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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

San Jose Pension Battle Raises Potential For Broader Cuts

By **Erin Coe**

Law360, San Diego (July 23, 2013, 10:47 PM ET) -- San Jose, Calif., employee unions are urging a state court at trial this week to block a citywide public pension reform measure approved by voters last year, but experts say a decision upholding the initiative could trigger a wave of similar measures in California and other states to reduce local governments' pension obligations.

The trial that kicked off Monday at the Santa Clara County Superior Court centers on Measure B, which gained approval from 70 percent of San Jose voters in June 2012 and would give current employees the option of paying up to 16 percent of their salaries to retain their existing retirement plan or accepting a second-tier retirement plan with lesser benefits so they can keep their current salaries.

"The outcome from the current litigation in California will either significantly expand or restrict the ability of municipalities to manage pension plans," said Thom Reilly, a professor at San Diego State University.

The San Jose Police Officers' Association — the lead plaintiff in the case consolidating six complaints by unions, workers and retirees — claims the measure impairs workers' rights under their agreements with the city by unilaterally increasing contributions for future retiree medical benefits above what was contractually agreed and constitutes a taking of private property rights without just compensation or due process.

Meanwhile, the city contends that the initiative, whose adoption has been put on hold in light of the litigation, should be upheld in an effort to address skyrocketing retirement costs, which are expected to reach \$325 million by 2015.

A ruling in favor of the city would likely encourage local governments struggling to rein in their retirement costs to take similar pension cut proposals to the voters or, depending on the state, drive similar voter initiatives on the ballot, according to Reilly.

"If the court rules in favor of the city, it gives more ammunition for other municipalities struggling with the issue," he said. "We're definitely more likely to see these pension issues being taken to a vote of the people."

A court decision that allows Measure B to take effect also could prompt California lawmakers or public employee unions to push for legislation seeking to stop the pension cuts, according to David Lewin, a professor at the University of California, Los Angeles' Anderson School of Management.

"If the court affirms the citizens' vote, there will be much more action in the State Legislature than if the court overturns it," he said. "There could be an effort by public employee unions or by any other constituents to try to pass a law that says if local governments promise employees retirement pay, it's illegal to renege on that promise."

The case over San Jose's measure to reduce retirement costs comes at a time when several distressed cities are wrangling over whether they can impair their pension obligations by filing for Chapter 9 bankruptcy. The California cities of Stockton and San Bernardino filed for municipal bankruptcy last summer and Detroit entered bankruptcy last week, and all of the cities have blamed their poor financial conditions in part on rising retirement costs. The same month that Measure B passed in San Jose, a similar measure to lower retirement costs was approved by voters in San Diego.

"Between the bankruptcies and the voter initiatives in San Jose and San Diego, a lot of eyes are going to be looking at the outcome in California," Reilly said.

At the same time, the economy is gradually recovering, and the problem Measure B sought to address is starting to be ameliorated by the rising value of equities in which San Jose pension funds are invested, according to Lewin.

"A modest recovery is reducing fiscal deficits in local, county and state governments," he said. "This game is playing in a rapidly changing platform."

Lewin predicted that the employee unions in the Measure B dispute had a good chance of prevailing, especially because San Jose wasn't bankrupt and had made explicit contractual promises to employees about the benefits they would receive when it hired them.

"Current employees want the benefits they agreed to when they were hired, and I think they are likely to get them," he said. "Local governments are not supposed to be reneging on a contractual promise to those they employed, no matter the circumstance. Trying to take that away after the fact strikes at the heart of what a contractual agreement is supposed to be."

But even if the court finds in favor of the employee unions and allows them to keep their existing pension plans, such a ruling may be only a short-term win for city workers, he said.

"A negative decision for the city could lead San Jose to hire fewer people or decide not to replace some employees once they leave ... to reduce labor costs," Lewin said. "Or the city might decide public services should be contracted out to the private sector."

Reilly said a decision for the employee unions in San Jose could make other municipalities more reluctant to tamper with pension plans for current employees, but he believed the court was more likely to find that local governments have the ability to increase workers' contributions to their pension plans.

"It's not clear Measure B took away workers' rights," he said. "It allows individuals to keep their pension plans, but they just have to pay more. Courts have been somewhat receptive to the argument that employees have to pay more."

The police officers' association is represented by Gregg Adam, Jonathan Yank, Gonzalo Martinez, Jennifer Stoughton and Amber West of Carroll Burdick & McDonough LLP.

The case is San Jose Police Officers' Association et al. v. City of San Jose et al., case number 1:12-cv-225926, in the California Superior Court for the County of Santa Clara.

--Editing by Elizabeth Bowen.

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