

LACAA
Los Angeles City Attorney's Association

July 27, 2011

VIA U.S. MAIL AND PERSONAL SERVICE

Board of Administration
Los Angeles City Employees' Retirement System
c/o President Roberta A. Conroy
360 East Second Street, 2nd Floor
Los Angeles, California 90012

Re: Request that the Board of Administration obtain independent legal advice with respect to Council's recent action to permanently freeze the vested retiree health subsidy of certain employees

Dear President Conroy and Commissioners of the Board:

The Los Angeles City Attorneys' Association ("LACAA") represents all deputy and assistant city attorneys in the Office of the Los Angeles City Attorney within MOU 29. As you no doubt are aware, Council recently adopted an ordinance to permanently freeze the vested¹ retiree health subsidy of all LACERS members who retire on or after July 1, 2011.² Council also adopted a companion ordinance to provide a "vested right" to increases in the retiree health subsidy for all employees in bargaining units that agree to certain labor concessions which include the payment of an additional 4% contribution to LACERS.³ Active LACERS members, therefore, are able to avoid the effects of a permanent freeze on their vested retiree health subsidy only if their bargaining units agree

¹ The City Administrative Officer and other city leaders acknowledge that the LACERS retiree medical subsidy is a vested retirement benefit. They also acknowledge that the benefit level cannot be capped for retirees. They have yet to explain why they believe they can legally cap the retiree health subsidy for active employees. In our view, there isn't any valid explanation.

² See Ordinance Number 181746. This ordinance also purports to freeze the Medicare supplement under sections 4.1103.2 and 4.1106 and the subsidy for surviving spouses under section 4.1107. Thus, any independent legal opinion should also address whether there is a vested right to increases in the subsidies provided in those codes sections.

³ Ordinance Number 181734.

to the additional 4% contribution. LACERS members who are negatively affected by these recent Council actions include all deputy and assistant city attorneys in LACAA.

We have grave concerns regarding the validity of Council's action to permanently freeze the vested retiree health subsidy. If in fact the City had offered an additional vested retirement benefit in return for the additional 4% contribution, as would be required under California law, the City would not also have resorted to the coercive tactic of freezing the retiree health subsidy. Simply put, there would have been no legitimate reason to do so.

We believe that the Board of Administration ("Board"), consistent with its fiduciary duties to all members of LACERS, must seek an independent legal opinion as to the following: 1) whether all members have a vested right to increases in the vested health subsidy; 2) whether all members who serve the City for twenty five or more years have a vested right to a health care subsidy that will reasonably secure two party coverage in an HMO plan; 3) whether your Board continues to have the authority and discretion to increase the health subsidy for all members within the parameters previously established by Council; and 4) whether Council's action to permanently freeze the retiree health subsidy for the non-ratifying employees usurps your sole and exclusive authority to administer the system to provide benefits to the affected members and their beneficiaries.

The Vested Rights Questions

The City leaders acknowledge that the current retiree health subsidy is vested, but they also claim that *increases* in that vested benefit are not guaranteed. The City seems to base this curious position on the fact that your Board was authorized to exercise its *discretion* to provide increases to the subsidy and therefore, the increases were never guaranteed. As discussed below, we have a very different view.

In determining whether *increases* in the vested health subsidy are themselves an integral part of the vested health subsidy, it is critical to determine what the City promised to its employees when it established the retiree health program and when it modified that program. The City's intent when it created and revised the retiree health program will define the scope of the promise and, in turn, the reasonable expectations of the members. The City's past practices will also assist in defining the scope of the promises made.

It is clear to us that the City's intent, until recently, has been to provide members who have served the City for twenty five or more years a health subsidy sufficient to provide two-party coverage in the Kaiser, non-Medicare plan. Consistent with that intent, the Board has been authorized to unilaterally provide increases to the retiree health subsidy, but not in excess of the increases in the Kaiser premium increases and not in excess of the actuarial medical trend rate for a defined time period. Your authority in this regard is co-extensive with your sole and exclusive authority to administer the retiree health program. Why? Because that is exactly how Council designed the health subsidy

benefit. Thus, at the very least, all active members and retired members have a reasonable expectation that your Board will continue to exercise its authority and discretion to increase the retiree health subsidy within the limits previously established by Council.

In the past, your constitutional and Charter-mandated duties to the members have guided your decisions to provide for increases in the subsidy, and your decisions to make those increases have been completely consistent with the way in which Council designed the benefit. In light of these realities, we believe that Council can not now legally usurp your authority to continue increasing the retiree health subsidy for all members, as warranted, within the parameters Council previously authorized in 1997 when it modified the retiree health subsidy in the LACERS Plan.

Below is a brief history of the retiree health insurance program which should demonstrate that Council's action to permanently freeze the retiree health subsidy for non-ratifying bargaining units is contrary to the intent of the retiree health program and without precedent in the administration of that program.

The legislative history of the retiree health program demonstrates an intent to provide a subsidy sufficient to secure coverage in a Kaiser two-party non-Medicare plan for LACERS members who serve the City for twenty five or more years.

In 1973, the City adopted Ordinance Number 145067⁴ to establish a health insurance program as a *retirement benefit* under the LACERS plan. The stated purpose of Ordinance 145067 was to "provide a health insurance program whereby former employees who are retired ... and their eligible dependents will be provided with *health insurance protection* and a subsidy to apply to health insurance premiums..." Ordinance 145067 also provided that the Board of Administration would administer the health insurance program. The Ordinance established that retirees aged sixty or over with ten years of City service were entitled to 40% of the retiree health subsidy; and that, for each year of service thereafter, 4% would be added until the maximum subsidy was earned (at twenty five years of service). Ordinance 145067 further provided that the premium subsidy and administrative costs would be provided "solely by the City Employees' Retirement Fund in order to lessen or defray part or all of the cost of such health insurance to such eligible retired employee..."

Since originally establishing the health insurance program as a retirement benefit, the City has modified the benefit numerous times. Until now, all modifications have advanced rather than detracted from the purpose of the retiree health program as stated in the enabling ordinance – to provide *health insurance protection for retirees and their eligible dependents*. For example, in 1982, the retirement plan was amended to provide for a full retirement formula after thirty years of service and attainment of age fifty-five rather than age sixty. At that time, the health subsidy provision was also amended to

provide an *entitlement* to retired employees at age fifty-five. (Section 4.1103 of Ordinance 157226.)

In 1990, the health subsidy provision was amended so that the maximum monthly subsidy was to be provided by the Board, rather than Council. (Section 4.1103(d) of Ordinance 165622.)

In 1997, the health subsidy provision was again amended to establish a set monthly amount of \$472, and to delegate to the Board of Administration the authority to increase or decrease the subsidy, commensurate with changes in the two-party, non-Medicare Kaiser plan. (Section 4.1103(d) of Ordinance 171743.) By adopting Ordinance 171743, Council clearly evidenced its intent to provide retirees who had earned a 100% health subsidy the ability to secure two-party coverage in an HMO plan. Clearly, the Kaiser plan was established as the benchmark for the value of the health subsidy. Council also determined that the Board, which has the sole and exclusive authority to administer the retirement plan, was best suited to periodically modify the health subsidy as needed.

In 2001, the Administrative Code was amended to increase the monthly subsidy to \$702, with discretion vested in the Board of Administration to increase the amount of the subsidy by the same amount of any increases in the two-party, non-Medicare Kaiser coverage. (Section 4.1103.1(a) of Ordinance 174365.) Administrative Code section 4.1103.1 reads in relevant part:

(a) ... The Board may in its discretion, by resolution, change the maximum monthly amount of the medical plan subsidy provided to retired employees as long as any increase:

(1) Does not exceed the dollar increase in the Kaiser two-party non-Medicare Part A and Part B premium, and

(2) The average percentage increase for the first year of the increase and the preceding two years does not exceed the average assumed actuarial medical trend rates for the same period.

(b) Any change made by the Board which exceeds the limits in (a)(1) or (a)(2) herein must be submitted for Council review accompanied by an actuarial report. Any increases that are not acted upon by the Council within 30 days after receipt of the report to Council for consideration of the increase are deemed approved. Should the Council reject the subsidy set by the Board, the Council shall determine the amount, if any, by which the subsidy shall be increased and shall adopt such change by resolution.

The Board regularly has increased the amount of the retiree health subsidy, within the limits set by Council. Currently, the maximum monthly subsidy for a pre-Medicare

retiree is \$1,190 per month. For retirees who are not yet Medicare eligible, \$1,190 per month is now sufficient to cover the cost of two-party coverage in the Kaiser plan. Obviously though, a subsidy that is permanently frozen at the current level is likely to become marginalized over time as it is eroded by the increasing cost of health care. Thus, the members subject to the health subsidy freeze will not be afforded any *protection* from inflation, despite the stated intent of the retiree health program and despite the fact that those members were promised such *protection* as part of their vested retirement benefit. Under these circumstances, it is difficult to imagine how the Board can appropriately carry out its myriad duties to these members.⁵

Additional evidence confirms that the City's legislative intent in designing the health subsidy in the manner it did was to provide two-party coverage in the Kaiser plan for LACERS members who earn the 100% subsidy through twenty five or more years of City service.

On August 28, 2001, the General Manager of LACERS provided a comprehensive summary of the retiree health subsidy in a letter to Council and Mayor Hahn. In his letter, General Manager Oscar Peters wrote: "The City's historical practice is to provide a subsidy sufficient to cover the two-party (member and spouse/domestic partner) premium rate in an HMO plan and the single-party premium rate in a PPO plan to retirees who are not Medicare eligible. That benefit level is maintained under the proposed amendments to the health insurance ordinance."

Actuarial consultants retained to estimate future costs of the LACERS' Retiree Health Plan have always assumed that the City would fund increases in the cost of retiree health care. On April 28, 2011, the Plan's actuary, Segal and Company, wrote to Thomas Simonovski of the CAO's office: "In preparing all the prior actuarial valuations for LACERS' Retiree Health Plan, we have always proceeded under the assumption that the plan benefit would continue to be paid indefinitely for the current members. In particular, we have assumed that the future medical subsidy amount would continue to increase with future medical inflation assumptions. As we previously stated, we have always assumed in preparing our cost analysis for the Retiree Health Plan that all the benefits would continue to be paid indefinitely and that future medical subsidy amounts would continue to increase with future medical inflation. Therefore, we do not believe that there would be any additional cost that has not been accounted for in the actuarial process if the benefits were determined to be vested."

⁵ We believe that, if Council assumes the setting of the retiree medical subsidy, it is legally obligated to act in the best interest of its employees. (See generally, *Engella v. Permanente Medical Group, Inc.* (1997) 15 Cal.4th 951, 977.) For obvious reasons, however, that is cold comfort to many LACAA members.

It seems apparent that the actuaries would assume that increases in the health subsidy would continue to be paid indefinitely for current members *only* if they were provided with a reasonable basis upon which to make such an assumption.⁶

The legislative history and past practice vividly demonstrate that the recent amendment to Section 4.1103.1 is a severe departure from the stated intent and the administration of the retiree health subsidy.

The City has created reasonable expectations among LACERS members that a 100% retiree health subsidy will be sufficient to obtain two party coverage in the Kaiser plan and that the Board will continue to exercise its authority to make reasonable increases in the subsidy, within the limits earlier set by Council.

Retiree health benefits often are provided in public employee retirement plans. Once retiree benefits have been promised, a public employer generally cannot diminish or eliminate those benefits without violating the constitutional rights of retirees and current employees. (*Thorning v. Hollister School District* (1992) 11 Cal. App.4th 1598.) Upon acceptance of public employment, an employee acquires a vested right to the benefits of the retirement system then in effect, even though the right to an immediate payment of a full pension may not mature until years later, after certain conditions are satisfied. (*United Firefighters of Los Angeles City (UFLAC) v. City of Los Angeles* (1989) 210 Cal. App.3d 1095.) City officials have repeatedly acknowledged in the last few months that the retiree health subsidy is vested, but that the increases in that vested subsidy are not vested. Accordingly, the City justifies its current permanent freeze of the subsidy for employees in non-ratifying bargaining units. The City's action seems outlandish on its face, not to mention punitive. What good is a vested retiree health subsidy if it is frozen at current levels and therefore, insufficient to obtain retiree health coverage when needed? This question needs to be taken seriously.

The *UFLAC* case, *supra*, clearly holds that the City can not easily impair, even on a prospective basis, the vested pension benefits that were promised to active employees. Further, the court in that case found that the City's fiscal woes do not justify a permanent impairment of employees' vested pension rights. In 1971, voters had approved a Charter amendment removing a cap on cost of living adjustments for the Fire and Police Pension System. In 1982, in the face of large unfunded liabilities of the pension system, the City placed Charter Amendment H on the ballot to re-impose a cap on the cost of living adjustment. Charter Amendment H was passed by the voters and became part of the Charter. The Charter amendment was only to apply prospectively to active employees' future years of service credit towards retirement. Nonetheless, the court of appeal found the Charter amendment unconstitutional. In so holding, the court gave great consideration to the reasonable expectations of the employees after the cap was removed in 1971. The court determined that the Charter amendment clearly defeated the

⁶ It also is apparent that the assumption has always been built into the actuaries' projected estimate of employer contributions. Accordingly, the additional 4% employee contribution represents a shifting to the employees of the employer's required contributions.

employees' expectations that pension benefits would be fully adjusted for inflation, and post-retirement standards of living would thus be protected from any further diminution. (*Id.* At 1108.) The court found that the Charter amendment lessened the economic security of retirees, impairing rather than preserving their standard of living. Further, the court found that the Charter amendment did not enhance the integrity of the pension fund, since it did not require the savings to be applied to the pension fund. Instead, the City spent the savings on other items or added those dollars to the general fund. Therefore the Charter amendment was "neither reasonable nor necessary to the maintenance or integrity and soundness of the pension systems."(*Id.* At 1113.)

In this instance, the City again claims that it must permanently freeze a vested pension right in order to effect cost savings that will ease the City's fiscal difficulties. The *UFLAC* case clearly holds that such action is illegal. Like the sworn employees in the *UFLAC* case, the negatively affected employees in the LACERS plan have a reasonable expectation to periodic increases in the retiree health subsidy that may be needed to preserve the value of that subsidy. Those reasonable expectations are based on the ordinance establishing the retiree health subsidy itself, as well as the manner in which the City consistently has implemented those provisions in the past. The vast majority of employees in LACERS have been contributing 6% of their income towards the City Employees' Retirement Fund since the day they commenced their employment with the City.⁷ The Fund is pooled with the City's contributions for investment purposes. The earnings from the investments are used to provide retirement allowances and health subsidies. In return for employee contributions of 6%,⁸ the City promised that, if those employees faithfully served the City for twenty-five years or more, they would receive a 100% medical subsidy that carries some *health care protection* for themselves and their eligible dependents. The City's action now to permanently freeze the retiree health subsidy is a severe departure from the promise that was made to every single LACERS member on the commencement of employment. Indeed, it is a breach of the contractual guarantee made to all employees.

Thorning v. Hollister School District (1992) 11 Cal. App. 1598, illustrates that a public employer can not diminish or eliminate post-retirement health benefits without violating the constitutional rights of retirees and current employees. Appellants were recently retired school board members who sought a writ of mandate to invalidate an action of the school district suspending their post-retirement health benefits pursuant to a new policy that had recently been adopted by the school board. The prior policy had been to give retiring board members who had served twelve or more years the option to continue their health coverage. The new policy, adopted shortly before Appellants

⁷ Pursuant to negotiated labor agreements wherein employees hired before 1983 agreed to forego significant pay raises, the City agreed to defray a portion of the pension contributions for those employees. As a result, pre-1983 hires contributed 2% of their pre-tax income to LACERS. Last year, the contribution rate for those employees was increased to 6%. For some of the pre-1983 employees, that increase was imposed unilaterally.

⁸ Last year, the contribution rate of all LACERS members was increased from 6% to 7% to subsidize a portion of the Early Retirement Incentive Program ("ERIP").

retired, provided that retiring board members who had served at least one full term could choose to continue in the health benefit program solely at their own expense. Appellants claimed that the school board violated their civil rights by diminishing the retiree health benefit they had been promised. Appellants contended that the retiree health benefits constituted both an inducement for their continued service on the board and deferred compensation. Additionally, they alleged that they had relied on the promise, both in continuing to serve on the board and in deciding to retire after serving for 12 years. (*Id.* at 1605.) The court agreed, finding that the former policy regarding post-retirement health was a vested right of all the members who had served on the board at any time while that policy was in effect, and therefore, that the former policy controlled the provision of post-retirement health benefits for Appellants. (*Id.* At 1606.) The court held that the school board had violated Appellants civil rights under U.S.C. § 1983 when it suspended payment for Appellants' continued health benefits claims. (*Id.* at 1610.)

A permanent freeze of the retiree health subsidy will significantly erode one of the most important of the retirement benefits that employees were promised when they commenced employment with the City. In our view, the Council's action has rendered the retiree health benefit next to meaningless for those employees whose bargaining units declined to ratify the most recent round of labor concessions. This action has a negative impact on all members of non-ratifying bargaining units. Further, if allowed to continue unabated, this action virtually guarantees that the City will continue to unilaterally change the terms of its vested contractual obligations through coercive tactics disguised as labor negotiations.

The LACERS Board of Administration has the sole and exclusive authority to administer the vested benefits of the members of the retirement system.

As we indicated earlier in this letter, Council's clear intent was to provide a retiree health subsidy sufficient to cover the cost of the two-party non-Medicare Kaiser plan for all members who have faithfully served the City for twenty five or more years. Accordingly, it delegated to your Board the unilateral authority to provide increases in that subsidy, but not in excess of the increase in the Kaiser premiums and not in excess of the actuarial medical trend rate for a defined three year period. Although your authority is couched as "discretionary" in Administrative Code section 4.1103.1, it actually is co-extensive with your sole and exclusive duty to administer the benefit consistent with the Plan sponsor's intent when it conferred that benefit. As explained below, your Board can not simply accede to the Council's usurpation of your constitutional and Charter-mandated authority to administer that benefit.

Under Article 16, section 17 of the California Constitution, your Board has "sole and exclusive" fiduciary responsibility over the assets of the retirement system. You also have sole and exclusive responsibility to "assure prompt delivery of benefits and related services to the participants and their beneficiaries." More particularly, you have the responsibility to do these things "solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries," with that duty taking "precedence over any other duty." Likewise, section 1106 of the Charter restates the

cardinal rule: "these fiduciary duties to participants precede any other fiduciary obligation." The Charter and the Constitution employ strikingly similar language, thereby complementing and reinforcing each other. The case law interpreting the Constitution is thus applicable to the Charter language.

In *Singh v. Board of Retirement of the Imperial County Employees' Retirement System* (1996) 41 Cal.App. 4th 1180, an employee who was denied a service-connected disability pension by a public retirement board sought and obtained a writ of mandate overturning the board's decision. On appeal, the retirement board argued that, because Article XVI, section 17, as amended by Proposition 162, conferred "plenary" authority on retirement boards, decisions of retirement boards were not subject to judicial review. The Court of Appeal rejected that contention after a careful analysis of the intent of the voters in passing Proposition 162. The court noted that Proposition 162 was placed on the ballot in response to a bill which had permitted the legislature and the governor to use reserve funds in the state Public Employees' Retirement System ("PERS") to substitute for the normal state payments required to fund the system — "thereby freeing state money to help close the budget shortfall." The court found that Proposition 162 was intended "to insulate the administration of retirement systems from oversight and control by legislative and executive authorities, and also return control of the actuarial function to the retirement boards themselves. This increased level of independence would make the [retirement] systems less of a target for local and state officials looking for a way to balance a budget." (*Id.* at 1192.) In affirming the lower court's order, the appellate court held: "Clearly, the word 'plenary' was intended to mean that retirement boards would have the sole and complete power to invest their funds and to administer their systems, as opposed to being subject to direction from state and local legislative and executive bodies in these matters." (*Id.*) (emphasis added)

The second instructive appellate decision is *Westly v. California Public Employees' Retirement System ("CalPERS")* (2003) 105 Cal.App.4th 1095. In that case, the state controller challenged CalPERS' assertion of plenary authority, under Article XVI, section 17, to exempt its employees from civil service, and to bypass the Controller's role in issuing stipends, salaries, and other payments. In addressing this contention, the court in *Westly*, like the Court in *Singh*, probed the evidence of the voter intent in passing Proposition 162. The court pointed out that the purpose of the proposition was, among other things, to "ensure that the assets of public pension systems are used exclusively for the purpose of efficiently and promptly providing benefits and services to participants of these systems, and not for other purposes" and to "give the sole and exclusive power over the management and investment of public pension funds to the retirement boards elected or appointed for that purpose, to strictly limit the Legislature's power over such funds, and to prohibit the Governor or any executive or legislative body of any political subdivision of this state from tampering with public pension funds." (*Id.* At 1110.) The court also noted that the "Findings and Declarations" accompanying the ballot measure included these statements: "To protect pension systems, retirement board trustees must be free from political meddling and intimidation" and "The integrity of our public pension systems demands that safeguards be instituted to prevent... encroachment upon the sole and exclusive fiduciary powers or infringement upon the

actuarial duties of those retirement boards. Finally, the court concluded that the "plenary authority" the Constitution grants to retirement boards over the "administration of the system" extends to the "*management of the assets* and their delivery to members and beneficiaries of the system." (*Id.* At 1111.)

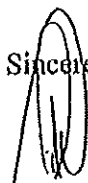
As discussed at length in the *Singh* and *Westly* cases, your Board can not simply accede to the Council's usurpation of your constitutional authority. These well-defined statements of your Board's authority build an impenetrable firewall, outside of which stands the Council whose motivation in the current situation appears to be the sort of "political meddling and intimidation" Proposition 162 was designed to eliminate.

The LACERS Board of Administration should obtain independent counsel to advise it on the issues presented in this letter.

Charter Section 275 permits your Board to recommend to the City Attorney the retention of outside counsel to advise you, subject to the City Attorney's written approval. We think the City Attorney must agree to such a request because he is conflicted due to his having drafted and approved as to form and legality the ordinance that now raises the legal questions outlined in this letter. He has nothing short of an ethical duty to consent to your request for outside counsel.

We hope the Board will give this letter its serious consideration. We will be more than willing to supply any additional information you may require.

Sincerely,



Oscar Winslow,
Resident
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/OW

cc: Thomas Moutes, General Manager
Los Angeles City Employees' Retirement System