CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Manager
EMPLOYEE RELATIONS

July 13, 2011

Robert Sapien
President
San Jose Fire Fighters, IAFF, Local 230
425 E. Santa Clara Street, Suite 300
San Jose, CA 95113

RE: City Manager's 5-Year Fiscal Reform Plan

Dear Robert:

We are in receipt of your letter dated May 17, 2011, to the Mayor and City Council, in which you make several inquiries regarding the City Manager's Fiscal Reform Plan. The following is in response to your request.

1. Where in the Manager's 5-year plan, as it pertains to retirement benefits, are the actual savings amounts broken down by each specific recommendation?

   The chart on page 60 of the Fiscal Reform Plan summarizes the total General Fund savings based on the recommendations contained in the memorandum.

2. What actuary was used to determine any projected savings and what assumptions were used?

   The Department of Retirement Services prepared the estimates in the memorandum. The current assumptions approved by the Boards were used. In addition, the current 7.75% earnings assumption was used, as well as a 6.75% earnings assumption.

3. What do the various suggested retirement formulas actually buy and how much will they save (i.e. what will the benefit look like)?

   The chart on page 60 of the Fiscal Reform Plan summarizes the total General Fund savings based on the recommendations contained in the memorandum.

4. Where is the supporting documentation that justifies the projected retirement costs for all funds as depicted on Page 8 and 16?

The information used to prepare the charts on page 8 and 16 include the actuarial reports prepared by the Boards' actuaries. Those reports can be found at the links below:

Federated:
http://www.sanjoseca.gov/employeeRelations/retirementbenefits/January2011CheironOPEBValuation.pdf
http://www.sanjoseca.gov/employeeRelations/retirementbenefits/2010FederatedAVR12032010.pdf

Police and Fire:
http://www.sanjoseca.gov/employeeRelations/retirementbenefits/12.22.10SegalValuationReport.pdf
http://www.sanjoseca.gov/employeeRelations/retirementbenefits/06.30.2010PFRetireeHealthcareValuation.pdf

5. Why don't these projections include the pre-payment discount as described below this chart on Page 8 of 61?

   The City evaluates on an annual basis whether it will make the pre-payment of its contributions at the beginning of the fiscal year. Because the City is not required to make this pre-payment at the beginning of the fiscal year and no decision has been made to make the pre-payment in the future years, the pre-payment discount was not included.

6. Why don't these projections on Page of 61 include the actual City cost after several bargaining units paid a portion of the City costs for FY 10-11?

   Several bargaining units agreed to pay a portion of the City's unfunded liability. For some groups, this was an agreement for FY 10-11 only, and for others, a portion was one time for FY 10-11, and another portion was on-going. We have since reached agreements, or the City Council imposed terms that undo the additional retirement contributions.

7. What are the general fund projected retirement costs for the years depicted in the chart on Page 8 of 61 broken out by fiscal year?

   The projected retirement costs prepared by the Department of Retirement Services did not include a breakdown of General Fund and Other Funds.

8. On Page 34 the City Manager re-states 15 guiding principles adopted by the City Council. Why isn't one of the principles to honor the legal promises the City has made?

   The City complies with state and federal law on employment matters; however, we understand that there may be a difference of opinion or interpretation.

9. On Page 35 Principle 1: Has there been material spiking? Since the plans exclude overtime, what is the source of the spiking? If it is due to promotions, who controls promotions? What is the magnitude? Isn't this build into the salary increase assumptions used by the plan's actuary? Is this really just an excuse to lower the cost by extending the averaging period for final salary? On page 46 you talk about spiking again. Other than

lengthening the averaging period, how would this be prohibited? We assume the word "prohibit" is not an exact term since I assume you are not suggesting something like – no promotions after the age of 55 as that would be discriminatory based on age.

The City does not have information readily available responsive to this request.

10. On Page 37 there is a focus on using a 6.75% (50/50) assumption and having based your cost or savings on this assumption. This raises several questions: We would like to see the input to the model that produces the 6.75% 50/50 result and the 7.75% 25/75 result (e.g. expected returns by investment class). Who controls the assumptions used for both Plans CAFRs? Is it the Boards of Trustees? Is the City responsible for the ARC (and the assumption it is based on) in the City's CAFR? Is this any different now than in the past? We would like to confirm that until the last few years, the City was supportive of the investment assumptions but now believes that the market has changed and the return expectations need to drop faster than the Board of Trustees have dropped the rate and that you believe the City should not pay for any of the impact of the changed in expected future returns. Do you agree?

    The Department of Retirement Services used the Board adopted actuarial valuations to prepare the cost or savings in the information provided in the Fiscal Year Plan. Please refer to item 4 above for the valuation reports.

    The retirement boards determine the assumptions that will be used to prepare the actuarial valuations.

    The retirement board actuaries determine the Annual Required Contribution (ARC) based on the actuarial assumptions approved by the Boards. Pursuant to the City Charter, the cost split for the Normal Cost is 8:3 (City and employees) for the pension benefits. The cost for retiree healthcare benefits is split 50:50 (City and employees) as described in the San Jose Municipal Code.

    As you know, the City and employees are now phasing in to fully pre-fund retiree healthcare over five years. In addition, the Boards recently approved a change to the methodology for payment of the Annual Required Contribution. Information regarding this change can be found at:

    http://www.sanjoseca.gov/employeeRelations/retirementbenefits/1.20.11.RecentRetirementActuarialValuation.pdf

    The Police and Fire Board approved to lower the earnings assumption to 7.75% for the June 2010 valuation. In the November 2010, Segal report, there was reference to the earnings assumption producing a net investment return assumption of 6.93%, which is much lower than the prior assumption of 8.0%. The November 2010, Segal report can be found at:

    http://www.sjretirement.com/uploads/PF/item14APFDEC10.pdf

11. If the 6.75% rate is "overly optimistic" who is responsible for paying for a further lowering of the assumption if lowering the rate is the direction of the Trustees?

    As indicated above, both the City and employees are responsible for paying the Annual Required Contributions. The City Charter and San Jose Municipal Code describe the ratio for the Normal Cost and Unfunded Liability between the City and employees for the retirement benefits.

12. Also on Page 37 there is a comment that some have raised questions about why retirees get a 3% increase even when the plan is in trouble and employees are getting pay cuts. Would the City prefer a pay-based indexation or Social Security (CPI) based indexation for retirees? Wouldn't the same argument apply to other taxpayers getting Social Security indexation even though Social Security is much more poorly funded than the pension plan?

    The City is open to exploring all options to reduce retirement costs.

    The City is unable to respond to your questions regarding the current Social Security system.

13. On Page 40 we do not understand the table: Retiree Healthcare (OPEB) Unfunded Liability as of June 30, 2010. How can a plan be 7% funded with $0.72 billion in unfunded liabilities based on Market Value (of assets) and 6% funded with $0.71 billion in unfunded liabilities based on Actuarial Value (of assets).

    The Board's actuary Segal, prepared the June 30, 2010, actuarial valuation that includes this information. If you are seeking further clarification on this information, a request would need to be made to the Police and Fire Department Retirement Plan Board.

14. Has there been any legal guidance provided on how the Retiree Health Care benefits might be amended or legal restrictions? Why now? Is there anything different now vs. 10 years ago?

    On February 7, 2008, Jones Day issued a Memorandum to the City Attorney regarding retiree healthcare benefits and vested rights. The City Council subsequently made this document public. Please find enclosed a copy of this memorandum.

    As you know, effective June 28, 2009, the City and all employees in the Federated Plan and Police members in the Police and Fire Plan, are phasing in to fully pre-fund retiree healthcare in five years. Fire members in the Police and Fire Plan began to make these additional contributions effective June 26, 2011. This is a change form 10 years go, in which the retirement plan was partially pre-funding retiree healthcare.

15. On Page 43, we just want to be clear that the Manager now wants the City to pay (for new hires) no more than the 6.2% rate that private section employers pay to Social Security. Please confirm that this is a complete reversal from what was told to the City Council on January 25, 2011.

    This recommendation was different than the recommendation, which was approved by the City Council in January 25, 2011. However, on May 24, 2011, the City Council modified this recommendation, and approved new employee retirement benefits to be limited to a hybrid plan that may consist of a combination of social security, defined benefits or defined contributions, but the maximum City contribution in total shall not be less than 6.2% nor greater than 9% of base salary or 50% of the costs of the benefits, whichever is less.

16. Further on page 43 there is a reference to a "401k or 457 in the public sector." Are we correct that the 401k reference should really be to a 401(a) defined contribution plan. Is a 401(k) plan possible for all City employees (since generally public sector employers cannot adopt a 401(k) plan)? The City has suggested that if a tier 2 defined benefit plan is adopted that future unfunded liabilities be shared equally. Isn't this just an illusion as such a concept would not be robust enough to surviving difficult times?

    Page 43 of the Fiscal Reform Plan was providing reference to a defined contribution plan, which in the public sector is a 457 Plan. There was reference to a 401(k) because the general public is more commonly familiar with this term.

17. On pages 44-45 and 48-50 we would appreciate knowing who creates these numbers? Assuming it was an actuary, we would like to see the details and know who the actuary is. We would like to see details including those described in ASOP 41 (Actuarial Standards of Practice 41 regarding Actuarial Communications) and understand all of the benefits valued (including disability benefits) and all of the decrements used. Do the responsible actuary and you believe that the assumptions used in these charts are reasonable?

    The Department of Retirement Services provided the cost estimates in the examples cited above. The examples include a 7.75% earnings assumption, which have been approved by the Board. As indicated in No. 10, the Police and Fire Board approved to lower the earnings assumption to 7.75% for the June 2010 valuation. In the November 2010, Segal report, there was reference to the earnings assumption producing a net investment return assumption of 6.93%, which is much lower than the prior assumption of 8.0%. The November 2010, Segal report can be found at:

    http://www.sjretirement.com/uploads/PF/item14APFDEC10.pdf

18. On page 45 (bottom) it says guaranteed annual increases (COLAs) would be eliminated. How would this be equitable if there is no Social Security safety net?

    The City has made no proposals to eliminate the COLA.

19. Page 46 Please explain how to create a "risk free" defined benefit Plan? Are you talking about buying annuities?

    It is important to the City that realistic actuarial assumptions are used. It is important that funding policies are based on sound actuarial methods to avoid underfunding the plans intergenerational transfers of benefit costs.

20. On page 48-50 please confirm that to "pay for" the lowering of the interest rate from 7.75% to 6.75% you are proposing to lower future benefit accruals. Said differently, is the City trying to reduce its risk by having the employees pay for it?

    The Fiscal Reform Plan includes examples to save $216 million in five years. The City Council subsequently approved to direct staff to prepare a draft ballot measure that would make changes to current employees, including, lower benefit accruals, for future years of service.

Sincerely,

Gina Donnelly
Deputy Director of Employee Relations

c: Jeff Welch, Vice President, San Jose Fire Fighters, IAFF, Local 230

Enclosure

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MEMORANDUM

CONFIDENTIAL PROTECTED BY ATTORNEY-CLIENT PRIVILEGE

TO: Richard Doyle, Esq.
City Attorney
City of San Jose

FROM: Kirstin D. Poirier-Whitley

DATE: 02/07/08

RE: Retiree Health Benefits and Vested Rights

You have asked Jones Day to consider whether the City of San Jose (the "City") may change the retiree medical and dental benefits currently provided by the City in light of the constitutional prohibition on impairment of contractual obligations. This memorandum includes three parts: (1) a summary of the relevant facts, (2) a statement of the issues presented with corresponding summary conclusions, and (3) a more detailed analysis of the issues presented.

My analysis and conclusions are based on a review of the materials furnished to me by the City, which include: (1) the City Charter; (2) current and former Municipal Code provisions governing retiree medical and dental benefits; (3) the most recent "Benefits Fact Sheet" and "Handbook" for the Federated City Employees' Retirement System and the Police and Fire Department Retirement Plan; and (4) excerpts from the current Memorandum of Agreement ("MOA") between the City and each collective bargaining unit. It has been represented to me, and I have assumed for the purposes of this memorandum, that the provisions relating to retiree medical and dental benefits in any prior versions of the Benefits Fact Sheets, Handbooks and MOAs did not differ materially from the current versions that have been furnished to me. My analysis and conclusions are based only on the documents provided; consequently, to the extent that there are other documents that govern or describe the retiree medical and dental program and which include additional or different descriptions of the City's obligations, the analysis and conclusions set forth herein may not apply.

Because of the length of this memorandum, I have provided a table of contents below to aid in your review of the document.

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I. FACTUAL BACKGROUND

A. City Charter Governing Retirement Benefits

Section 1500 of the San Jose City Charter (the "Charter") provides for the creation of a retirement plan or plans for the city employees and also states that "the Council may at any time, or from time to time, amend or change any retirement plan or plans or adopt or establish a new or different plan or plans for all or any officers or employees."

Charter Section 1503 provides that all retirement systems in existence when the Charter was adopted are valid and will continue until otherwise provided by ordinance. Like Section 1500, however, this section also expressly states that "the Council shall at all times have the power and right to repeal or amend any such retirement system or systems, and to adopt or establish a new or different plan or plans for all or any officers or employees."

Charter section 1504 guarantees minimum benefits and contributions for certain members of the City Police and Fire Departments. Under this section, pre-funding contributions must be made by the employees and the City in a ratio of three to eight. Additionally, Charter section 1504 requires that any retirement plan or system established for members of the Police and Fire departments must be actuarially sound.[1]

Charter section 1505 similarly guarantees minimum benefits and contributions for certain officers and employees of the City who are not members of the Police or Fire Departments. Under this section, pre-funding contributions must be made by the employees and the City in a ratio of three to eight.[2]

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[1] The guaranteed benefit is a monthly retirement allowance equal to fifty percent of his or her "final compensation" if the member completes twenty years of service and attains the age of fifty-five or completes twenty years of service and is disabled while employed by the City.

[2] The guaranteed benefit for service retirement is an annual retirement allowance equal to two percent of "final compensation" per year of "service" for the first twenty-five years of service plus one percent of such final compensation for each year of service above twenty-five years if the employee completes twenty-five or more years of service and attains the age of fifty-five or attains the age of seventy regardless of years of service. An officer or employee who has 10 years of service and is disabled also is entitled to certain minimum retirement benefits. It was represented to me that, because the terms "service" and "final compensation" are all defined with reference to the pre-1975 retirement plan ("Old Plan"), the City takes the position these minimum benefits apply only to the classification of employees covered by the Old Plan. I have not independently analyzed this issue.

In any event, the same restriction does not apply to the minimum contribution requirement. See Charter section 1505(f) (excluding individuals excluded under section 1501, officers and employees in the Police and Fire Departments, retirees, and persons in classifications excluded from participating in the Old Plan on the date the Charter was enacted).

B. Federated Retiree Health Plans

1. History of the Plan

In September 1984, the Council of the City of San Jose (the "Council") enacted ordinances granting medical benefits to members of the Federated Employees Retirement Plan (the "Federated Plan"), and in 1986, the Council approved ordinances adding dental benefits to the Federated Plan (collectively, the "Federated Retiree Health Plan"). Originally, the Federated Retiree Health Plan provided that a member retired for service or disability and who was entitled to credit for fifteen or more years of service (or five or more years of service for dental benefits) or who received a retirement allowance equal to at least thirty-seven and one-half percent of such member's compensation would be eligible to enroll in a medical or dental insurance plan sponsored by the City provided that the member retired upon leaving service and was enrolled in a health plan at that time. In addition, a member could only obtain medical coverage for a spouse if he or she was married at the time of retirement. Certain surviving spouses and children also were entitled to medical and dental benefits. Retired members and survivors were entitled to a subsidy equal to the premium for the lowest-cost medical insurance plan available to an employee of the City and for 100% of the cost of dental insurance offered as part of the City's employee benefits. These benefits were provided not only to active members and their families, but to existing retirees and survivors.

Since the Plan's enactment, a number of changes have been made. Most importantly, in 1988, the Council amended the Plan to extend retiree medical insurance to members who leave employment with enough service to have a nonforfeitable benefit but who cannot retire immediately upon leaving employment – i.e., "Deferred Vested Members." In 2006, the Council added a medical benefits account provision to address tax law issues and conformed other plan provisions.[3]

2. Current Provisions

Currently, the Federated Retiree Health Plan provides that a member who has retired for service or disability (whether immediately or on a deferred vested basis) and who is entitled to credit for fifteen or more years of service or who receives a retirement allowance equal to at least 37½% of such member's compensation (without regard to any offset for worker's compensation benefits) may enroll for medical insurance coverage in an eligible medical insurance plan. §§ 3.28.1950 and 3.28.1970.[4] In addition, Section 3.28.1960 generally provides that a member's

[3] Other minor changes not particularly relevant to the questions posed also were made. In 1986, the Plan was amended to provide that a worker's compensation offset is disregarded for the purposes of determining eligibility. In 1991, the Council amended the Plan to extend coverage to certain surviving spouses, and, in 1992, the Council amended the Plan to extend coverage to individuals who left employment pursuant to an early retirement incentive program. In 2002 and 2005 respectively, the Council amended the Plan to permit a spouse who is a guardian of a minor child to elect family medical coverage and to extend coverage to domestic partners.

[4] All section references are to the San Jose Municipal Code, unless otherwise indicated.

surviving spouse, domestic partner and/or child who is receiving a survivor or optional allowance under the Federated Plan is entitled to continue receiving medical benefits provided that the member dies while still employed or after retirement and, at the time of death, the member either had 15 years of service or was receiving a retirement allowance equal to 37½% of such member's compensation (without regard to any offset for worker's compensation benefits). It further provides that the portion of the premium to be paid from the medical benefits account "shall be the portion that represents an amount equivalent to the lowest of the premiums for single or family medical insurance coverage...which is available to an employee of the city at such time as said premium is due and owing." § 3.28.1980.

Sections 3.28.2000 and 3.28.2020 provide that a member who retires for service or disability and who is entitled to at least 5 years of service credit or an allowance equal to at least 37½ % of such member's compensation (without regard to any offset for worker's compensation benefits) may enroll for dental insurance coverage in an eligible dental insurance plan. In addition, Section 3.28.2010 generally provides that a member's surviving spouse, domestic partner and/or child who is receiving a survivor or optional allowance under the Federated Plan is entitled to continue receiving dental insurance provided that the member dies while still employed or after retirement and, at the time of death, the member either had 5 years of service or was receiving a retirement allowance equal to 37½% of such member's compensation (without regard to any offset for worker's compensation benefits). Section 3.28.2030 provides that the Plan pay 100% of the cost of the dental insurance provided to members and survivors. Members or their survivors may enroll only in an "eligible dental plan" which is a plan "with which the city has entered into a contract for the provision of dental benefits as part of the city's benefits to city employees." § 3.28.2040.

The Federated Retiree Health Plan is co-funded by employee and employer contributions in a specified ratio. Specifically, section 3.28.380(C) now provides that contribution rates to fund medical and dental benefits are established by the Board as determined by the Board's actuary and are borne by the City and the members of the Plan in a one-to-one ratio for medical benefits and an eight-to-three ratio for dental benefits. Although this co-funding ratio was first codified in 2006, it has been applied and reflected in the actuarial reports and other documentation connected with the Plan since inception.

As of August 2006, the Federated Retiree Health Plan provides that the City reserves its right to amend the Plan to limit medical or dental benefits as necessary to satisfy the requirements of Internal Revenue Code ("IRC") section 401(h), and more specifically that, in the event contributions required to fund the specified benefits would exceed the limits permitted by

IRC section 401(h), the portion of the premium to be paid by the Plan may be reduced as necessary to satisfy IRC section 401(h).[5] §§ 3.28.1995 and 3.28.2045.

C. Police and Fire Department Retiree Health Plans

1. History of the Plan

In June 1984, the Council enacted ordinances granting medical benefits to members of the Police and Fire Department Plan (the "Police and Fire Plan"), and in 1986, the Council approved ordinances adding dental benefits to the Police and Fire Plan (collectively, the "P&F Retiree Health Plan"). Originally, the P&F Retiree Health Plan provided that a member retired for service or disability and who was entitled to credit for fifteen or more years of service or who received a retirement allowance equal to at least 37½% of such member's compensation would be eligible to enroll in a medical insurance plan sponsored by the City provided that the member retired upon leaving service and was enrolled in a health plan at that time. In addition, a member could only obtain medical coverage for a spouse if he or she was married at the time of retirement. Retired members and survivors were entitled to a subsidy such that they would be required to pay no more for medical insurance than an active employee in the classification from which the member retired. A member was entitled to dental insurance benefits if he retired for service or disability; there was no minimum service or allowance level requirement. The Plan paid 100% of the premium for available dental insurance. Certain surviving spouses and children also were entitled to medical and dental benefits. These benefits were provided not only to active members and their families, but to existing retirees and survivors.

Since the Plan's enactment, a number of changes have been made. For example, in 1991, the Plan was amended to extend medical and dental coverage to a spouse where marriage occurs after retirement. In 1992, the Plan was amended to extend coverage to Deferred Vested Members separating from service after July 5, 1992 with 20 or more years of service and their survivors. In 1998, pursuant to an arbitration award, the Plan was amended to enhance the premium level paid for persons retiring after February 4, 1996 to be the same as that paid under the Federated Retiree Health Plan – i.e., the premium for the lowest-cost plan available. This change was also extended to individuals who had retired prior to February 4, 1996. In 2001, the Council added a medical benefits account provision to address tax law issues and add reimbursement for certain Medicare Part B payments. Coverage was extended to Deferred Vested Members who separated from service before July 5, 1992 and their survivors in May

[5] As you know, the contributions to the medical benefits account (plus contributions to fund life insurance protection) may not exceed 25% of total aggregate contributions (other than contributions for past service credits) to the retirement system.

2002. In 2006, the medical benefit account provision was reenacted in order to correct certain numbering errors.[6]

2. Current Provisions

Currently, Sections 3.36.1900 and 3.36.1920 provide that a member who (1) has retired for service or disability and either is entitled to credit for fifteen or more years of service or receives a retirement allowance equal to at least thirty-seven and one-half percent of such member's compensation, or (2) receives an allowance as a Deferred Vested Member with at least 20 years of service, may enroll for medical insurance coverage in an eligible medical insurance plan. If a retiree marries after retirement, he may add his spouse to coverage. § 3.36.1920C. In addition, Sections 3.36.1910 and 3.36.1920 generally provide that a member's surviving spouse, domestic partner and/or child is entitled to continue receiving medical benefits provided that either (1) the survivor is receiving a monthly allowance under part 8 of the Police and Fire Plan and, at the time of death, the member either had 15 years of service or was receiving a retirement allowance equal to 37½% of such member's compensation; or (2) the survivor is receiving a monthly allowance under part 11 of the Police and Fire Plan because of the death of a Deferred Vested Member with at least 20 years of service.

Sections 3.36.1930B and C provide that the portion of the premium to be paid from the medical benefits account beginning in 1998 shall be equivalent to the "lowest cost medical plan;" but shall not exceed the actual premium for the eligible medical plan in which the member, former member or survivor enrolls." The "lowest cost medical plan" means that medical plan (single or family coverage as applicable) which is an "eligible medical plan" and which has the lowest monthly premium of all eligible medical plans then in effect. § 3.36.1930D. An eligible medical plan is a plan "with which the city has entered into a contract for the provision of hospital, medical, surgical and related benefits as part of the city's benefits to city employees." § 3.36.1940.

Sections 3.36.2000 and 3.36.2020 provide that a member who (1) became a member of the Plan prior to July 1, 1998 and retires for service or disability, (2) who is retired for service or disability and either has at least 15 years of service credit or an allowance equal to at least 37½% of such member's compensation, or (3) is receiving an allowance as a Deferred Vested Member with at least 20 years of service, may enroll for dental insurance coverage in an eligible dental insurance plan. Sections 3.36.2010 and 3.36.2020 generally provide that a member's surviving spouse, domestic partner and/or child receiving an allowance under parts 8 or 11 of the Police

[6] Other minor changes not particularly relevant to the questions presented also were made. For example, in 1991, the Plan also was amended to make technical changes substituting the term "spouse" for the terms "husband" and "wife," and to extend medical coverage to certain individuals who had transferred from the Central Fire District. In 1998, the Plan was amended to impose additional eligibility requirements for dental benefits for individuals becoming members on and after July 1, 1998. In 2002 and 2006 respectively, the Council amended the Plan to permit a spouse who is a guardian of a minor child to elect family medical coverage and to extend coverage to domestic partners.

and Fire Plan is entitled to continue receiving dental insurance under certain conditions. Section 3.36.2030 provides that the Plan pay 100% of the cost of dental insurance provided to members and survivors. Members or their survivors may enroll only in an "eligible dental plan" which is a plan "with which the city has entered into a contract for the provision of dental benefits as part of the city's benefits to city employees." § 3.36.2040.

The P&F Retiree Health Plan is co-funded by employee and employer contributions in a specified ratio. Specifically, section 3.36.575(C) now provides that contribution rates to fund medical and dental benefits are established by the Board as determined by the Board's actuary and are borne by the City and the members of the Plan in a one-to-one ratio for medical benefits and a three-to-one ratio for dental benefits. Although this co-funding ratio was first codified in 2000, it has been applied and reflected in the actuarial reports and other documentation connected with the Plan since inception.

II. ISSUES PRESENTED AND SUMMARY OF CONCLUSIONS

Question 1. *Can changes be made to the retiree medical and dental benefits provided by the City of San Jose in light of the constitutional prohibition on the impairment of contractual obligations?*

As you know, both the United States and the California Constitutions prohibit the impairment of contractual obligations. Although the terms and conditions of public employment generally are controlled by statute or ordinance rather than by contract, the right to compensation already earned—particularly in the form of a pension—has been held to be vested and therefore protected under these constitutional provisions. A public employee's vested contractual right to pension benefits *accrues upon acceptance of employment.* By entering public service an employee obtains a vested contractual right to earn a pension on terms substantially equivalent to those then offered by the employer and to earn additional pension benefits pursuant to improved terms conferred during continued employment. The vested contractual right that accrues upon acceptance of employment includes promised survivor benefits.

Vested pension rights have been held to include, not only the benefits payable at retirement, but the scope of a member's contribution obligation as defined under the terms of the contract. In addition, courts have extended the application of the vested rights doctrine to benefits, other than traditional service pensions, that have served as an inducement for continued service and which, at least partially, already have been earned through the performance of service to the employer. Based on these authorities, a court likely would conclude that the constitutional protection applicable to traditional pension rights would also be applicable to the Federated and P&F Retiree Health Plans.

Not all benefit changes will impair vested contract rights, however. First, as a general rule, the City may modify vested rights before an employee retires if such alterations bear some material relation to the theory of a pension system and its successful operation *provided that any*

changes which result in disadvantage to the employees' vested rights are offset by comparable new advantages. Because you have not identified any possible offsetting advantages that would accompany potential changes, I have not addressed how this "reasonable modification doctrine" would apply in this context.

Second, and more relevant to the City's inquiry, *any changes made to benefits that are consistent with, rather than in derogation of, the terms of the applicable "contract" should not impair vested rights.* Thus, as described in more detail below, determining whether a proposed change will impair the City's retiree medical and dental benefit "contract" with its employees involves a careful analysis of the terms of that contract. In this case, the "contract" between the City and its employees probably consists of the Municipal Code provisions setting forth the terms of the Federated and P&F Retiree Health Plans and, arguably, at least some of the overarching provisions of the Charter.

Of course, even if a change to retiree medical or dental benefits would not impair vested rights, some retirees or members might still argue that the City is estopped from altering their benefits. Given the lack of affirmative representations by the City regarding the duration or immutability of these benefits, I think members likely would have a difficult time making a persuasive argument in this regard.

Question 2. *Does the prohibition on impairment of contracts apply differently to different categories of retirement system members – i.e., retirees, current employees who have satisfied service eligibility requirements, current employees who have not satisfied service requirements, Deferred Vested Members and newly hired employees?*

As noted above, the terms of an employee's retirement benefits vest upon acceptance of employment. Thus, whether or not an employee has completed all of the service necessary for benefit eligibility generally has no bearing on that employee's vested contract rights. The only context in which an employee's years of completed service may be relevant is in connection with the analysis of a reserved right to amend as discussed under Question 3 below.

An employee does not have a vested right to benefits that are granted *after* the employee has left employment. Similarly, future employees generally do not have a vested right to any particular retirement benefits or to continuation of the retirement plan in operation prior to their employment. The employer generally is free to alter the terms of the benefits offered to new employees until they actually accept employment.

Once an employee has retired and begun receiving benefits, his or her benefits are no longer subject to the reasonable modification doctrine mentioned above. Changes, however, may still be made to the extent those changes are consistent with the terms of the contract governing those retirees.

Question 3. *What are the limitations, if any, on changes that may be made under the terms of the relevant "contract"?*

As noted above, benefits that are awarded after an employee leaves employment should not be constitutionally protected from impairment unless the individual exchanged other contractual rights for the new benefits. Accordingly, the City should be able to change the eligibility criteria, plan design or benefit level with regard to an employee who was first awarded coverage under the terms of the Plan after leaving City service – e.g., Deferred Vested Members under the Police and Fire Plan who left employment before 1992[7] or members of either the Police and Fire Plan or the Federated Plan who retired prior to the implementation of retiree health benefits in 1984 who were allowed to enroll– without impairing a vested contract right.

As also noted above, *any changes made to benefits that are consistent with, rather than in derogation of, the terms of the applicable "contract" should not impair vested rights.* More specifically, if the employer has expressly reserved its right to make changes to a plan member's benefits, any change made consistent with that reserved right should not impair vested contract rights. In accordance with this principle, the City may take the position that its Charter reserves the Council's right to amend any retirement benefits, including retiree medical benefits, and that *any* changes it makes to the Federated or P&F Retiree Health Plans pursuant to this reserved right would not impair vested contract rights.

Given that the Charter's reservation of right only expressly applies to "officers or employees," however, a court likely would conclude that the Charter provision does not apply to those who have already left employment – e.g., retirees and their families or survivors. Moreover, active and retired members alike may make persuasive arguments that the reservation of right in the Charter was intended to apply only to traditional pension benefits and not to post-retirement medical benefits. In conclusion, while the City has a reasonable basis for concluding that it has reserved its right to amend retiree health benefits at least with regard to active employees, there is a substantial risk that even active employees could successfully argue that the Charter's "reservation of right" is inapplicable to retiree health benefits.

In addition, even assuming that the reserved right to amend in Article XV of the Charter does apply to the retiree medical and dental benefits, members who already have performed enough service to qualify for these benefits when they retire may argue that their benefits and the conditions for receiving them may not be modified. Specifically, these members reasonably may argue that they have performed or "substantially" performed under the terms of the contract – i.e., that their benefits have been fully earned– and that their already earned benefits may not be modified notwithstanding any reservation of right. If this argument were successful, the reservation of rights clause would effectively preserve the City's right to modify the terms of a benefit only for those who have not done all or "substantially" all they have to do to earn it.

[7] When coverage for Deferred Vested Members was added to the Federated Retiree Health Plan in 1988, it appears that coverage was added only for those who became Deferred Vested Members after the date of the change, and not retroactively. Accordingly, this analysis is not applicable to the Federated Retiree Health Plan.

Finally, even if a court concluded that the reservation of right to amend in Article XV of the Charter applies, the court might also require the City to be internally consistent and apply the contribution and funding provisions in Article XV to its retiree medical and dental benefits as well.

Assuming that the reservation of right in the Charter does not apply to the Federated or P&F Retiree Health Plans, there are a few changes that may nonetheless be consistent with the terms of the applicable "contract" and, accordingly, should not impair vested rights. These changes are discussed below in answer to Question 3. In any event, as noted above, future employees have no vested right to receive benefits under the current retiree medical and dental programs.

Question 3.A. *Assuming the reservation of right to amend in the Charter does not apply, may the City nevertheless change the number of years of service required before employees are eligible for benefits?*

Each current employee, retiree or Deferred Vested Member who accepted employment or continued in employment after the relevant Plan was adopted or became applicable to that individual likely has a vested right to receive benefits based on the years-of-service eligibility criteria in effect at that time. Even if an employee does not yet have sufficient service credit to qualify for benefits, he or she has a right to continue to earn benefits under these terms. Any change in the years of service requirement likely would constitute an impairment of contract (unless the detriment imposed were permissibly offset by comparable advantages in accordance with the "reasonable modification doctrine" discussed in section III.A.7.).

Question 3.B. *Assuming the reservation of right to amend in the Charter does not apply, may the City nevertheless change the level of benefit – i.e., the premium level – paid under the Federated and P&F Retiree Health Plans?*

The current ordinances for both Plans provide for payment of an amount equivalent to 100% of the lowest of the available premiums for single or family medical insurance coverage. The Federated Retiree Health Plan has offered this benefit level from its inception; the P&F Retiree Health Plan, however, did not offer this benefit level until 1998, when it was extended to individuals retiring after February 4, 1996, pursuant to an arbitration award, and also to retirees (and their family members) who left service before that date.

A court likely would conclude that current employees and most Deferred Vested Members and retirees have a vested right to receive this promised level of benefits, and that any change made to this level of benefit by the City would impair that vested right (unless the detriment imposed were permissibly offset by comparable advantages in accordance with the "reasonable modification doctrine" discussed in section III.A.7.). The City, however, may reasonably conclude that those retirees and Deferred Vested Members who are members of the P&F Retiree Health Plan and who left the City's service prior to 1998 have a vested right only in

the premium amount under the terms of the Plan in existence when they left employment – i.e., a right to pay only as much as current employees in the job classification from which the member retired. Of course, notwithstanding the vested rights analysis, it appears that the City could not cut the benefit back to this level for people retiring between February 4, 1996 and 1998 without violating the arbitration award.

Question 3.C. *Assuming the reservation of right to amend in the Charter does not apply, may the City nevertheless change the level of funding provided by employees and the City?*

Under the current provisions of both the Federated and P&F Retiree Health Plans, contributions rates are established by the Board in consultation with its actuary. Thus, because the terms of the "contract" contemplate that the total contribution rate may vary, the Board should be free to increase the total contribution rate to be borne collectively by the City and the employees without impairing employees' vested rights.

Unlike the total contribution rate, however, the contribution *ratios* are express "contract" terms set forth under the provisions of the Plans. Thus, a court probably would conclude that the employees' right to contribute under the ratios currently set forth in the Municipal Code is vested and the City may not alter this ratio without impairing its contractual obligations (unless the detriment imposed were permissibly offset by comparable advantages in accordance with the "reasonable modification doctrine" discussed in section III.A.7.).

Question 3.D. *Assuming the reservation of right to amend in the Charter does not apply, may the City nevertheless alter the design of the medical and dental plans made available to retired members and their survivors?*

The current ordinances providing for retiree health benefits do not identify a specific medical or dental insurance plan design that must be offered to retired members, their families and survivors. Rather, these ordinances specify that the plans available to retirees will be those that are contracted for by the City as part of its employee benefits program for active employees. Thus, provided it makes similar changes to the plans made available to active employees, the City should be able to alter the design of the medical and dental insurance plans made available to its retirees without impairing the vested rights of current retirees, Deferred Vested Members, current employees or future employees. The City also could defend the somewhat more aggressive position that it may alter the design of dental and medical insurance offered under its retiree health plans but not those plans offered to active employees; however, there is a substantial risk that plan members could successfully challenge this position.

Question 4. *What impact does the Meyers-Milias-Brown Act and City Charter Section 1111 have on the City's ability to make changes to retiree health benefits?*

Health benefits are terms and conditions of employment that are subject to the meet and confer requirements of the Meyers-Milias-Brown Act. Thus, the City will be required to meet

and confer in good faith about any proposed changes to the available benefits. A collective bargaining unit may not bargain away individual statutory or constitutional rights. Thus, even if the City and the union agree to certain modifications, such modifications would be impermissible if employees had a vested right in the benefit being modified.

III. LEGAL ANALYSIS

Whether the City may alter its existing retiree health program involves an analysis of several questions: (1) Are retiree health benefits the type of benefits that are constitutionally protected from impairment under the so-called "vested rights" doctrine; (2) if so, what is the scope of the benefits that are protected under the relevant "contract"? In addition, even if the employees and retirees do not have vested contractual rights with regard to retiree health benefits, the question remains whether the City may be estopped from changing the program with regard to current employees and retirees.

In that regard, the following analysis includes three parts: (1) an overview of the so-called "vested rights" doctrine, including an analysis of its application to retiree health benefits generally, (2) an analysis of the terms of the Federated and P&F Retiree Health Plans in light of "vested rights" principles, and (3) a discussion of estoppel considerations.

A. Overview of Vested Rights Doctrine

1. Pension Rights Vest Upon Acceptance of Employment

Both the United States and the California Constitutions prohibit the impairment of contractual obligations.[8] Although the terms and conditions of public employment generally are controlled by statute or ordinance rather than by contract,[9] the right to compensation already earned—particularly in the form of a pension—has been held to be vested and therefore protected under these constitutional provisions.[10]

It has been recognized that public pension benefits were created to serve "as an inducement to enter and continue in public employment"[11] and to "provide agreed subsistence to retired public servants who have fulfilled their employment contracts."[12] A public employee's vested contractual right to pension benefits *accrues upon acceptance of employment.*[13] Although

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[8] U.S. Const. art. I, § 10; Cal. Const. art. I, § 9.

[9] Markman v. County of Los Angeles, 35 Cal. App. 3d 132, 134-35 (1978).

[10] See, e.g., Allen v. Bd. of Admin., 34 Cal. 3d 114, 120 (1984).

[11] Quintana v. Bd. of Admin., 54 Cal. App. 3d 1018, 1021 (1976).

[12] Carman v. Alvord, 31 Cal. 3d 318, 325 n.4 (1982); Bellus v. City of Eureka, 69 Cal. 2d 336, 351 (1968).

[13] Allen v. Bd. of Admin., 34 Cal. 3d at 120.

"an employee does not earn the right to a full pension until he has completed the prescribed period of service, . . . he has actually earned some pension rights as soon as he has performed substantial services for his employer."[14] "By entering public service an employee obtains a vested contractual right to earn a pension on terms substantially equivalent to those then offered by the employer"[15] and to earn additional pension benefits pursuant to improved terms conferred during continued employment.[16] This means that the employee has a vested right not merely to preserve the pension benefits already earned, but also to continue to earn benefits under the terms previously promised through continued service.[17] Thus, whether an employee has earned enough service to make the benefits nonforfeitable and, thus, "vested" in that sense has no bearing on whether the benefits are constitutionally "vested" and protected from impairment.

The vested contractual rights that accrue upon acceptance of employment include promised survivor benefits. Although a public employee's survivor does not have a *separate and independent* vested right to survivor benefits prior to the employee's death,[18] such benefits are treated as part of the pension benefits offered to the employee in return for the employee's

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[14] Kern v. City of Long Beach, 29 Cal. 2d 848, 855 (1947).

[15] Carman, 31 Cal. 3d at 325.

[16] Betts v. Bd. of Admin., 21 Cal. 3d 859, 866 (1978) ("An employee's contractual pension expectations are measured by benefits which are in effect not only when employment commences, but which are thereafter conferred during the employee's subsequent tenure."); United Firefighters v. City of Los Angeles, 210 Cal. App. 3d 1095, 1102 (1989).

[17] Legislature v. Eu, 54 Cal. 3d 492, 530 (1991) ("We conclude that incumbent legislators had a vested right to earn additional pension benefits through continued service . . . "); Pasadena Police Officers Ass'n. v. City of Pasadena, 147 Cal. App. 3d 695, 703 (1983) ("[T]he employee has a vested right not merely to preservation of benefits already earned pro rata, but also, by continuing to work until retirement eligibility, to earn the benefits, or their substantial equivalent, promised during his prior service").

[18] Packer v. Bd. of Retirement of the Los Angeles County Peace Officers' Retirement System, 35 Cal. 2d 212, 215 (1950); see also Dickey v. Retirement Board of the City and County of San Francisco, 16 Cal. 3d 745, 749 fn. 2 (1976) (noting that right of wife of public employee to a pension does not vest on her husband's acceptance of employment but upon the happening of the contingency upon which her benefits are payable); Frazier v. Tulare County Bd. of Retirement, 42 Cal.App.3d 1046, 1049 (1974) (noting that neither employee's designated beneficiary nor his wife had a separate vested right to receive any benefits from the pension system since provisions for them were merely a part of the employee's pension right); Henry v. City of Los Angeles, 201 Cal. App. 2d 299 (1962) (finding that disadvantageous modification to widow's pension was unconstitutional because it was not accompanied by a comparable benefit).

services.[19] As a result, those benefits should be protected from impairment under the same principles applicable to the employee's own retirement benefits.[20]

A former employee, however, does not have a vested right to benefits granted after the employee leaves employment.[21] For example, in Pasadena Police Officers Ass'n v. City of Pasadena, the city amended its charter in 1969 to include a cost of living adjustment to retirement benefits.[22] The city sent an election form to its retirees allowing them to opt-in to the new system, effectively giving up their fixed pensions in favor of a system under which their benefits would be subject to a cost of living adjustment ("COLA"). The members experienced a substantial increase in their pension benefits as a result of opting in to the new system. The city amended its charter again in 1981 to cap the COLA at 2%. The COLA was uncapped when it was initially introduced in 1969. The city excepted from the 2% cap those employees who had retired between 1969, when the uncapped COLA was introduced, and 1981, when the COLA was capped. Retirees who had retired prior to 1969, and so were not covered by the exception, sued, arguing that they had a vested right to receive the COLA benefits which had been put into place in 1969.[23]

The court stated that employees who had retired prior to the COLA's enactment in 1969 "had no vested contractual right, based on *the contract in effect during their employment*, to continuation of the COLA benefit." (emphasis in original).[24] The court, however, went on to find that the members' election to opt-in to the new system had effectively created a new contract which was binding on the city. Therefore, the city could not reduce the COLA without infringing on the pensioners' rights under their contract with the city.[25]

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[19] Packer, 35 Cal. 2d at 215 (benefit to widow is "one of the elements of compensation held out to her husband."); Henry, 201 Cal. App. 2d at 313 ("[The widow's right to receive a pension following the demise of her husband] is an element of the husband's contractual compensation and earned by him by performing services for the city.")

[20] See Packer, 35 Cal. 2d at 216 (widow's pension was part of husbands' pension benefits and subject to reasonable modification); Henry, 201 Cal. App. 2d at 314 (same). For a discussion of the "reasonable modification doctrine, see Section III.A.7.

[21] Olson v. Cory, 27 Cal. 3d 532, 542 (1980) (stating that pensioners whose benefits are based on service that terminated prior to a change in the law have no vested right to benefits resulting from that change).

[22] 147 Cal. App. 3d 695 (1983).

[23] Id. at 701.

[24] Id. at 706.

[25] Id.

2. Pension Does Not "Mature" Until Conditions Are Satisfied

While the right to pension benefits vests upon employment, the right to immediate payment of those benefits does not necessarily mature until certain conditions have been satisfied. Events may occur that will prevent the benefit from maturing and the employee from becoming entitled to payment. For example, Miller v. State involved a challenge to an amendment to California Government Code Section 20981 that lowered the mandatory retirement age from age 70 to age 67.[26] The plaintiff was a civil servant who had been employed by the state for over 30 years. The pension that the plaintiff received as a result of being forced to retire at age 67 was substantially lower than that which he would have received had he retired at age 70. The plaintiff sued the state, arguing that he had a vested right in continuing to be employed by the state until age 70, based on the mandatory retirement age that was in effect when he began his employment with the state. The plaintiff additionally argued that the amendment unconstitutionally impaired his vested pension rights by forcing him to accept a pension substantially less than he would have received had he worked until age 70.

The court rejected the plaintiff's first argument, noting that public employment is held by statute not by contract and that no public employee has a vested contractual right to continued employment beyond that fixed by law.[27] Thus, the power of the legislature to reduce the tenure of a civil servant cannot be limited by contract.[28] The court also rejected the plaintiff's second argument that his pension rights were nevertheless impaired. The court instead found that the plaintiff's loss of pension benefits resulted from the occurrence of a condition subsequent to the accrual of those rights rather than from an impairment of those rights. The court noted that although the plaintiff's right to a pension was vested, he was not assured of receiving maximum benefits. Thus, "the power of the Legislature, unfettered by contract, reduced the mandatory age of retirement and thereby created the condition subsequent the occurrence of which not only terminated plaintiff's employment but also defeated his expectation of additional salary and a larger retirement allowance."[29]

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[26] 18 Cal. 3d 808 (1977).

[27] Id. at 813.

[28] Id. at 814.

[29] Id. at 817. The court reached a similar result in Tante v. Board of Administration of the Public Employees' Retirement System, 93 Cal. App. 3d 615 (1979). In this case, a public employee sued when his application to retire with retirement benefits when he turned 67 was declined because he had not yet served 5 years. On the date that the plaintiff became employed, Government Code section 20981 provided that state employees were required to retire upon attaining the age of 67. Three years after the plaintiff began his employment, this section was amended to require retirement at age 70 instead of age 67. Government Code section 20393 stated that only employees with 5 years of service or more were eligible for retirement benefits. Before the legislature increased the mandatory retirement age, however, the Board of Retirement's past practice had been to allow employees who reached the age of 67 without 5 years of service to receive a service retirement pension based on their years of service. The plaintiff argued that he had a vested right to receive a pension based on this practice. Id.

As indicated above, however, once the employee accepts employment, the employer may not alter the contract terms that an employee must satisfy for the benefits to mature.[30]

3. Benefits May Be Changed for New Hires

The contractual basis of the right to retirement benefits is "the exchange of an employee's services for the pension right offered by the statute."[31] Thus, in contrast to current employees and retirees, future employees generally do not have a vested right to any particular retirement benefits or to continuation of the retirement plan in operation prior to their employment.[32] The employer generally is free to alter the terms of the benefits offered to new employees – e.g., by amending statutory language -- until they actually accept employment, at which point their retirement benefit rights vest.[33] In other words, so long as the employer does not alter the applicable statutes or other contractual language, new employees will continue to acquire vested rights in the existing retirement program as they are hired.[34]

Although a governmental employer generally is free to amend or repeal a statute providing retirement benefits with regard to future employees, one court has suggested that an employer might contractually bind itself *not* to alter such statutory benefits. But, it went on to say that such "[a] promise not to change the character of a pension program as to new employees is a fundamental constraint on the freedom of action" of the applicable legislative body.[35] Accordingly, a court should not interpret a contractual provision as containing such a promise unless it has "no other reasonable choice" – that is, where the provision "clearly abdicates the legislative power to make changes in the pension system for prospective employees."[36]

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at 617. The court held that the Board of Retirement's past generous policy did not create a vested interest and so the plaintiff was not entitled to receive a pension before he had accumulated five years of service. Id. at 619.

[30] Legislature v. Eu, 54 Cal. 3d at 530; Pasadena Police Officers' Ass'n, 147 Cal. App. 3d at 703.

[31] Claypool v. Wilson, 4 Cal. App. 4th 646, 670 (1992).

[32] Legislature v. Eu, 54 Cal. 3d 492, 534 (1991); California Assoc. of Prof. Scientists ("CAPS") v. Schwarzenegger, 137 Cal. App. 4th 371, 383 (2006); Claypool v. Wilson, 4 Cal. App. 4th 646, 670 (1992); San Francisco Fire Fighters v. City and County of San Francisco, 152 Cal. App. 3d 113, 120 (1984); Whitmire v. City of Eureka, 29 Cal. App. 3d 28, 34 (1972); Estes v. City of Richmond, 249 Cal. App. 2d 538, 545 (1967).

[33] See CAPS, 137 Cal. App. 4th at 385.

[34] Id. at 385.

[35] Id. at 383 (quoting Claypool, 4 Cal. App. 4th at 670).

[36] Id. at 383-84. In the CAPS case, the state entered a memorandum of understanding ("MOU") with CAPS effective from July 1, 2003, through July 1, 2006. Section 8.8 of the MOU contained language providing that "[P]ursuant to Government Code [section] 21070.5, new employees who meet the criteria for CalPERS membership would be enrolled in the First Tier plan and have the right to be covered under the Second Tier plan within 180 days

To recap, under established vested rights principles, an employer generally is free to alter the retirement benefits that will be provided to new employees – e.g., by amending governing statutory language -- until those employees actually accept employment, provided that the employer has not clearly bargained away its right to do so.

4. Contribution Levels As Well As the Benefits Funded by Those Contributions May Become Vested

Vested pension rights have been held to include, not only the benefits payable at retirement, but the scope of a member's contribution obligation *as defined under the terms of the contract*. For example, in Allen v. City of Long Beach, the city attempted to make a number of changes to the pension rights of its employees.[37] One of these changes was to increase the amount of each employee's contribution from 2% of his salary to 10% of his salary. The court held that this change was unlawful because it substantially increased the cost of pension protection to the employee without any corresponding increase in the benefits he could expect to receive upon retirement.[38]

Contribution levels may be modified, however, if such modification is consistent with, rather than in derogation of, the terms of the contract (see discussion in section III.A.8.(c) below).

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of the date of their appointment." In 2004, the state enacted a new law creating an alternate defined contribution retirement program effective during the first two years of employment for employees first hired after the effective date of the law. As part of the new law, a new subdivision (e) was added to section 21070.5, which provided that, for members subject to the new retirement program, the 180-day election period for electing Second Tier participation did not commence until the first day after the two years spent in the alternate retirement program.

CAPS alleged that application of the alternate retirement program to new employees conflicted with Section 8.8 of the MOU, and therefore violated the constitutional prohibitions on impairment of contracts. The court noted that "[w]hen a collective bargaining agreement purports to secure pension rights for future employees, it may well be that the federal and state contract clauses protect the rights of future employees," but concluded that it "need not decide that issue" because the MOU at issue did not contain such a promise.

The court concluded that section 8.8 of the MOU did not suggest the state was bargaining away its sovereign right to change the character of pension rights for future employees. The statutory provision addressed in the MOU was one that was applicable to employees in a bargaining unit only if incorporated in an MOU. Thus, the MOU language was necessary to make the statutory provision applicable to employees in the CAPS bargaining unit. The court reasoned further that, so long as the Legislature made no further changes to the applicable statute, CAPS' new employees had a right to First Tier benefits unless they timely elected Second Tier benefits. There was nothing in the MOU, however, that committed the Legislature to maintaining the same statutory benefits for all prospective CAPS employees through the effective period of the MOU. In other words, the MOU simply incorporated, and thereby made operative, one part of existing statutory retirement law, which was itself subject to future modification by the Legislature.

[37] 45 Cal. 2d 128, 130 (1955).

[38] Id. at 131.

5. Retiree Health Benefits Are Probably Constitutionally Protected from Impairment under the "Vested Rights" Doctrine.

It appears that, depending upon the nature and terms of the "contract" involved, retiree health benefits, like pension benefits, may become "vested" and constitutionally protected from impairment. Courts have extended the application of the vested rights doctrine to benefits, other than traditional service pensions, that have served as an inducement for continued service and which, at least partially, already have been earned through the performance of service to the employer.[39] For example, in California League of City Employee Ass'n v. Palos Verdes Library District,[40] the court held that employees had a contractual vested right to certain longevity benefits, which were awarded after a designated number of years of service. The court noted that the benefits were (a) important to the employees, (b) had been an inducement to remain employed, and (c) were a form of compensation already (at least partially) earned. The court reasoned that, with regard to employees who already had performed service toward the attainment of these benefits, "it would be grossly unfair to allow [the employer] to eliminate such benefits and reap the rewards of such long-time service without payment of an important element of compensation for such services."[41]

Following the reasoning in California League, Thorning v. Hollister School District,[42] is the first case in California to extend the vested rights doctrine to protect retirement health benefits. In Thorning, the court considered the decision by a school district board to eliminate retirement health benefits provided to retired board members under a declaration of policy previously adopted by the board. In 1988, during the terms of office of the plaintiffs and pursuant to Government Code section 53201, the school district adopted Policy No. 9250(a) as part of the "Bylaws of the Board." Policy No. 9250(a) provided: "Any members retiring from

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[39] Thorning v. Hollister Sch. Dist., 11 Cal. App. 4th 1598 (1992) (retiree health); Cal. League of City Employee Ass'ns v. Palos Verdes Library Dist., 87 Cal. App. 3d 135 (1978) (longevity benefits); Frank v. Board of Administration, 56 Cal. App. 3d 236 (1976) (industrial disability retirement benefits; "No reason exists in plaintiff's case to apply a different rule to disability retirement benefits than to service retirement benefits."); see also Youngman v. Nev. Irrigation Dist., 70 Cal. 2d 240 (1969) (not mentioning vested rights doctrine, but concluding that plaintiffs had stated a claim for a contractual right to salary increase under step classifications); Ivens v. Simon, 212 Cal. App. 2d 177 (1963) (same); cf. San Bernardino Public Employees Assn. v. City of Fontana, 67 Cal. App. 4th 1215, 1223-24 (1998) ("San Bernardino") (terms and conditions of employment set forth exclusively in an MOU of fixed duration cannot "become permanently and irrevocably vested" and may be changed upon expiration of the MOU); Creighton v. Regents of Univ. of Cal., 58 Cal. App. 4th 237, 243-45 (1997), rev. denied, 1998 Cal Lexis 51 (holding that early retirement was a one-time limited incentive for early retirement, accompanied by an express disclaimer, and could be withdrawn before acceptance without violating vested rights); Viehlehr v. State, 104 Cal. App. 3d 392 (1980) (change to statute governing the calculation of interest on withdrawn contributions was related to an employment right, not a retirement benefit or right, and was not protected under the contract clause).

[40] 87 Cal. App. 3d 135 (1978).

[41] Id. at 140.

[42] 11 Cal. App. 4th 1598 (1992) review denied, 1993 Cal. LEXIS 1557 (1993).

the [school district] Board after at least one full term shall have the option to continue the health and welfare benefits program if coverage is in effect at time of retirement, except that Board members who have served less than twelve (12) years, but at least one term shall pay the full cost of health and welfare benefits coverage." In July, 1990, the board revised this policy to provide that "[t]he Board *may* authorize payment of premiums for retired members who have served twelve (12) years or more." On November 27, 1990, the board voted to continue payment of health benefits for the plaintiffs for the next ten years. The plaintiff's terms ended as of December 1, and on December 11, 1990 the new board voted to suspend payment of plaintiffs' health benefits.

The court looked to Policy No. 9250(a) as adopted in 1988 as the governing contract setting forth the plaintiffs' rights to retirement health benefits. It concluded that the July, 1990 change in the Policy -- a change made prior to the plaintiffs' retirement -- could not diminish the benefits already awarded to the plaintiffs during their term of office.[43] Considering the three criteria established by the California League case, the court indicated that the rights set forth under the 1988 Policy were akin to pension benefits and concluded that they vested because they were a part of the compensation promised to the board members and, as such, were important to the board members as an inducement for their continued service on the board and a factor in their ultimate decision to retire. The court further concluded that, because the terms of the policy provided that only individuals with less than 12 years of service were required to contribute to the cost of coverage, the vested contractual right for the plaintiffs (who had more than 12 years of service) included the right to have the employer pay the cost of their coverage.[44]

Arguably, the scope of Thorning is limited given that it involved only *elected officials* of the school district, and not public employees generally. Although the general rule is that current salary benefits for public employees do not vest and may be changed by the employer[45] -- subject of course to collective bargaining restraints, as applicable -- there is an exception for elected or appointed officials. Salaries for elected or appointed officers vest for the term of office, although they may be changed for a new term.[46] Consequently, salaries, as well as deferred compensation, of elected officials may not be decreased during the term of office. In fact, in concluding that the 1990 revision to the Policy was not controlling, the Thorning court relied heavily on vested rights cases dealing with elected officials, citing them for the proposition that

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[43] Id. at 1606.

[44] Thorning, 11 Cal. App. 4th at 1598; accord 83 Op. Cal. Att'y Gen. 14 (2000) (city had vested contractual obligation to provide health benefits to former city council member under resolution adopted pursuant to Government Code section 53201); 67 Op. Cal. Att'y Gen. 510, 513 (1984) (health insurance benefits "conferred for life, in the nature of deferred compensation and as an inducement of continued service, pursuant to an official declaration of policy may not be discontinued").

[45] Butterworth v. Boyd, 12 Cal. 2d 140, 150 (1938).

[46] Olson v. Cory, 27 Cal. 3d 532 (1980).

salary and other elements of compensation conferred during a *term of public office* cannot be diminished during that term.[47]

Notwithstanding the facts and cited authorities in Thorning, Thorning's conclusion that retiree health benefits may vest upon acceptance of employment should be equally applicable to all public employees and retirees. Although the Thorning decision does cite vested rights cases addressing elected officials, these cases actually describe vested rights principles uniformly applicable to the pensions of all public employees. Moreover, Thorning does not expressly rely on plaintiffs' status as elected officials or to any distinction between elected officials and other public employees as a basis for its conclusion that retiree health benefits are a form of compensation that vests. Finally, the Thorning court ultimately analogizes retiree health benefits, not to salary, but to pension benefits which, as already noted, vest upon acceptance of employment for all public employees.[48]

The holding in Thorning also arguably is limited to retirees given the court's reasoning that the health benefits at issue were "of importance to the board members as an inducement for their continued service on the board and *as a factor in their decision to retire.*"[49] The contractual change that the court invalidated, however, was the July 1990 change making retiree health benefits discretionary – which occurred prior to the plaintiffs' retirement.

Thorning's precedential value also might be questioned based on the fact that, roughly six years after Thorning was decided, the California League decision was criticized in San Bernardino Public Employees Assoc. v. Fontana.[50] Like California League, the San Bernardino case dealt with a form of longevity pay, as well as certain leave accruals, but it reached a contrary conclusion. The San Bernardino court criticized California League for determining that benefits acquire the protection of the contract clause whenever those benefits are "important" to employees. The primary basis for the court's decision in San Bernardino, however, was that the vested rights cases were factually distinguishable on the grounds that the longevity benefits before it were not a statutorily based right of retirement, but were terms and conditions of active employment contained in a collective bargaining agreement of fixed duration. Accordingly, the benefits at issue were not "permanently and irrevocably vested" but could be renegotiated when the bargaining agreements expired. Notwithstanding its criticism of California League, I do not believe that San Bernardino alters the fundamental conclusion that retiree health benefits are a form of deferred compensation that may vest upon acceptance of employment.

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[47] Citing to Olson, at 539 ("if salary benefits are diminished by the Legislature during a judge's term . . . the judge is nevertheless entitled to the contracted-for benefits during the remainder of such term.") and to Betts, 21 Cal. 3d at 863 & 866 (elements of compensation conferred during a term of public office become contractually vested).

[48] Allen v. Bd. of Admin., 34 Cal. 3d at 120.

[49] 11 Cal. App. 4th at 1607.

[50] 67 Cal. App. 4th 1215 (1998).

In summary, notwithstanding the foregoing considerations, and although there appears to be only one decision -- which is unpublished -- that cites Thorning with approval,[51] I believe that it would be difficult to argue that retiree health benefits are not elements of deferred compensation that, like pension benefits, may vest upon acceptance of employment.

6. Vested Rights May Not Be Bargained Away

Employer-employee relations between the City and its union-represented employees are governed by the Meyers-Milias-Brown Act ("MMBA").[52] Employee collective bargaining units are authorized to represent their members in all matters relating to employment conditions and employer-employee relations, including wages, hours and other "terms and conditions of employment."[53] Because the phrase "wages, hours and other terms and conditions of employment" in the MMBA tracks the language of the National Labor Relations Act ("NLRA"), California courts and the Public Employee Relations Board (which decides cases under the MMBA) look to National Labor Relations Board ("NLRB") decisions for guidance when applying the MMBA. Under the NLRA, pension and post-retirement health care benefits for current employees are "terms and conditions of employment" about which employers must negotiate and may not unilaterally change.[54] Nevertheless, a collective bargaining unit may not bargain away individual statutory or constitutional rights that "flow from sources outside the collective bargaining agreement itself,"[55] and collective bargaining agreements may not contain

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[51] Mayers v. Orange Unified School District, 2003 Cal. App. Unpub. LEXIS 6346 (June 30, 2003).

As discussed later in this letter, another related case, Sappington v. Orange Unified School District, 119 Cal. App. 4th 949 (Cal. App. 4th Dist. 2004), rev. denied, decertification request denied, 2004 Cal. LEXIS 8870 (Sept. 15, 2004) found it unnecessary to determine whether the retiree health rights at issue were "vested" because the terms of the contract did not support the rights claimed by the plaintiffs. Two other cases that preceded Thorning did not expressly address vested rights, but concluded that the counties involved did not have a mandatory duty to provide certain retiree health benefits under the statute at issue. Ventura County Retired Employees' Ass'n v. County of Ventura, 228 Cal. App. 3d 1594, 1598-59 (1991) review denied, (1991) ("Ventura County"); Orange County Employees' Ass'n v. County of Orange, 234 Cal. App. 3d 833, 843-44 (1991) review denied (1991) ("Orange County").

[52] Gov. Code § 3500 et seq.

[53] Gov. Code § 3504.

[54] Allied Chemical and Alkali Workers of America v. Pittsburg Plate Glass, 404 U.S. 157, 159 (1971). And see, e.g., Betts, 21 Cal. 3d at 863 (a public employee's retirement benefit constitutes an element of compensation).

[55] See San Bernardino Public Employees Ass'n v. City of Fontana, 67 Cal. App. 4th 1215, 1225 (1998); Wright v. City of Santa Clara, 213 Cal. App. 3d 1503, 1506, (1989); Phillips v. State Pers. Bd., 184 Cal. App. 3d 651, 660, (1986) disapproved on other grounds in Coleman v. Dep't of Pers. Admin., 52 Cal. 3d 1102, 1123 n.8 (1991) (holding that a collective bargaining agreement could not waive an employee's right to due process); cf. Soc. Servs. Union v. Bd. of Supervisors, 222 Cal. App. 3d 279, 287 (1990) (because Labor Code expressly authorizes agreements between public employees and their employers for payment of health care costs through payroll deductions, such an agreement is not a waiver of rights under the State's wage exemption statutes).

provisions that abrogate fundamental constitutional rights.[56]. Such constitutional rights include pension rights.[57]

California law is consistent with analogous private sector cases,[58] as well as cases in other states dealing with public employment rights,[59] which have followed the rule that vested contractual rights may not be bargained away without the consent of the employee. For example, the Court of Appeals for the Sixth Circuit stated in Yard-Man that while a union may

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[56] Soc. Servs. Union, 222 Cal. App. 3d at 287; Phillips, 184 Cal. App. 3d at 660 (even though statute permitted the parties to a collective bargaining agreement to supplant existing procedures by which employees are discharged or disciplined, an employee's right to due process cannot be waived in a collective bargaining agreement).

[57] San Bernardino, 67 Cal. App. 4th at 1221. In San Bernardino, a labor union sought to set aside provisions in several memoranda of understanding ("MOUs"); relating to reductions in personal leave accrual and longevity pay benefits. 67 Cal. App. 4th 1215. The court held that the fringe benefits at issue were the negotiable terms and conditions of employment, distinguishing them from vested rights such as pension rights. While the latter are entitled to contract clause protection, the former could not become irrevocably vested because they were a product of collective bargaining, and provided for in collective bargaining agreements of fixed duration, and no outside statutory source gave the employees additional protection or entitlement to future benefits. Id. at 1223-25.

[58] See e.g., United Mine Workers Health & Retirement Funds v. Robinson, 455 U.S. 562, 575 n.14 (1982) ("under established contract principles, vested retirement rights may not be altered without the pensioner's consent"); Allied Chem. & Alkali Workers of Am. v. Pittsburgh Plate Glass Co., 404 U.S. 157, 182 n.20 (1971) (same); Weimer v. Kurz-Kasch, Inc., 773 F.2d 669 (6th Cir. 1985) (same); Williams v. WCI Steel Co., 170 F.3d 598, 605-06 (6th Cir. 1999) (language of prior agreements gave employees and retirees a vested contractual right to trust residue that could not be the subject of future collective bargaining); Bokunewicz v. Purolator Products, Inc., 907 F.2d 1396, 1401-02 (3rd Cir. 1990) (disabled employees' rights to disability pension was vested at time of closure agreement and, thus, union and employer were without power to negotiate those benefits away); UAW v. Yard-Man, Inc., 716 F.2d 1476 (6th Cir. 1983) (finding that retirees became vested in certain benefits upon retirement); Hurd v. Hutnik, 419 F. Supp. 630 (D.N.J. 1976) (where employer previously entered into a multi-employer pension plan, it may not enter into a new agreement with the union extinguishing the pension fund by eliminating further contributions to it without making provision for the financial protection of retired employees currently receiving pension benefits from the fund, due to vesting of the pensioners' right to lifetime benefits under state law); Hauser v. Farwell, Ozmun, Kirk & Co., 299 F. Supp. 387 (D. Minn. 1969) ("whereas a union may bargain as to prospective matters such as seniority rights, future conditions of employment, etc., it cannot bargain away the accrued or vested rights of its members" without their consent).

While the pension or other retiree rights in many of these federal cases became vested upon retirement, the reasoning therein would be applicable to the vested rights of active employees as well; the key being that the rights in question were vested, not how or to whom they became vested.

[59] See, e.g., Welter v. City of Milwaukee, 571 N.W.2d 459, 464 (Wis. Ct. App. 1997) rev. denied, 217 Wis. 2d 519 (1998) ("The City's argument that the officers should be deemed to have consented to the modification of their vested retirement-system rights because the concessions were agreed to by their unions ignores that a union may not bargain away the vested rights of its members without the express consent of those members."); In re Morris Sch. Dist. Bd. of Educ., 718 A.2d 762 (1998) cert. denied, 156 N.J. 407 (1998) (noting that "[i]n a variety of factual settings, courts have held that a union has no authority on behalf of its membership to bargain away various forms of deferred compensation earned during the terms of prior collective bargaining agreements absent knowing consent by those who would be adversely affected").

choose to forego certain benefits in future negotiations in favor of more immediate compensation, "it may not...bargain away retiree benefits which have already vested in particular individuals."[60] Such rights, the court stated, are interminable once vested.[61]

7. Reasonable Modification Doctrine: Benefits May Be Modified Before Retirement If Comparable Offsetting Advantages Provided

Any statutory benefit is subject to the implied qualification that the governing body may make modifications and changes to the statute.[62] The employee does not have an absolute right to any "fixed or definite benefits, but only to a substantial or reasonable pension."[63] Thus, "vested contractual pension rights *may be modified prior to retirement* for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system."[64] Nonetheless, "[such] modifications must be reasonable," and to be sustained as such, a modification must satisfy a two-pronged test: first, any resulting disadvantage to a member must be accompanied by comparable, offsetting advantages; and second, the modification of the member's pension rights "must bear some material relation to the theory of a pension system and its successful operation . . . ."[65] The City has not asked that we consider any specific proposed "comparable advantages" under this "reasonable modification" doctrine.

8. The Scope of the Vested Right Is Limited By the Terms of the Relevant Contract.

As already noted above, the rights of City employees and retirees to retiree health benefits under the terms of the applicable contract most likely became constitutionally "vested" – i.e., protected from impairment – upon their acceptance of employment with the City. This does

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[60] 716 F.2d at 1482 n.8.

[61] Id.

[62] Kern, 29 Cal. 2d at 855.

[63] Id.

[64] Int'l Ass'n of Firefighters v. City of San Diego, 34 Cal. 3d 292, 300-01 (1983) (internal citations omitted). Courts have concluded that retirees, unlike active employees, are not subject to the reasonable modification doctrine. Terry v. City of Berkeley, 41 Cal. 2d 698, 702-03 (1953); Claypool v. Wilson, 4 Cal. App. 4th 646, 664 (1992).

In addition, under limited circumstances not relevant here, impairment of a contractual obligation may be justified. See Olson v. Cory, 27 Cal. 3d 532, 539 (1980) (four factors warranting legislative impairment of vested rights: : (1) the enactment serves to protect basic interests of society, (2) there is an emergency justification for the enactment, (3) the enactment is appropriate for the emergency, and (4) the enactment is designed as a temporary measure, during which time the vested contract rights are not lost but merely deferred for a brief period, interest running during the temporary deferment).

[65] Id.

not necessarily mean, however, that the City is without any discretion to make changes. In accordance with the legal considerations discussed below, the City's ability to modify its retiree health program will depend upon the terms of the governing contract.[66]

(a) Documents that Constitute the "Contract"

For a right to vest, it must be created under a valid contract; "the contract clause does not protect expectations based upon legal theories other than contract."[67] This "contract" between the employer and employee generally consists of the statute, ordinance or other official action of the governing body of the employer that sets forth the terms of the benefit the employer agrees to provide.[68] Although we have not found any case that squarely addresses the issue, it also appears that the "contract" may include an MOA under which the members are third-party beneficiaries, and that the rights set forth in the MOA may also be constitutionally protected, at least for the duration of the MOA.[69]

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[66] Int'l Ass'n of Firefighters v. City of San Diego, 34 Cal. 3d 292 (1983), 302; Kern, 29 Cal. 2d at 850 (the nature and extent of employer's obligation must be ascertained from the language of the pension provisions and judicial construction of those provisions or similar provisions at the time the contractual relationship was established); Lyon v. Flourney, 271 Cal. App. 2d 774, 783 (1969) ("it is necessary to perceive the terms of the contract and to utilize those terms to measure the claimed impairment"); see also Thorning, 11 Cal. App. 4th at 1607-08 (looking to the terms of the board's declaration of policy to determine whether the vested contractual right included the right to have the employer pay for the cost of coverage). This is consistent with the approach taken by courts determining whether amendments may be made to retiree welfare benefit plans sponsored by private employers under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). See Cinelli v. Sec. Pac. Corp., 61 F.3d 1437, 1441 (9th Cir. 1995) ("[a]n employer may amend or terminate [retiree life insurance] benefits pursuant to the terms of the plan at any time"); Stearns, 297 F.3d at 711-12 (well settled that an unambiguous reservation-of-rights provision is sufficient without more to defeat a claim that retirement welfare benefits are vested); Gable v. Sweetheart Cup Co., 35 F.3d 851, 856 (4th Cir. 1994) (plan document did not contain a promise to vest retiree medical benefits; employer expressly reserved the right to modify or terminate the participant's benefits); Sprague v. Gen. Motors Corp., 133 F.3d 388, 401 (6th Cir. 1998) (en banc) (plaintiffs' retiree medical benefits were not vested; plan stated that the terms of the plan were subject to change); Frahm v. Equitable Life Assurance Soc'y, 137 F.3d 955, 960 (7th Cir. 1998) (written terms of the retiree medical plan are the effective terms).

[67] Walsh v. Bd. of Admin., 4 Cal. App. 4th 682, 696-97 (1992).

[68] See, e.g., Int'l Ass'n of Firefighters, 34 Cal. 3d at 302 (looking to city charter and ordinance); Ventura County, 228 Cal. App. 3d at 1598-99 (looking to the Government Code to determine employer's obligations); Orange County, 234 Cal. App. 3d at 843-44 (same); Thorning, 11 Cal. App. 4th at 1607-08 (looking to official declaration of policy issued pursuant to Government Code); 83 Op. Cal. Att'y Gen. 14 (2000) (benefits provided pursuant to city resolution adopted under Government Code).

[69] Compare California Assoc. of Prof. Scientists ("CAPS") v. Schwarzenegger, 137 Cal. App. 4th 371 (2006); San Bernardino, 67 Cal. App. 4th 1215 (1998); Mayers, 2003 Cal. App. Unpub. LEXIS 6346 (considering as part of the "amorphous" implied-in-fact contract collective bargaining agreements and MOUs).

The CAPS case noted that none of the vested rights authorities it cited addressed a situation involving collective bargaining agreements, but stated that if a collective bargaining agreement purports to secure rights even for *future* employees, it may well be that the those *future* employees have contract clause protection. It found it

Other than one unpublished case which suggests that informal communications (as well as course of conduct) might constitute part of an amorphous, implied-in-fact contract,[70] we have not found any California cases in which participants argued or courts held that a *vested right* was created by a statement in an employee communication. Generally, the cases that address employee communications analyze the promises or misstatements under an estoppel theory.[71] This may be explained, in part, by the relatively informal process to which internal employee communications are subject when compared to the official, legislative process involved when a public entity adopts an ordinance, resolution or statute.[72]

In this case, the "contract" between the City and its employees probably consists of the Municipal Code sections which establish the Federated and P&F Retiree Health Plans and, as discussed in section III.B.1 below, arguably includes at least some of the overarching provisions of the Charter as well. Although the MOAs between the City and the relevant collective bargaining units arguably might be considered part of this "contract," the language of the MOAs contains virtually no substantive terms and merely references the relevant statutory provisions. Additionally, for purposes of this advice letter, discussion of employee communication materials generally will be addressed in the context of a potential claim under promissory estoppel or

(continued...)

unnecessary to decide the issue because the contract at issue did not promise to leave the pension rights of future employees unchanged.

The San Bernardino court was addressing in-service, longevity benefits that were established by MOU and distinguished them from statutorily-based retirement benefits. It concluded that, at least for active employees, benefits set forth exclusively in an MOU of fixed duration cannot "become permanently and irrevocably vested" and may be changed upon expiration of the MOU. The employees in that case had no legitimate expectation that the benefits would continue unless they were renegotiated.

[70] Mayers, 2003 Cal. App. Unpub. LEXIS 6346. In addition, California courts have found the existence of implied or unilateral contracts on the basis of informal employment documents in cases that did not involve employee benefits. See, e.g., Hepp v. Lockheed-California Co., 86 Cal. App. 3d 714, 719 (1978) (triable issue of fact whether company's rules and policies regulating rehiring of employees laid off for lack of work were intended as a positive inducement for employees to take and continue employment); Scott v. Pacific Gas and Electric Co., 11 Cal. 4th 454, 465 (1995) (discipline guidelines in policy manual created implied contract not to demote employee without good cause).

[71] See Int'l Ass'n of Firefighters, 34 Cal. 3d 292 (analyzing summary plan description under estoppel rather than vested rights analysis); Crumpler v. Bd. of Admin., 32 Cal. App. 3d 567 (1973) (employer estopped from retroactively reclassifying misclassified employees, but such employees had no vested right in an erroneous classification).

[72] See Int'l Ass'n of Firefighters, 34 Cal. 3d at 306 (Kaus, J., concurring) ("without some substantial showing of actual harm, it would be ludicrous if carefully crafted pension legislation could be effectively amended by a bureaucrat's somewhat inept attempt at summarization"). See also Wallace v. State Personnel Bd., 168 Cal. App. 2d 543, 546-47 (1959) (court refused to give effect to narrow interpretation in the Personnel Transaction Manual of the evidence required to prove the necessity for sick leave under the Government Code; the relevant section of the manual was never adopted as a rule by the Personnel Board and hence can be considered as nothing more than an administrative directive for the guidance of department heads).

equitable estoppel. They also are referenced briefly in the discussion of the retiree health "contract" where relevant to show extrinsic evidence of the City's intent with regard to the terms of that contract.

(b) Contract Terms and Reasonable Expectations Generally

Whether a proposed change impairs a vested right will depend upon how the member's rights are defined under the terms of the governing contract.[73] In other words, the nature and extent of the City's obligation must be ascertained from the language of the governing provisions—i.e., the City Charter and the Municipal Code[74]—and judicial construction of those provisions or similar provisions at the time the contractual relationship was established.[75] "[I]t is necessary to perceive the terms of the contract and to utilize those terms to measure the claimed impairment."[76] It is the reasonable expectations of the employee that are protected.[77]

When construing the scope of the governing statutes, the primary task is to ascertain the Legislature's intent.[78] If the language is clear and unambiguous, there is no need for construction or resort to other evidence of Legislative intent.[79] On the other hand, if a statute is ambiguous, courts typically will consider evidence of intent beyond the language and examine the history and background of the statute in an attempt to ascertain the most reasonable interpretation.[80] Moreover, even where the language is clear, courts still may analyze whether the literal meaning of a statute comports with its purpose.[81] "The intent prevails over the letter, and the letter will, if possible, be read as to conform to the spirit of the act."[82] Examples of cognizable legislative history include different versions of the bill, analysis by legislative party

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[73] Int'l Ass'n of Firefighters v. City of San Diego, 34 Cal. 3d 292, 302 (1981); Kern, 29 Cal. 2d at 850.

[74] See., e.g., Int'l Ass'n of Firefighters, 34 Cal. 3d at 302 (looking to city charter and ordinance); Ventura County, 228 Cal. App. 3d 1594 at 1598-99 (looking to the Government Code to determine employer's obligations); Orange County, 234 Cal. App. 3d at 843-44 (same); Thorning, 11 Cal. App. 4th at 1607-08 (looking to official declaration of policy issued pursuant to Government Code); 2000 Cal. AG Lexis 3 (January 28, 2000) (benefits provided pursuant to city resolution adopted under Government Code).

[75] Kern, 29 Cal. 2d at 850.

[76] Lyon v. Flournoy, 271 Cal. App. 2d 774, 783 (1969), appeal dismissed, 396 U.S. 274 (1970).

[77] Allen v. Bd. of Admin., 34 Cal. 3d at 120; Ass'n of Blue Collar Workers v. Wills, 187 Cal. App. 3d 780 (1986) (right vested was "reasonable expectation" that city would meet its statutory obligation to fund past-service liability).

[78] Brown v. Kelly, 48 Cal. 3d 711, 724 (1989).

[79] Lundgren v. Deukmejian, 45 Cal. 3d 727, 735 (1988).

[80] Watts v. Crawford, 10 Cal. 4th 743, 751 (1995).

[81] Lundgren, 45 Cal. 3d at 735.

[82] Id.

caucuses, analysis of the Legislative Analyst, analysis prepared for and by various legislative committees, and the Legislative Counsel's Digest.[83] Statements reflecting the subjective opinions of interested parties or individual Legislators which are not shared or made known to the Legislature as a whole are disregarded.[84]

Although any ambiguity or uncertainty in retirement legislation must be resolved in favor of the petitioner, the construction must be consistent with the clear language and purposes of the statute.[85] This rule of liberal construction is "applied for the purpose of effectuating the obvious legislative intent and should not blindly be followed so as to eradicate the clear language and purpose of the statute and allow eligibility for those for whom it was obviously not intended."[86]

A number of cases in the retiree health context similarly illustrate how carefully the terms of the relevant "contract" must be parsed. Two recent cases involving the Orange Unified School district have similarly concluded that the contract at issue did not guarantee the plaintiff retirees 100% employer-paid coverage. In 1976, the Orange Unified School District's governing board adopted Policy 4244.2, which provided: "The district shall underwrite the cost of the district's Medical Hospital Insurance Program for all employees who retire from the district provided they have been employed in the district for the equivalent of ten (10) years or longer." Based on the facts outlined in both cases it appears that district had the following history with regard to changing health benefits: Between 1977 and 1997, the district offered retirees 100% district-paid coverage under an "ever-changing combination of HMOs, indemnity plans, and PPOs" (although, in 1992, the school district ended eligibility for post-retirement health benefits for new hires). In 1994, the school district stopped fully subsidizing the premiums for coverage of active employees and active classified employees were required to pay part of the premium to enroll in the more expensive PPO plan. Sometime in the late 1990's, the district also began imposing a charge on retirees (a so-called "buy-up") for the PPO plan. The district continued to offer a 100% district-paid HMO option.

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[83] See, e.g., Dubois v. Workers' Compensation Appeals Board, 5 Cal. 4th 382, 393 (1993)(legislative committee reports); Hogoboom v. Superior Court, 51 Cal. App. 4th 653, 670 (2d App. Dist. 1996)(Legislative Counsel's Digest and committee reports); Regents of the University of California v. Superior Court, 225 Cal. App. 3d 972 (2d App. Dist. 1990) (reviewing committee analysis which included committee staff analyses, summary prepared for a committee hearing, Legislative Analyst's analysis and analysis of the Senate Democratic Caucus); Kaufman & Broad Communities, Inc. v. Performance Plastering, Inc., 133 Cal. App. 4th 26 (3rd App. Dist. 2005), rev. denied 2006 Cal LEXIS 5193 (April 26, 2006) (listing documents constituting cognizable and inadmissible legislative history and various citations largely from the Third Appellate District supporting those lists; cognizable legislative history includes, for example, different versions of the bill, reports of the legislative analyst, committee reports and analysis, Legislative Counsel's Digest, party caucus analysis, statements of sponsors communicated to the Legislature as a whole, enrolled bill reports).

[84] See, e.g., Quintano v. Mercury Casualty Co., 11 Cal. 4th 1049 (1995); Kaufman, 133 Cal. App. 4th at 37.

[85] Ventura County Deputy Sheriff's Ass'n v. Board of Retirement, 16 Cal. 4th 483, 490 (1997).

[86] Barrett v. Stanislaus County Employees Retirement Ass'n, 189 Cal. App. 3d 1593, 1608-09 (1987).

In Sappington, the "buy-up" charge for the PPO option was challenged by a class of retirees who had been administrative employees prior to their retirement. The Sappington court agreed with the trial court that the 1976 board policy did not create a vested right to free PPO coverage. Rather, the court held that all the district promised retirees was to provide a medical insurance program in which they could enroll, and to subsidize their costs for enrolling in one of the plans offered. The court looked to the Webster's dictionary definition of "underwrite" and concluded that the statement in the board policy that the district will "underwrite the cost" of the district's health program for eligible retirees did not constitute a promise to pay the *entire* cost for enrolling in a district health plan. In addition, the reference to the district's "Medical and Hospital Insurance Program" was a "generic" term that failed to specify the type of health benefit plan or level of benefits promised. The court concluded that "the language is so broad it appears to obligate the district only to provide *a program* – there is no requirement that the program include any particular kind of insurance."

Finally, the court dismissed the plaintiff's claim that the District's practice of providing a choice between free HMO or PPO coverage for 20 years, which the plaintiffs accepted, was evidence that the parties had interpreted the District's policy to *require* free PPO coverage. The court noted that this position was unsupported by the language of the policy and that the plaintiffs failed to cite any evidence that they, as a group, had a reasonable expectation that they would always receive free PPO coverage. "Generous benefits that exceed what is promised in a contract are just that: generous. They reflect a magnanimous spirit, not a contractual mandate."[87] The Court of Appeal did not reach the issue of whether the District was obligated by the board policy to provide at least one fully-paid health plan for retirees, as was implicitly found by the trial court, because it was not at issue on appeal.

In Mayers, an unpublished opinion, the former president of the classified employees' union brought a class action challenging the imposition of premium sharing for the PPO option on retirees and seeking declaratory and injunctive relief. In that case, the trial court and Court of Appeal reviewed a number of documents, including the 1976 board policy, a series of collective bargaining agreements between the District and the classified employees, memoranda of understanding and various letters to individual retirees to determine whether the retirees were entitled to free health care during retirement.

The trial court noted that no single document could be called a contract between the parties, noting that the board policy was a "policy" rather than a contract, and the collective bargaining agreements each had language that only obligated the District to pay retiree health benefits for the duration of the contract, and questioning whether the letters had been written by someone with authority to bind the District. The trial court determined that, pursuant to the terms of this amorphous "contract," the District should be enjoined from treating the classified retirees different from active employees regarding the selection of and participation in the medical plans offered by the District. The effect of the trial court's ruling was that, since the

[87] Sappington v. Orange Unified School Dist., 119 Cal. App. 4th at 955.

District was requiring active employees to pay a portion of the premium for PPO coverage, it could also require retirees to pay a portion of the premium for such coverage.

The Court of Appeal affirmed the trial court's conclusion that Orange Unified School District retirees who had been classified employees with the District were only entitled to the same health benefits as provided active classified employees, and that there was no continuing duty for the District to provide these retirees with a free-enrollment PPO plan if the District did not do the same for its active classified employees. The appellate court concluded that school District employees did not have a statutorily based vested right to retirement health benefits. The court cited section 7002.5(a) of the Education Code and the opinions in Ventura County and Orange County which, as discussed below, concluded that section 53205.2 of the Government Code does not mandate the provision of health plans for retirees that are equal to those given to active employees. The Mayer court also characterized the retirees' rights as having emanated from an "implied-in-fact contract based on the long-term conduct of the parties" and concluded that the retirees did not carry their burden of proving that there was no substantial evidence supporting the trial court's interpretation of this "contract." The appellate court agreed with the trial court's conclusion that the statement in the board rules that the District "shall underwrite the cost of the District's Medical and Hospital Insurance Program" for all employees who retire from the District with 10 years or more of service did not obligate the District to underwrite the "entire cost" of the health insurance coverage. Finally, the Mayer court would not be baited into answering the question that was at the heart of the appeal: Whether the District could eliminate all health coverage for retirees if it eliminated the coverage for the active employees.

(c) Reserved Discretion to Make Changes

If, under the terms of the contract, the employer or other entity charged with implementing the benefits program has discretionary authority to alter the benefit, action taken consistent with such reserved discretion is not an action that impairs vested rights.[88] The fact that retirement benefits are subject to modification under certain enumerated circumstances,

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[88] Int'l Ass'n of Firefighters, 34 Cal. 3d at 302; Walsh, 4 Cal. App. 4th at 700; Pasadena Police Officers' Ass'n v. City of Pasadena, 147 Cal. App. 3d 695 (1983); and see San Bernardino, 67 Cal. App. 4th ay 1223-25 (benefits could not have become permanently and irrevocably vested as a matter of contract law, because the benefits were earned on a year-to-year basis under an MOU of limited duration that expired under its own terms; employees had no legitimate expectation that the benefits would continue unless renegotiated); Creighton v. Regents of the Univ. of Cal., 58 Cal. App. 4th 237, 245 (1997), rev. denied, 1998 Cal. LEXIS 51 (one-time offer of special incentives for early retirement, accompanied by an express disclaimer that vested rights were created, is not governed by vested rights doctrine); Ventura County, 228 Cal. App. 3d at 1598-99; Orange County, 234 Cal. App. 3d at 843-44; 80 Op. Cal. Att'y Gen. 119 (1997) (noting that benefits granted pursuant to Government Code sections 53200-53210 might be adjusted upward or downward during a term of office depending on the conditions established by the city council in providing for such benefits).

however, does not mean that the benefits are not constitutionally "vested" and protected from impairment absent those circumstances.[89]

Only a handful of cases addressing employer discretion, however, deal with express reservations of right to amend benefits. For example, in Legislature v. Eu, the Court struck down an initiative provision which would have terminated the Legislators' Retirement Law (LRL) for certain legislators. The Legislature had reserved its right to limit retirement benefits for legislators through the *legislative* process. But the Court concluded that the reserved right of the Legislature to make changes to the LRL did not mean the rights under the LRL were inchoate and unprotected from impairment by the *initiative* process. In other words, the mere existence of the limited reservation of right did not preclude the benefits from being constitutionally vested absent the exercise of that reserved right.[90]

On the other hand, in Walsh v. Board of Administration, the court looked to the same reservation of right and affirmed judgment against a state senator who challenged the *legislative* repeal of an early retirement provision in the LRL. The court noted that, throughout Walsh's service, the Constitution contained an express reservation of the power of the Legislature to limit the retirement benefits of legislators before their retirement.[91] Specifically, it provided: "The Legislature may, prior to their retirement, limit the retirement benefits payable to members of the Legislature who serve during or after the term commencing in 1967."[92] The court noted that Walsh's benefits had not been abrogated or eliminated, and concluded that the denial of early retirement benefits was within the Legislature's reserved power to "limit" benefits.[93] The court distinguished the Eu case, noting that the Eu decision was based on the fact that the right to limit benefits was reserved to the Legislature, and not to the people through the initiative process.[94]

Some courts have considered employer discretion which, although not expressly stated in the form of a reservation of right to amend, is implicit in the terms of the contract.

First, several cases involving health benefits have concluded that the governing statute did not mandate the provision of benefits, but instead made their availability subject to the discretion of the employer.[95] In Ventura County Retired Employees' Ass'n v. County of Ventura, the court addressed a claim that Government Code section 53205.2 required the county to

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[89] Legislature v. Eu, 54 Cal. 3d 492, 529 (1991).

[90] Id.

[91] 4 Cal. App. 4th at 700.

[92] Id. at 700-01.

[93] Id. at 701-02.

[94] Id. at 704.

[95] See Ventura County, 228 Cal. App. 3d at 1598-9; Orange County, 234 Cal. App. 3d at 843-44.

provide health care benefits to retirees that were equal to those provided to active employees. This section provided that the county "shall give preference to such health benefit plans as do not terminate upon retirement of the employees affected, and which provide the same benefits for retired persons as for active personnel at no increase in costs to the retired person . . . ." The court concluded that, under this section and sections 53202 and 53202.1, the county's decision to furnish health care benefits to retirees was purely discretionary.[96] Moreover, the court determined that the county was not obligated to subsidize the premium costs for any retiree health benefits it did offer given that Government Code section 53205 provided that the county "may authorize payment of all, or such portion as it may elect, of the premiums . . . for health and welfare benefits of . . . employees [and] retirees."[97] In other words, under the Government Code provisions on which they were relying, the retirees did not have a right -- contractual or otherwise -- to health benefits and premiums equal to those offered to active employees.

Addressing the same Government Code provisions, and following the analysis of the Ventura County court, the court in Orange County Employees' Ass'n v. County of Orange, noted that the use of the word "preference" in the statute implies the exercise of judgment and stated that if the Legislature had intended the county to select or approve a particular kind of plan, it could have done so.[98] The court concluded that the statute imposed a mandatory duty to exercise discretion in implementing the provisions of the statute, not a duty to select a cost-equalizing plan.[99]

Similarly, in International Association of Firefighters v. the City of San Diego, the California Supreme Court concluded that, in an actuarially based retirement system, members' contribution rates can be adjusted in accordance with revised actuarial assumptions and factors

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[96] 228 Cal. App. 3d at 1598-99. Government Code section 53202 permits a local agency to contract with one or more admitted insurers or health maintenance organizations, as the local agency determines to be in the best interest of itself, its officers and its employees electing to accept the benefits.

[97] Id. at 1599.

[98] Orange County, 234 Cal. App-3d at 842.

[99] Id. at 843.

At first blush, the Ventura County and Orange County cases appear to be in direct conflict with the Thorning decision because they all involve health benefit plans offered pursuant to the same provisions of the Government Code, but reach different conclusions. The Thorning court, however, looked beyond the authorizing statute to the official policy issued by the employer pursuant to that statute to conclude that the employer had committed to provide retiree health benefits. In contrast, in both Ventura County and Orange County, the court did not address, and there did not appear to be at issue, any "contract" other than the Government Code that governed the permissible conduct of the counties. Rather, the issue was whether the statute itself imposed a duty which could be compelled by mandamus. See 76 Op. Cal. Att'y Gen. 119 (May 5, 1993) (noting that its opinion at 67 Op. Cal. Att'y Gen. 510 involved a discussion of vesting where there is an official declaration of policy and indicating through a "but see" cite that the Ventura County and Orange County cases contained a different analysis); cf. 80 Op. Cal. Att'y Gen. 119 (noting that section 53200-53210 do not expressly authorize or prohibit decreases in health and welfare benefits).

that are intrinsic to the system, even though the change incidentally shifted the relative contribution rates of employer and employee.[100] In that case, the governing terms of the system as set forth in the City charter and ordinances provided that the normal rates of contribution shall be such as to provide a specified annuity at retirement according to the tables adopted by the Board of Administration. The plan provisions further provided that the Board "shall adopt such mortality, service and other tables and interest as it deems necessary and make such revisions in rates of contribution of members as it deems necessary to provide the benefits for which the rates for normal contributions are required to be calculated." The court concluded that there was no express provision freezing the rate of employee contributions.[101] In fact, "[r]ather than being foreign to the City's retirement system, modification of the contribution rates of both employees and City is intrinsic to the ordinances basing those rates on actuarial factors which can be revised."[102] Accordingly, the Court concluded that the revision in contributions was made pursuant to, and not in derogation of, the governing charter and ordinances.[103] "Change in contribution is implicit in the operation of City's system and is expressly authorized by that system and no vested right is impaired by effecting such change."[104]

Alternatively, an employer can expressly forgo its right to change a contribution amount. The court in Teachers' Retirement Board v. Genest concluded that the members of the California State Teachers' Retirement System had a vested enforceable right to state contributions to a supplemental account of 2.5% of creditable compensation required by Assembly Bill 1102.[105] The Department of Finance ("DOF") attempted to argue that it was not required to make the contributions if the system was actuarially sound. The DOF argued that, because the statute required that the State make the contributions "for the purposes of making the supplemental payments under Section 24415," then it did not need to contribute funds unless the system would be unable to make the supplemental payments.[106] In rejecting the DOF's argument, the court noted that former Government Code section 22954 expressly reserved the Legislature's right to reduce state contributions to the supplemental account. However, AB 1102 repealed this section and added a section which expressly stated that it was "the intent of the Legislature in enacting this section to establish the supplemental payments pursuant to Section 24415 as vested

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[100] Int'l Ass'n of Firefighters, 34 Cal. 3d at 300, 302-03.

[101] 34 Cal. 3d at 303.

[102] Id. at 300.

[103] Id. at 302.

[104] Id. at 303.

[105] 154 Cal. App. 4th 1012 (2007).

[106] Id. at 1029.

benefits."[107] The court noted that the Legislature would not have repealed the language reserving its rights to reduce its contributions if it intended to continue to reserve the right.[108]

(d) Full or Substantial Performance

Even where the employer has reserved discretion to make changes to a plan, however, the employer still may be precluded from changing the benefits of employees who have completed performance under the terms of the contract. For example, in Creighton v. Regents of the University of California (the "Regents"),[109] the court considered an early retirement window program that provided for the crediting of additional age and service credit. The Regents originally authorized the program on May 21, 1993 for individuals who elected, during a window between July 1 and October 1, 1993, to retire on November 1, 1993. As originally authorized, it granted an additional 5 years of service credit upon early retirement. On July 16, 1993, however, the Regents revised the program to provide for only 3 years of service credit. The plaintiffs elected to participate after July 16, 1993 and retired on November 1, 2003. Plaintiffs then claimed that reducing the years of service credit granted from 5 to 3 impaired their vested contract rights.

The court first noted that the early retirement benefit was different in kind from the normal pension benefit because it was a one-time, limited offer to induce foreshortened service, not continued service.[110] More importantly, the governing document contained an express disclaimer providing that the crediting of additional age and service credit and the payments associated therewith "shall not be a vested or accrued Plan benefit."[111] Thus, the court concluded that this was not the type of benefit which vested immediately. Nevertheless, the court concluded that upon an eligible employee's formal acceptance of the program and subsequent retirement – i.e., upon full performance – the contract terms would vest.[112] In this case, the change was permissible because it was made before the contract rights vested.

Some cases outside the context of the constitutionally based "vested rights doctrine" similarly suggest that an employer may not be able to modify benefits to the extent the employee already has satisfied (or "substantially" satisfied) the conditions for receiving those benefits. Although this issue has not been analyzed in the area of retiree health, there are several analogous cases addressing accrued vacations and severance pay. For example, in Kistler v. Redwoods Community College Dist., school administrators whose contracts were expiring were

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[107] Id. at 1030.

[108] Id. at 1031.

[109] 58 Cal. App. 4th 237.

[110] Id. at 243-44.

[111] Id. at 244.

[112] Id. at 245.

informed that their administrative contracts would not be renewed, but they would be assigned to faculty positions instead.[113] The plaintiffs had accrued large amounts of vacation pay as administrators, but would not be permitted to use or accrue vacation pay when they were teachers. They were directed to use up their accrued vacation pay by taking time off with pay prior to leaving their administrative positions. The court held that the defendant could not force them to do this. The court stated that this was necessary to "recognize the vested, accrued nature of vacation pay as wages, earned and payable, but receipt of which is delayed."[114]

In the seminal case of Suastez v. Plastic Dress-Up Co.,[115] the California Supreme Court noted that "'there is an "increasingly complex use of compensation in the form of 'fringe benefits,' some types of which inherently are not payable until a time subsequent to the work which earned the benefits . . . " [citation]'." Finding that an employee "has earned some vacation rights 'as soon as he has performed substantial services for his employer'," the court held that the right to a paid vacation, when offered in an employer's policy or contract of employment, constitutes deferred wages for services rendered and a proportionate right to a paid vacation "vests" as the employee's labor is rendered.[116] The court further noted that, "Courts have allowed recovery for vacation despite the fact that contract eligibility requirements were not met, if the employee had *substantially performed*."[117]

The substantial performance doctrine recently was utilized by a federal court when deciding that an employer could not change the terms of a severance pay plan on the eve of a layoff because the right to severance benefits vests upon the employee's 'substantial performance' of the employment contract, which may occur well before termination."[118] The court noted that "employment benefit plans are unilateral contractual offers by the employer which an employee accepts by 'substantially performing' his or her employment."[119] Thus, "[w]here an employee has substantially performed, and a unilateral contract for employment

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[113] 15 Cal. App. 4th 1326 (1993).

[114] Id. at 1333.

[115] 31 Cal.3d 774, 780 (1982).

[116] Id.

[117] Id. at 783 (emphasis added)

In fact, a variation of this "substantial performance" doctrine was relied upon in the development of the modern, constitutionally-based vested rights doctrine that is the main focus of this memorandum. See Kern v. City of Long Beach, 29 Cal.2d 848, 855 (1947) ("It is true that an employee does not earn the right to a full pension until he has completed the proscribed period of service, but he actually has earned some pension rights *as soon as he has performed substantial services* for his employer.") (Emphasis added).

[118] In Re Global, Inc., No. 01-039-LPS, 2007 WL 4403146, at *11 (D. Del. December 12, 2007) (applying Wisconsin law).

[119] Id.

benefits has thereby been formed, the employee's right to the offered employment benefits has vested. Once the benefits have vested, the employer may not unilaterally change the terms of the employment benefit."

These cases may be cited for the proposition that an employee benefit (such as health insurance during retirement) is fully earned when the employee has done all he/she had to do to earn the benefit – that is, work for the required number of years, until the required age, and retire. They also might be cited for the more nebulous proposition that an employee benefit is likewise fully earned when the employee has done "substantially" all he or she had to do to earn the benefit. Thus, it might be argued that once an employee has fully (or substantially) performed under the contract – i.e., once the benefit has been fully earned – the benefit cannot be modified or eliminated even if the employer has reserved the right to do so.

B. Analysis of the City's "Contract" With Its Employees, Former Employees and Retirees

As indicated above, the "contract" between the City and its employees probably consists of the Municipal Code sections which establish the Federated and P&F Retiree Health Plans and, as discussed in section III.B.1 below, arguably includes at least some of the overarching provisions of the Charter as well. The terms of this "contract" govern the scope of the vested rights of the City's employees, Deferred Vested Members and retirees.

1. The City Arguably Has Reserved the Right to Modify Retiree Health Benefits Prior to Retirement and, Thus, Is Not Impairing Vested Contractual Rights By Making Any of the Proposed Changes.

(a) Principles of Construction

The city charter is the supreme law of the city and supersedes all inconsistent municipal ordinances, rules or regulations.[120] The same rules of statutory interpretation that apply to statutory provisions also apply to local charter provisions.[121] While the interpretation of statutes by the administrative body charged with enforcing them is entitled to great deference, it is only one factor among many that a court takes into consideration when determining a statute's meaning.[122] The language of the statute itself is the first interpretative tool courts will use because it is the best indicator of legislative intent.[123] Only if the language is ambiguous will courts turn to extrinsic aids such as administrative construction to aid in interpretation.[124]

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[120] Stuart v. Civil Service Comm'n, 174 Cal.App.3d 201, 207 (1985).

[121] Giles v. Horn, 100 Cal. App. 4th 206, 221 (2002).

[122] Yamaha Corp. of America v. State Bd. of Equalization, 19 Cal. 4th 1, 12 (1998).

[123] Hoechst Celanese Corp. v. Franchise Tax Bd., 25 Cal. 4th 508, 519 (2001).

[124] Id.

When a statute is ambiguous, "[c]onsistent administrative construction of a statute over many years, particularly when it originated with those charged with putting the statutory machinery into effect, is entitled to great weight."[125] When there has been no consistent administrative construction of a statute over many years, such deference is not required.[126] Additionally, an administrative body may adopt a new interpretation of a statute and reject the old interpretation.[127] Courts also will interpret charter provisions "with reference to the entire scheme of law of which it is part so that the whole may be harmonized and retain effectiveness."[128] In doing so, courts must avoid an interpretation of a statute that renders part of the statute meaningless or inoperative.[129]

Although any ambiguity or uncertainty in retirement legislation must be resolved in favor of the petitioner, the construction must be consistent with the clear language and purposes of the statute.[130] This rule of liberal construction is "applied for the purpose of effectuating the obvious legislative intent and should not blindly be followed so as to eradicate the clear language and purpose of the statute and allow eligibility for those for whom it was obviously not intended."[131]

(b) Analysis of City Charter

As noted above, Sections 1500 and 1503 of Article XV of the City Charter grant the City Council broad discretion to design and adopt retirement plans, subject to certain minimum benefit limitations. In addition to giving the Council discretion in establishing retirement plans, these sections also give the Council power to amend or otherwise change those plans with regard to "all or any officers or employees."

It may be argued that, under the plain language of the Charter, any retirement plan benefits that are more generous than the minimum benefits that may be required under sections 1504 and 1505 of the City Charter -- including any retiree health benefits -- are subject to the Council's expressly reserved right to amend those benefits under Charter section 1500. Because the Charter reserves the right to amend the terms of its retirement plans, the Council would be acting consistently with the "contract" between the City and the employees when modifying its retiree health program and, thus, as in Walsh and similar to International Ass'n of Firefighters,

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[125] Mason v. Retirement Bd. of City and County of San Francisco 111 Cal. App. 4th 1221, 1228 (2003); Thornton v. Carlson, 4 Cal. App. 4th 1249, 1257 (1992).

[126] City of Los Angeles v. Superior Court, 40 Cal. App. 4th 593, 603 fn. 12 (1995).

[127] Hudson v. Bd. of Admin., 59 Cal. App. 4th 1310, 1326 (1997).

[128] Mason, 111 Cal. App. 4th at 1229.

[129] Hassan v. Mercy American River Hospital, 31 Cal. 4th 709, 716 (2003).

[130] Ventura County Deputy Sheriff's Ass'n v. Board of Retirement, 16 Cal. 4th 483, 490 (1997).

[131] Barrett v. Stanislaus County Employees Retirement Ass'n, 189 Cal. App. 3d 1593, 1608-09 (1987).

no contract rights would be impaired. Given this express reservation of rights, employees could not have a reasonable expectation that the existing retiree health benefits would necessarily remain unmodified (or in existence at all).

At a minimum, however, retirees and Deferred Vested Members (and their survivors) have a strong argument that the reservation of right in the City Charter does not authorize changes affecting them because it does not expressly reference retirees or other former employees. Rather, because the Charter references only "officers or employees," to the extent it has reserved the Council's right to make changes, it has done so only with regard to active employees. As the California Supreme Court indicated in Eu, a reservation of right to amend must be exercised in strict accordance with its terms to be effective. The mere existence of a reserved right to amend does not prevent benefits from being protected from impairment absent the proper exercise of that reserved right. Moreover, they may argue that a reservation of right may not be relied upon to alter their benefits in any event because they have completed their required performance under the terms of the contract and, thus, those benefits have been fully "earned" and cannot be forfeited.

In addition, active employees and retirees alike may argue that the reservations of right in Sections 1500 and 1503 must be harmonized with the other provisions of Article XV. Specifically, the minimum substantive benefit requirements in Sections 1504(a) and 1505(a) and (b) address only traditional pension benefits. Thus, it is reasonable to infer that the voters' intention was to address such traditional pension benefits when adopting all of Article XV. Furthermore, they may allege that this inference is further supported by the fact that a retiree health program was not among the benefits provided by the City when the Charter was adopted in 1965 and, thus, could not have been a variety of benefit contemplated by the voters when they referred to "retirement plans" and "retirement systems."

Moreover, active employees and retirees alike may argue that, because the scope of the reservation of right to amend in the Charter is ambiguous, it is appropriate to look to extrinsic evidence of its meaning. In particular, the City's own application of its Charter shows that Article XV of the Charter – including the reserved right to amend – was intended to apply to only traditional pension benefits like the minimum benefits set forth in Sections 1504 and 1505 and is not part of the "contract" governing the Federated or P&F Retiree Health Plan. Specifically, they may argue that the City itself has never treated its retiree health program as a "retirement plan" subject to Article XV of its Charter. For example, the contribution ratios established for the retiree health program are not consistent with the contribution ratios for current service (i.e., normal cost ratios) required by the Charter. Furthermore, it appears that the P&F Retiree Health Plan is not maintained on an actuarially sound basis consistent with the Charter provisions applicable to police and firefighter retirement plans.

A possible counterargument is that the City generally has treated the Federated and P&F Retiree Health Plans as part and parcel of the overarching "retirement plan" or "retirement system" – i.e., the Federated Plan and the Police and Fire Plan respectively – as evidenced by the

fact that the Retiree Health Plans are enacted within the Municipal Code Chapters which govern the respective retirement systems. A description of the Retiree Health Plans also is included in the respective Handbooks describing retirement benefits generally. Moreover, the medical benefits account through which the retiree health benefits are now funded is necessarily part of the qualified retirement plan under applicable tax law.[132] Finally, in any case under the terms of the applicable retirement system where a person is entitled to a return of employee contributions, such contributions shall include employee contributions to the medical benefits account, with the refund to be paid from the pension assets, not the assets of the medical benefits account.[133]

In addition, with regard to the City's failure to apply *all* of Article XV to the Retiree Health Plans, it may be argued that the reservation of rights language in Article XV applies to any and all retirement plans – including Retiree Health Plans – but that the requirements for contributions and funding apply only to traditional pension benefits. There is no real textual support in the Charter, however, for drawing this distinction given that the reservation of right provisions refer to "retirement plans" and "retirement systems" and the contribution and funding requirements likewise refer to "retirement plans" and "retirement systems." Normally, when the same terms are used multiple times within the same statutory scheme those terms will be interpreted to have a consistent meaning.[134] Thus; even if a court concluded that the reservation of right to amend in Article XV of the Charter applies, the court might also require the City to be internally consistent and apply the contribution ratio and actuarial funding provisions in Article XV to its retiree medical and dental benefits.

Furthermore, the City has never relied on this reservation of rights to change its retiree health program and, in fact, recently added more limited reservations of right to amend the Retiree Health Plans. Specifically, Sections 3.28.1995, 3.28.2045, 3.36.1950 and 3.36.2050 provide that the City reserves the right to limit medical benefits and alter the cost allocation for dental benefits as necessary to satisfy the requirements of IRC Section 401(h). Employees may argue that the most reasonable inference is that the City has not reserved its right to amend its retiree health benefits for any other reason. Arguably, if the City had the right to limit retiree health benefits under the reservation of right in Article XV of the Charter, there would be no need for a specific provision in the Municipal Code stating that the City has the right to alter medical and dental benefits to satisfy 401(h) requirements. In fact, interpreting the Article XV reservation of right to apply to retiree health benefits would render the Municipal Code provisions extraneous, contrary to accepted principles of statutory construction. Thus, the presence of Sections 3.28.1995, 3.28.2045, 3.36.1950 and 3.36.2050 further supports the conclusion that the Council did not view the Charter as allowing it to amend the retiree health benefits at any time or for any reason.

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[132] IRC § 401(h); §§ 3.28.380.A. and 3.36.575.A.

[133] §§ 3.28.380.F. and 3.36.575.F.

[134] Hassan, 31 Cal. 4th at 716. ("[W]ords should be given the same meaning throughout a code unless the Legislature has indicated otherwise.")

Finally, members may point to the fact that the City has never communicated this reserved right to amend retiree health benefits to members as evidence that Sections 1500 and 1503 of the Charter do not apply to these benefits.

It may be argued that there is no official written interpretation or policy regarding the scope of Article XV and that the conduct cited does not amount to a long-standing administrative construction of the statute. Absent other evidence of the voters' intent to the contrary, however, a court might conclude that the reasonable inference to be drawn from the City's conduct is that it has not ever viewed Article XV as applying.

It also might be argued that, even assuming the City previously took the position that some provisions of Article XV of the Charter did not apply to retiree health benefits, it may adopt a new interpretation of the Charter. A court might still conclude, however, that the City's changed interpretation is unreasonable in light of other considerations.

In sum, there is a reasonable argument that the City has reserved its right to amend the Federated and P&F Retiree Health Plans in the Charter. Retirees and Deferred Vested Members, however, have a strong argument that the reservation of right to amend *by its own terms* applies only to active employees and not to them. Additionally, City employees may argue that (1) the City has never treated the Federated or P&F Retiree Health Plan as subject to Article XV of the Charter; and (2) the inclusion of a provision in the Municipal Code allowing for specific changes to the Federated Retiree Health Plan ordinances to ensure compliance with Code section 401(h) suggests that the City has not reserved its right to make any other changes. Thus, there is a substantial risk that members could successfully argue that the reserved right to amend in Article XV is inapplicable to the Retiree Health Plans.

In addition, even assuming that the reserved right to amend in Article XV of the Charter does apply to the Retiree Health Plans, members who already have performed enough service to qualify for medical or dental benefits when they retire may argue that their benefits and the conditions for receiving them may not be modified. Specifically, relying on the Creighton, Kistler and Suastez cases discussed above, they reasonably may argue that they have performed all necessary services to earn these benefits – that is, that they have performed or "substantially" performed under the contract – and that their rights may not be modified notwithstanding any reservation of right. If this argument were successful, the reservation of rights clause would effectively preserve the City's right to modify the terms of a benefit only for those who have not done all or "substantially" all they have to do to earn it.

Finally, if a court concluded that the reservation of right to amend in Article XV of the Charter does apply, that court might also require the City to be internally consistent and apply the contribution and funding provisions in Article XV to its retiree medical and dental benefits.

2. To the Extent the City Has Not Reserved Its Right to Amend Retiree Health Benefits, Some Changes Still May Be Consistent with the Terms of the "Contract."

Even if active employees may successfully argue that their rights to receive benefits under the current Municipal Code provisions are not subject to a general reserved right to make changes, and notwithstanding the fact that retired employees do not appear to be subject to that reserved right in any event, certain of the proposed changes are arguably still within the scope of contractual rights granted by the City. Most of the proposed changes, however, probably would constitute impairment of vested contractual rights absent the City conferring offsetting advantages. You have asked us to consider the following proposed changes: (1) an increase in the number of years of service required for an employee to be eligible to receive retiree health benefits; (2) a change in the level of benefits – i.e., premium payments -- provided; (3) an increase in the amount of the contributions paid by employees to pre-fund retiree health benefits; and (4) a change in the plan design of the medical or dental insurance programs.

Before discussing each of these features individually, however, it is important to revisit the rule that benefits which are awarded after an employee leaves employment are not constitutionally protected from impairment unless the individual exchanged other contractual rights for the new benefits.[135] Accordingly, the City should be able to change the eligibility criteria, plan design or benefit level with regard to an employee who was first awarded coverage under the terms of the Plan after leaving City service – e.g., Deferred Vested Members under the Police and Fire Plan who left employment before 1992, but who first were given eligibility in 2002[136] or members of either the Police and Fire Plan or the Federated Plan who retired prior to the implementation of retiree health benefits in 1984 who were allowed to enroll– without impairing a vested contract right.

(a) Years of Service Requirement

As noted above, members are eligible for retiree health benefits only if the member retires for service or disability and, at the time of such retirement is entitled to 15 or more years of service or is otherwise entitled to a retirement allowance equal to 37½% of his final compensation (without regard to any reduction for workers compensation). With the exception of adding eligibility for Deferred Vested Members as discussed above, the service requirements have essentially been the same since the inception of the retiree health program. Thus, each member who accepted employment or continued in employment after the relevant Plan was adopted or became applicable to that individual, if later, likely has a vested right to receive

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[135] See Kern, 29 Cal. 2nd at 856; California League, 87 Cal. App. 3d at 140; Thorning, 11 Cal. App. 4th at 1607; San Bernardo Public Employees' Ass'n, 67 Cal. App. 4th at 1215.

[136] When coverage for Deferred Vested Members was added to the Federated Retiree Health Plan in 1988, it appears that coverage was added only for those who became Deferred Vested Members after the date of the change, and not retroactively. Accordingly, this analysis is not applicable to the Federated Retiree Health Plan.

benefits based on the years-of-service eligibility criteria in effect at that time. Even if an employee does not yet have sufficient service credit to qualify for benefits, he or she has a right to continue to earn benefits under these terms. Any change in the years-of-service requirement likely would constitute an impairment of such employee's contract absent the implementation of an offsetting advantage.

A possible counterargument is that, like the State in Miller, the City is merely altering a member's required period of service in a way that affects the maturation of the member's benefit and, thus, is not impairing a vested right. Such an argument, however, is unlikely to persuade a court. In Miller, the plaintiff's right to receive maximum pension benefits was subject to certain conditions and contingencies – i.e. age and service requirements. Although the reduction in the mandatory retirement age resulted in the plaintiff being unable to satisfy all the conditions for him to receive the maximum benefit, *the conditions themselves – i.e., the age and service retirement formula provisions -- were not changed to his detriment.* Additionally, the court in Miller focused on the fact that public employees have no contractual right to continued employment. In contrast, if the City were to increase the years of service requirement, it would not simply be altering an employment right, but would be changing the condition – i.e., the contract term -- itself and, thus, almost certainly would impermissibly infringe on a vested right.

(b) Benefit Level

As noted above, the Plans provide for payment of an amount equivalent to the lowest of the premiums for single or family medical insurance coverage (as applicable) which is available to an employee of the City at the time the premium is paid. Sections 3.28.1980B & 3.36.1930B. Likewise, the Plans provide for payment of 100% of the premiums for dental insurance coverage. Sections 3.28.2030 & 3.36.2030. In this memorandum, these premium benefit levels are referred to collectively as the "100% Premium Benefit." These terms have remained essentially unchanged since inception for the Federated Retiree Health Plan, but first became a term of the P&F Retiree Health Plan in 1998. This change was a benefit enhancement to the P&F Retiree Health Plan and was extended not just to current employees (and retirees covered by the arbitration), but to members who terminated employment prior to 1997. Prior to 1998, the P&F Plan provided that a retired member was required to pay a premium for medical insurance coverage in the same amount as was paid by a current city employee in the classification from which the member retired.

Thus, each member who accepted employment or continued in employment after the applicable plan first provided for this premium payment likely acquired a vested right to receive the 100% Premium Benefit upon satisfaction of the eligibility conditions. Any change in the promised 100% Premium Benefit level likely would be treated by a court as an impairment of such employee's contract.

Retirees and Deferred Vested Members who are members of the P&F Plan and who left the City's service prior to 1998, however, should not have a vested right to the 100% Premium

Benefit. As discussed above, members do not have a vested right in any increase in benefit level that they enjoy after separating from City service. Thus, these members would have a vested right only in the premium amount under the terms of the Plan in existence when they left employment – i.e., a right to pay only as much as current employees in the job classification from which the member retired. Of course, notwithstanding the vested rights analysis, it appears that the City could not cut the benefit back to this level for people retiring between February 4, 1996 and 1998 without violating the arbitration award.

As noted above, both Retiree Health Plans now reserve the right to change the portion of the premium paid by the Plan if necessary to satisfy the funding restrictions of IRC section 401(h). We are not aware of any facts which suggest that IRC section 401(h) limitations have been reached, and thus it does not appear that this provision has been triggered. In addition, each of these provisions arguably could not be applied to alter the rights of individuals who became members prior to that date that provision was added without impairing their vested contract rights.

(c) Amount of Funding Paid by Employees and by the City

As noted in the Factual Background section of this memorandum, under Sections 3.28.380 and 3.36.575, contribution rates "shall be established by the Board as determined by the Board's actuary . . ." Pursuant to this language, each Board should be free to increase the total contribution rate to be borne by the City and employees if doing so would be consistent with the recommendation of that Board's actuary. In fact, I understand that each Board has done so in the past. As in International Ass'n of Firefighters, such changes are consistent with, rather than in derogation of, the terms of the applicable "contract" and, thus, should not impair employees' vested rights.

Unlike the statutory provisions in International Ass'n of Firefighters, however, the discretion granted under these sections does not appear to permit the Board or Council to adjust **the ratio** of City contributions and member contributions. Rather Sections 3.28.380 and 3.36.575 provide that the total contributions shall be borne by the City and employees in specified ratios: eight-to-three for dental benefits and one-to-one for medical benefits. Thus, given these fixed ratios, as in the Allen case, employees would almost certainly be successful in arguing that their rights to contribute under these ratios are vested and cannot be changed. Although these ratios were not codified until 2001 (for the P&F Retiree Health Plan) and 2006 (for the Federated Retiree Health Plan), current employees' vested contract rights include not only the provisions of the "contract" in effect when they became employed, but additional benefits conferred during employment. Moreover, as noted in the Factual Background section, even before codification, these ratios are reflected in materials dating back to the original adoption of the Federated and P&F Retiree Health Plans. Thus, a court likely would treat the employees' rights to contribute under the ratios currently set forth in the Plan as vested, and any action by the City to alter this ratio as an impairment of its contractual obligations.

It might be argued that the ratio provisions govern only contributions to fund current service (i.e., the so-called normal cost), and that any unfunded liability could be shifted to employees without violating these provisions. Unlike the Charter, however, which states that the specified contribution ratios relate to current service, Sections 3.38.380 and 3.36.575 do not limit the ratios to current service contributions. Thus, employees could reasonably take the position that any past service liabilities could not be funded using less favorable ratios.

(d) Plan Design Change for Benchmark and Other Options

As indicated above, the Federated Retiree Health Plan provides for a payment equal to the lowest cost premium for a medical insurance plan (single or family as applicable) "*which is available to an employee of the city* at such time as said premium is due and owing." Section 3.28.1980. It further provides that payment will only be made for an "eligible medical plan" or an "eligible dental plan" which are defined to mean a medical or dental plan respectively with which the City has contracted "*as part of the city's benefits to city employees.*" Sections 3.28.1980, 3.28.1990 (emphasis added).

The P&F Retiree Health Plan likewise provides payment only for the lowest-price "eligible medical plan" and "eligible dental plan" which are defined to mean a medical or dental plan respectively with which the City has contracted "*as part of the city's benefits to city employees.*" §§ 3.36.1940 and 3.36.2040.

Thus, the terms of the plan do not specify a health insurance plan design that must be provided, but simply state that the health insurance plan(s) available to retirees will be ones that are contracted for by the City as part of its employee benefits program. In other words, the City should be able to alter the design of the benchmark plan and other health insurance plans that it offers to its employees and retirees – for example, by changing covered services, co-payments or deductibles – consistent with the terms of the governing "contract" and, thus, without impairing vested rights.

In addition, the City arguably may make design changes to its retiree health plans without making similar changes to plans provided to active employees. In support of this position, it may be argued that the requirement that the plans be "part of the city's benefits to employees" simply means that, in order for the Plan to pay the retiree health premium, the plan in which the member enrolls must be among those contracted for by the City in connection with its employee benefits program. Arguably, such language does not mean that the retiree health plan(s) for which the City contracts must be identical to the plans offered to active employees.

Members, however, may make a reasonable argument that the requirement that a retiree health plan be "part of the city's benefits to city employees" means that the retiree health plans offered will be the same as those offered to active employees. In fact, this position is consistent with representations made in the Police & Fire Department Retirement Plan Handbook to Deferred Vested Members. Handbook page 83. Members covered by the Federated Retiree

Health Plan in particular may argue that section 3.28.1980 specifically requires the City to offer a benchmark plan "*which is available to an employee of the city.*" In other words, they may argue that the City cannot create a low-cost alternative that applies only to retirees for the purposes of setting the benchmark. Thus, members may successfully argue that the City cannot make design changes to the benchmark medical plan (or other retiree insurance plans) without making equivalent changes to plans offered to active employees.

C. The Doctrine of Estoppel

1. Applicable Legal Principles

A government body in California may be bound under the doctrine of equitable estoppel where justice and right require it, if being bound is not otherwise harmful to some specific public interest or policy, or an expansion of the authority of a public official.[137] The following elements would have to be established for equitable estoppel against the City: (i) the City must be apprised of the facts; (ii) the City must intend that its conduct be acted upon, or must act in a way that the participants had a right to believe it was so intended; (iii) the participants must be ignorant of the true state of facts; and (iv) they must rely upon the City's conduct to their injury.[138] Good faith conduct of public officers or employees does not excuse inaccurate information given negligently.[139]

Related to equitable estoppel is promissory estoppel, defined as follows: "A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise."[140] Unlike equitable estoppel, the representation is promissory, not a misstatement of an existing fact.[141]

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[137] Crumpler, 32 Cal. App. 3d at 580; Fleice v. Chualar Union Elem. Sch. Dist., 206 Cal. App. 3d 886, 893 (1988) (finding no room to apply the estoppel doctrine where teacher had been erroneously classified as tenured but was later reclassified and her employment not renewed, because estoppel would have the court ordering a public agency to do what it had no statutory power to do).

[138] Crumpler, 32 Cal. App. 3d at 581.

[139] Id. at 582.

[140] See Frebank Co. v. White, 152 Cal. App. 2d 522, 525 (1957) (citing Restatement of Contracts, § 90).

[141] A related, alternative claim might be one for fiduciary breach based upon an affirmative misrepresentation or failure to disclose. See Hittle v. Santa Barbara County Employees' Retirement Ass'n, 39 Cal. 3d 374, 393-94 (1985) (pension plan trustees have a fiduciary obligation to inform members fully and fairly of the plan and its various options and features); and see, e .g., In re Unisys Corp. Retiree Medical Benefit "ERISA" Litigation, 2006 U.S. Dist. Lexis 72026 (granting injunctive relief based on conclusion that plaintiff's detrimentally relied upon affirmative misrepresentations or inadequate disclosure notwithstanding the fact that the SPD contained an express reservation of right to amend) , on remand from 242 F.3d 497 (3rd Cir. 2001) ("A judgment remains to be

Although estoppel generally is based upon affirmative conduct, silence in the face of a duty to speak may support an estoppel in some circumstances.[142]

An estoppel binds not only the immediate parties to a transaction but those in privity with them.[143] "Privity is generally defined as the relationship in which a person is so identified in interest with another that he is said to represent the same legal right; its discernment resting upon a case-by-case examination."[144] Consistent with this concept of privity, if the representation or conduct relied upon was committed by a party other than the government entity to be estopped, the proof necessary for estoppel generally includes proof of an agency relationship between the government entity to be estopped and the person or entity that made the promise or act on which the estoppel is based.[145]

In International Ass'n of Firefighters, the California Supreme Court declined to estop the city from increasing safety members' rates of contribution for the retirement fund, because it found no misrepresentation in the retirement handbook issued to the safety members.[146] While the handbook assured safety members that their rates of contribution would not change with their age as they grow older, the court concluded "this is not to say...that all rates could not be adjusted at some future time to reflect either changes in benefit provisions of the system or increased earnings of the...Fund."[147] The court held that this statement would not reasonably induce a safety member to believe that these were the only factors that could affect his or her rates, but were instead merely examples. Justice Kaus, concurring, determined that as there was no showing of any employee accepting employment or remaining on the job in reliance on the statement, the requisite element of harm was missing.[148]

(continued...)

made as to whether a reasonable fiduciary in Unisys' position would have foreseen that its conduct towards the various plaintiffs would result in important decision making on their part based upon a mistaken belief that they possessed guaranteed lifetime benefits.").

[142] Moore v. State Board of Control, 112 Cal. App. 4th 371, 384 (2003); Lix v. Edwards, 82 Cal. App. 3d at 580 (trustees had a fiduciary obligation to provide notice of result of break in employer contributions).

[143] Crumpler, 32 Cal. App. 3d at 582.

[144] Id. at 583.

[145] Moore, 112 Cal. App. 4th at 385.

[146] 34 Cal. 3d 292.

[147] Id. at 304-05.

[148] Id. at 306. As for the relation between the plan document and the handbook, Justice Kaus stated "without some substantial showing of actual harm, it would be ludicrous if carefully crafted pension legislation could be effectively amended by a bureaucrat's somewhat inept attempt at summarization."

The information presented to public employees in California must be read as a whole for estoppel to apply.[149] In Lee v. Board of Administration, retirement pamphlets distributed to members of the California Public Employee Retirement System ("CalPERS") indicated to members that each member possessed the power to effectively designate any person he or she desired as a beneficiary. The court determined that the pamphlets, though far from complete, made clear that the information provided therein was general and simplified, and "[did] not purport to be the definitive statement of the retirement law," and thus held that estoppel would not lie where the retirement pamphlets contained such express caveats.[150]

In cases brought under ERISA, courts generally look to the written statements and representations made to former employees *in effect at the time that they retired* to determine what retiree health benefits were promised to retirees and *whether the employer adequately reserved the right to modify or terminate the retiree health plan.* Statements that the employer may change or terminate the plan are referred to herein as "reservation of rights." For example, in Sprague v General Motors Corp.,[151] the employee communications described the retiree health plan as a "lifetime" benefit that would be "provided at GM's expense." However, the employee communications also put plan participants on notice of GM's right to change or terminate the health care plan at any time. The court, relying on these unambiguous "reservation of rights" in the employee communication materials or the plan, concluded that retirees had no vested right under ERISA to fully subsidized retiree health benefits and no valid claim under the principles of estoppel.[152]

In the ERISA context, ambiguity in the summary plan description ("SPD") must be resolved in favor of the employee and made binding against the drafter.[153] Although the beneficiary's view of the SPD is important, the correct interpretation must focus on the entire SPD or it will "represent an unrealistically narrow view of how a reasonably prudent employee would read and review this important document."[154] But if the employer publishes an inaccurate SPD and an employee *relies on that plan description to his or her detriment*, the employer will be bound by that inaccuracy.[155]

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[149] Lee v. Bd. of Admin., 130 Cal. App. 3d 122, 134 (1982).

[150] Id. at 134-35; but see Hittle, 39 Cal. 3d at 393-94 (pension plan trustees have a fiduciary obligation to inform members fully and fairly of the plan and its various options and features).

[151] 133 F.3d 388 (6th Cir. 1998).

[152] Id. at 403-04; see also Stearns v. NCR Corp., 297 F3d at 711-12 (well settled that an unambiguous reservation-of-rights provision is sufficient without more to defeat a claim that retirement welfare benefits are vested).

[153] Wise v. El Paso Natural Gas Co., 986 F.2d 929, 939 (5th Cir. 1993) (ERISA welfare plan).

[154] Id.

[155] Grosz-Salomon v. Paul Revere Life Ins. Co., 237 F.3d 1154, 1162 (9th Cir. 2001).

In addition, in the ERISA context, how and when a "reservation of rights" is communicated may be important. Even if a reservation of rights appears in an SPD, the existence of that reservation of rights also may need to be communicated contemporaneously with other, separately-provided information about the duration and cost of retiree health benefits in order to prevent that other information from being misleading.[156]

2. Analysis of City Communication Materials

The following analysis is a limited discussion of the claims that employees and retirees might make based on the communication materials that were provided by the City. These materials include a Benefits Fact Sheet and a Handbook for both the Federated Plan and the Police and Fire Plan. The outcome of any actual dispute could differ dramatically depending on employee and retiree communications that may be produced but that were previously unknown to the City or were not available for us to examine.

In order to estop the City from altering the benefits currently offered to employees and/or retirees, current and retired employees would have to show either a misstatement of fact or a promise on the part of the City indicating these benefits would not be changed. It is unlikely that employees could make this showing with regard to the underlying health plans or the contribution amounts that they are required to pay. The Handbook specifies only that "The Retirement fund pays the full premium for the lowest cost medical plan." Nowhere does the Handbook specify the actual amount of such premiums. Additionally, the contribution amounts are not discussed in the Handbook. Additionally, the Handbook itself implies that retirement benefits are subject to change, noting that "retirement benefits are subject to the meet and confer process under the Meyers-Milias-Brown Act which requires employers to meet with employees to confer about changes in wages, hours, or terms and conditions of employment. Proposed changes in retirement benefits are discussed during negotiations between City representatives and representatives of the recognized employee bargaining organizations."

Although it appears that employees would have a difficult time arguing that the City affirmatively told them that their retiree health benefits would remain the same for their lifetimes, they might make a colorable argument that the City had a duty to disclose its right to make changes to those benefits. It does not appear that the City indicated that it could alter its funding obligations, its contribution ratio, the eligibility requirements, or the level of benefits provided under the Plans. Thus, employees could argue that the City's failure to disclose this alleged right was misleading in light of the Handbook and Summary Sheet, both of which suggest that the City will continue to provide the enumerated retiree health benefits.

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[156] In re Unisys, 2006 U.S. Dist. Lexis 72026, conclusions of law 13-36 (notwithstanding reservation of rights in SPD, statements regarding duration and cost of benefits were misleading because company failed to qualify those statements with the caveat that the company could modify or terminate the benefits at any time; a reference to the right to terminate made at the same time the company communicated cost and duration of benefits in connection with retirement decisions would have made the representations complete as opposed to a "half-truth").

Assuming that employees or retirees could demonstrate a promise or misrepresentation concerning the duration and immutability of their benefits, the case law suggests that they also would have to prove their reliance on the promise or representation. It is not clear, however, what showing of reliance will be required—that the employees or retirees continued to work based on the descriptions of benefits,[157] that they didn't go to work for someone else who did have this benefit, that they retired based on the promise, that they retired earlier than they otherwise might have, that they did not get another job after retirement, or they changed their position in some other way.[158] Reliance will be a factual question to be resolved at the trial court level.[159]

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[157] See Baillargeon v. Dept. of Water and Power, 69 Cal. App. 3d 670, 676-79 (1977) (holding that the plaintiff had adequately stated a claim for estoppel with regard to certain supplemental disability benefits where she alleged that she relied on certain statements concerning those benefits "in continuing her employment and in not accepting other employment.").

Where the employee's continued service is correctly viewed as bargained for consideration, however, the action is one for breach of contract (express or implied) and there is no need to resort to the doctrine of estoppel. See Youngman v. Nev. Irrigation Dist., 70 Cal. 2d 240, 250 (1969).

Under analogous circumstances, several California courts have held that a unilateral contract is or may be created when an employee continues in employment after the employer promises a benefit or working condition. See Hunter v. Sparling, 87 Cal. App. 2d 711 (1948) (continued employment was consideration for offer of pension); Newberger v. Rifkind, 28 Cal. App. 3d 1070 (1972). (remaining in employment constituted acceptance and consideration for stock option); Chinn v. China National Aviation Corp., 138 Cal. App. 2d 98 (1955) (employer's "regulation" providing for severance pay was an offer of a unilateral contract that was accepted when the employee, who had previously notified the employer of his intention to quit, remained in his job because of the offer); Hepp v. Lockheed-California Co., 86 Cal. App. 3d 714, 719 (1978) (issue of fact whether employee provided consideration by continuing in employment in reliance on defendant's "policy" of recalling employees who had been laid off). However, in Hunter v. Sparling, the court also found that the employer's offer of a pension was enforceable on promissory estoppel grounds, because the employee had turned down other offers of employment in order not to lose his pension; the court stated that "under such circumstances" the doctrine of promissory estoppel is applicable, suggesting that something more than merely continuing in employment may be necessary for the promise to be enforceable under the doctrine. 87 Cal. App. at 725.

[158] See, e.g., In re Unisys, 2006 U.S. Dist. Lexis 72026, conclusions of law 37-55 (detrimental reliance was established by evidence that employees would not otherwise have retired at that time, and could have been established by proving that other employment or benefit opportunities were declined or that other important financial decisions were made).

[159] Walsh v. Bd. Of Admin., 4 Cal. App. 4th 682, 708 (1992).