Please note that the State of California may not be a debtor under Chapter 9.)

In conclusion, under California law, while there are "strict limitations on the conditions which may modify the pension system in effect during employment" (*Allen v. City of Long Beach* (1955) 45 Cal.2d 128), those limitations are not absolute. I look forward to assisting the Commission in navigating the legal, economic and political waters as it seeks to improve the health and sustainability of pensions for our State's public employees.

Respectfully submitted,



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