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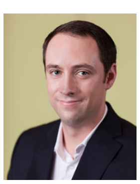
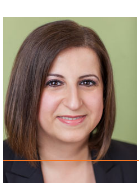
Courts Split On Pension Vested Rights Analysis





by Raymond F. Lynch & Matthew J. Peck & Judith W. Boyette & Nancy Hilu

On January 8, 2018, the California Court of Appeal for Division 4 of the First Appellate District issued a decision in Alameda County Deputy Sheriff's Association v. Alameda County Employees' Retirement Association ("Alameda"). The outcome in Alameda results in conflicting decisions in California appellate courts on the appropriate "vested rights" analysis where pension rights are being reduced or eliminated for existing employees. The conflicting cases involve challenges to implementation of the Public Employee Pension Reform Act of 2013 ("PEPRA") by several county retirement systems operating under the County Employees' Retirement Law of 1937 (the "CERL"). However, the questions raised in these cases regarding the ability to make changes that affect pre-PEPRA employees also would apply to other public retirement systems in California where benefit changes may have already been made or would be made in the future.

PEPRA modified Section 31461 of the CERL by adding a list of pay items that are excluded from the definition of "compensation earnable." "Compensation earnable" is the term used under the CERL to determine the amount of salary that is used in calculating benefits for members of a county retirement system. Consistent with the changes adopted in PEPRA, the county retirement systems for Alameda, Contra Costa and Merced Counties applied the new definition of "compensation earnable" to both new hires and pre-PEPRA members. Lawsuits challenging the application to pre-PEPRA members by these three systems were consolidated and became the *Alameda* case. The *Alameda* court examined whether pre-PEPRA members have a vested right to a pension benefit calculated using the definition of "compensation earnable" as it was defined prior to the changes enacted by PEPRA.

The *Alameda* court first concluded that PEPRA substantively changed the CERL definition of "compensation earnable" with respect to items such as on-call pay and pension enhancement pay, and did not merely clarify existing law. The court then asked whether the substantive changes constituted a reasonable modification to prior plan terms, or whether the changes impaired the contractual rights of pre-PEPRA members.

In reviewing those issues, the *Alameda* court declined to apply the vested rights analysis applied in the other recent case involving implementation of PEPRA under the CERL. That case, *Marin Association of Public Employees v. Marin County Employees' Retirement Association* ("*MAPE*"), was decided in 2016 by Division 2 of the same Appellate District. The *MAPE* court affirmed the power of the Legislature to modify pension rights as was done in PEPRA without providing comparable new advantages. The *MAPE* court also ruled that: 1) PEPRA's changes to the CERL represented a reasonable modification of vested pension rights given the state-wide crisis involving the significant underfunding of public pension systems, and 2) because affected employees remained entitled to a "substantial" or "reasonable" pension, there was no impairment of "vested rights" claim.

While the *Alameda* court agreed with the *MAPE* court that the Legislature has the power to modify pension rights without providing comparable new advantages, the *Alameda* court nonetheless found that the reasonableness of PEPRA's changes to CERL Section 31461 must be judged independently in each county so that the effect on pre-PEPRA members could be evaluated in the context of each county's particular CERL system. The *Alameda* court rejected the *MAPE* court*'s* broad focus on the general unfunded pension liability crisis in the State as a whole. The *Alameda* court remanded these factual issues to the trial court with instructions to: (1) recognize that the application of detrimental changes to pre-PEPRA members can only be justified by compelling evidence establishing that the required changes bear a material relation to the theory of a pension system and its successful operation, (2) focus on the impacts of the identified disadvantages on the specific pre-PEPRA members at issue, and (3) if justification for the changes is the financial stability of a specific CERL system, consider whether the exemption of pre-PEPRA members from the identified changes would cause that particular CERL system to have difficulty meeting its pension obligations with respect to those members. As such, the analytical framework adopted in *Alameda* mandates a detailed factual analysis as to each of the three prongs.

MAPE and *Alameda* also conflict on whether a public agency may be subject to an estoppel claim that promised benefits cannot be changed. The *MAPE* court rejected such a claim, reasoning that since the right to include certain compensation for calculating pension benefits is statutory, a public agency lacks authority to expand benefits by defining compensation in a way that would be contrary to statute. The *MAPE* court found a public agency could not be held liable for promised benefits that would exceed or conflict with the benefits provided under applicable law. By contrast, the *Alameda* court would allow this type of claim to be asserted based on the facts presented in the consolidated case. The *Alameda* court agreed with the *MAPE* court that a retirement board cannot by contract create a vested pension right that exceeds statutory limitations, but held that does not mean a public retirement system is immune from all claims based on promised benefits *per se*. According to the *Alameda* court, a retirement board's "plenary authority" to administer the system permits it to settle pension disputes in a way that ensures delivery of prompt and certain benefits to the system's members. Based on this analysis, the *Alameda* court allowed plaintiffs to pursue an estoppel claim to obtain benefits based on pre-PEPRA settlement agreements.

The California Supreme Court previously granted review of the *MAPE* case, but stayed further action pending this decision in the *Alameda* case. The *Alameda* parties filed petitions for review with the Court. Given the conflict between the appellate decisions, it is quite likely that the Court will grant review in *Alameda* to clarify the proper "vested rights" analytical framework under these circumstances.

Given the unsettled nature of the law, retirement systems or plan sponsors considering changes to pension benefits offered to current employees should work closely with counsel on implementing any proposed changes. This is especially true if the Court affirms the analytical framework adopted by the *Alameda* court which would necessarily require a specific factual inquiry.

For more information, please contact:

Raymond F. Lynch, Partner
415-995-5055
rlynch@hansonbridgett.com

Matthew J. Peck, Senior Counsel
415-995-5080
mpeck@hansonbridgett.com

Judith W. Boyette, Partner
415-995-5115
jboyette@hansonbridgett.com

Nancy Hilu, Partner
213-395-7630
nhilu@hansonbridgett.com