CITY OF PHILADELPHIA

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Privileged and Confidential Advice of Counsel

Honorable Anna C. Verna
President of City Council
Room 494 City Hall
Philadelphia, PA 19107

RE: Repealing DROP

Dear President Verna:

By letter dated August 3, 2010, you asked for my opinion as to the power of City Council to repeal the City's Deferred Retirement Option Plan ("DROP") (§22-310 of the Public Employees Retirement Code ("Code")). In particular, you have asked if some current City employees have a constitutionally protected property right in the continuation of DROP. If so, you have asked about such rights as to at least four categories of current City employees. In addition, you have asked whether, with respect to employees represented by a union, the City may unilaterally repeal DROP, or whether it is an issue that must be bargained with unionized employees. If it is a bargainable issue, you have asked for the process that the City must undertake with each union before it may repeal DROP.

I. Executive Summary

Whether the City can unilaterally repeal DROP with respect to certain City employees, and the substantive analysis in support of repeal, depends on the category of the respective employees, and, with respect to union employees, the history of collective bargaining on pension issues with each of the unions. Subject to the detailed analysis set forth below, I have identified the relevant employee categories and have concluded as follows:

A. Employees currently enrolled in DROP: This category of employees likely has a constitutionally protected contract right in DROP that cannot be taken away.

B. Employees eligible for, but not yet enrolled in DROP: With respect to this category of employees, I believe, if litigated, a court could determine that enrollment in DROP is a requirement for vesting of DROP, and therefore, DROP can be repealed as to those who have not yet enrolled in DROP without a constitutional violation. The ordinance's reservation of rights clause supports this position. Moreover, in lieu of DROP, nearly all employees will accrue a higher retirement benefit for their additional service during what would have been the DROP period, providing an additional defense to a constitutional challenge.

C. Employees vested in the City's pension system, but not yet eligible for DROP: With respect to this category of employees, I believe, if litigated, a court could determine that the DROP benefit can be repealed because the employee has not met the age and service requirements, is not yet even eligible to enroll in DROP, and is therefore not vested in DROP. The ordinance's reservation of rights clause supports this position. This category presents a stronger case in support of repeal than the immediately preceding one.

D. Employees not yet vested in the Retirement System: With respect to this category of employees, I believe, if litigated, a court should conclude that there is no impediment to repealing DROP, as the employee has no vested rights in any retirement benefits. The ordinance's reservation of rights clause supports this position.

E. Union Employees: While the general rule is that pension changes must be bargained, I believe, if litigated, a court could determine that the City may utilize a common law exception to repeal DROP as to union employees (to the extent described in the categories above) without bargaining with the Union where, as I believe to be the case here, repeal does not contravene a specific term of the collective bargaining agreement and the City did not previously bargain over DROP.[1] Alternatively, a court could find that the reservation of rights clause in the ordinance has been incorporated into the collective bargaining agreement, allowing the City to repeal DROP without bargaining.

II. Background

Under the City's DROP ordinance, any employee who has reached his or her plan's normal retirement age and who has at least 10 years of service is eligible to participate and can enter the program. Upon entry, which is irrevocable, the employee ceases to pay pension contributions or accrue benefits. The employee may continue to work for the City for a maximum of four years. During that time, his monthly pension benefit is credited to a tax-deferred, interest-bearing account. The Board of Pensions and Retirement (the "Board") determines the interest rate, subject to a minimum of 4.5 percent, the rate payable since the

[1] The factual record of negotiations over the last eleven (11) years with each of the City unions as to DROP will have to be developed as part of the analysis.

inception of the program. On eventual retirement, the balance in the account is paid to the employee as a lump sum.

There are several factors unique to DROP that are relevant to City Council's right to repeal. First, DROP was initially adopted by City Council in 1999 for a limited duration or test period, as the cost was uncertain. This cost uncertainty is evident from the DROP ordinance itself, which states, "It is the intent of City Council that the design of this test DROP is such that the impact of the Plan will not result in more than an immaterial increase in the City's normal cost of annually funding the Retirement System." Code §22-310(1). The ordinance required a review of DROP by the Board after four years and a determination by the Board that the cost was "immaterial" in order for the program to continue. City Council provided a backstop of protection from the Board's determination by expressly reserving the right to amend DROP, including the right to amend to account for a time when the cost may no longer be immaterial. The DROP ordinance provides that "the DROP...will continue under the same terms (except those relating to the "test" aspects) indefinitely unless and until further amended by City Council." This reservation of the right to amend, in my view, relates to the period of time after the test period. It is contained in the same paragraph as the test period provision and is introduced by the words "the test DROP is subject to the following conditions," which, as a matter of statutory construction, leads to a conclusion that DROP benefits are subject to a condition that they can be amended, and that the program will not continue "indefinitely" if City Council so amends the ordinance.[2] Code §22-310(1)(a).

A second unique feature of DROP is that its repeal will provide employees with an alternative benefit, the continued accrual and vesting of normal retirement benefits (between 2% and 3.5% of a potentially increasing average final compensation for each year of service). Thus, if the DROP program is truly cost neutral, one could maintain that by repeal, City Council is replacing one benefit with an equivalent benefit.[3] If DROP is not cost neutral, then one may be able to maintain that the repeal improves the actuarial soundness of the Plan, a standard discussed further below.

The City has a severe financial crisis and the City pension fund is severely underfunded. It has been declared a "Distressed Fund" by the Commonwealth, and is reported to be only 45% funded. The City has received an analysis, dated July 29, 2010, entitled "The Impact of a DROP Program on the Age of Retirement and Employer Pension Costs," prepared by the Center for Retirement Research at Boston College. This analysis states that DROP "results in a substantial increase in pension cost," and estimates that DROP "has cost the city around $258 million over the period to 31 December 2009." It concludes: "Although our estimates are somewhat sensitive

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[2] If DROP is repealed, a court could maintain that such an amendment to the ordinance is beyond what was contemplated by the right to amend. In any event, there cannot be an immediate repeal as to employees with vested rights, so that any repeal of the DROP would be of limited application and more in the nature of an amendment.

[3] This would be true for all except those whose pension benefit has already reached the maximum and whose average compensation is not increasing.

to the assumptions made regarding interest rates and wage growth, at no plausible combinations is it cost-neutral." (Page 24).

III. Constitutional Principles: The Contract Clauses

The City's Home Rule Charter vests the "complete power of legislation" in City Council. The Pennsylvania Supreme Court has defined legislative power as "the power to make, alter, and *repeal* laws."[4] Although the City has the power to repeal DROP, constitutional and contract law principles will determine whether the power to repeal can be applied to the referenced categories of employees covered by DROP.

The contracts clauses of the United States[5] and Pennsylvania[6] Constitutions (collectively, the "Contract Clause") protect contracting parties from subsequent legislation that either impairs or abridges a pre-existing contract. The Contract Clause analysis requires three threshold inquiries: (a) whether there is a contractual relationship; (b) whether a change in a law has impaired that contractual relationship; and (c) whether the impairment is substantial.[7] If legislative action substantially impairs a contract, the inquiry does not end. The court must then determine whether the law at issue has a legitimate and important public purpose, such as remedying a social or economic problem.[8] If the answer is yes, then, in light of that purpose, is it reasonable and appropriate to adjust the rights of the contracting parties?[9]

Pennsylvania courts have on numerous occasions found that public employee retirement benefits are viewed as being part of a contractual agreement between the public employer and its employees, and thus would be protected from repeal by the Contract Clause.[10] Addressing the

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[4] *City of Philadelphia v. Schweiker*, 858 A.2d 75, 89 (Pa. 2004) (quoting *In re Marshall,* 69 A.2d 619, 626 (Pa. 1949) (emphasis added)).

[5] U.S. Const. Art. I, § 10.

[6] Pa. Const. Art. I, § 17.

[7] *General Motors Corp. v. Romein*, 503 U.S. 181, 186 (1992).

[8] *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 242-44 (1978). *See also, Parsonese v. Midland National Insurance Co, et al*, 550 Pa. 423, 706 A.2d 914 (Pa. 1988) (severe contractual impairment unconstitutional as it did not safeguard any vital interest of the people). The Pennsylvania Intergovernmental Authorities Act ("PICA Act"), which created the Pennsylvania Intergovernmental Cooperation Authority ("PICA"), requires that the City develop, at least annually, Five-Year Financial Plans that provide for balanced budgets and must be reviewed and approved by PICA. The City is further required to undertake "a review of compensation and benefits" and to ensure that expenditures, including those for employee wages and benefits, are balanced with revenue. 53 P.S. §12720.102(b)(1)(iii)(H); 12720.109(b) and (c). If the City does not comply with the PICA Act, the State may withhold funding and tax revenues designated for the City. In this regard, I would note that the City submitted a revised Five-Year Financial Plan to PICA on July 14, 2010, which was approved on August 10, 2010. Unfunded pension liabilities is listed as the greatest long-term fiscal challenge facing the City.

[9] *Id.*

[10] See, e.g., *Wright v. Allegheny County Retirement Board*, 134 A.2d 231 (Pa. 1957); *see also Catania v. State Employees' Retirement Board,* 498 Pa. 684, 450 A.2d 1342 (1982) (retirement benefits vest when

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pension rights of public sector employees, the Pennsylvania Supreme Court in *Harvey v. Allegheny County Retirement Board* further held that an employee who has not complied with all conditions necessary to receive a retirement allowance may be subject to legislation that changes the terms of the retirement contract "if the change is a reasonable enhancement of the actuarial soundness of the retirement fund."[11] In *Harvey*, the Supreme Court has allowed a change to a municipality's pension plan that increased the retirement age from 50 to 60 for all employees who, on the effective date of the act, had not attained eligibility to receive a retirement allowance. However, an employee's pension rights under a retirement act are constitutionally protected against legislative changes once the employee fulfills the conditions prerequisite to the receipt of retirement pay, i.e., those rights have then ripened into a full contractual obligation.

More recently, however, the Pennsylvania Supreme Court held in *Association of PA State College & Univ. Faculties v. State Sys. Of Higher Educ. ("APSCUF")*[12] that a "unilateral devaluation of the retirement benefits of non-vested members [of a state employees plan] would be prohibited absolutely without regard to the Commonwealth's claim of actuarial enhancement." The Court found that the state legislation that raised employee pension contribution rates was unconstitutional, concluding that shifting the contribution burden to employees does not impact actuarial soundness. The Court acknowledged that "actuarial soundness is a valid basis for some changes in a retirement system" (emphasis in original), but did not elaborate on the types of changes that might pass constitutional muster as to existing, non-vested participants. In one instance prior to this case, the Pennsylvania Supreme Court affirmed that it is actuarially sound to increase the length of service requirements in order for an employee's pension rights to vest.[13] Replacing DROP with continued accruals may be another situation that would be permitted under an actuarial soundness argument with appropriate supporting evidence. None of these cases addressed reservation of rights clauses.

In the most relevant judicial pronouncement on the subject, the Third Circuit, in a 1998 opinion,[14] held that where a retirement plan contains express "reservation of rights language"

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employee is eligible to take them and remain inchoate until that time). In *Catania v. Commonwealth State Employees' Retirement Board (Catania II)*, 455 A.2d 1250 (Pa. Cmwlth. 1983), the court concluded that when a member's rights have been treated as "vested" by reason of attaining the minimum years of tenure, any and all changes which reduce benefits then applicable are barred."

[11] 141 A.2d 197, 203 (Pa. 1958). In *Harvey*, the particular vesting conditions were age and years of service. Until an employee satisfied both conditions, his retirement pay was an inchoate right. *Harvey*, at 200 (quoting *Retirement Board of Allegheny County v. McGovern*, 316 Pa. 161, 174 A. 400 (1934)). Both *McGovern* and *Harvey* state that an employee's pension rights under a retirement act are constitutionally protected against legislative changes once the employee fulfills the conditions prerequisite to the receipt of retirement pay; they have then ripened into a full contractual obligation.

[12] 479 A.2d 962, 966 (Pa. 1984)

[13] *Eisenberger v. Harrisburg Police Pension Fund*, 162 A.2d 347, 348 (Pa. 1960) (decided between *Harvey* and *APSUF)*.

[14] *Transport Workers Union of America, Local 290 v. SEPTA ("TWU, Local 290")*, 145 F.3d 619, 623 (3d Cir. 1998).

(e.g., the power to modify, alter or amend the plan (similar to that contained in the DROP ordinance)), the employer may amend the plan without violating the Contract Clause. The Third Circuit held that the Contract Clause protects only the legitimate expectations that arise from the contractual relationships from unreasonable legislative interference. The Third Circuit found that, because of the express reservation clause, a plan amendment requiring employee contributions did not frustrate any legitimate expectation of the plaintiff union. This was even though "the [Plan] document evinces an intent to continue the Plan indefinitely." The plan's provisions gave notice to the union that the terms of the plan were alterable by the governmental authority. The Third Circuit explicitly rejected an assertion that Pennsylvania law holds that the terms of a public pension plan are irrelevant to a determination of whether rights protected by the Contract Clause have been substantially impaired. The court held that an express reservation of rights to modify is effective with respect to employees who have not satisfied the plan requirements for retirement benefits (i.e., employees whose benefits have not vested). In determining whether vesting has occurred under the DROP program, the plan requirements control (i.e., age, years of service, and enrollment).

As to whether the DROP ordinance's reservation of rights permits repeal in accordance with *TWU, Local 290*, we note that it is contained in the paragraph introduced as a "condition" to DROP, thus putting employees on notice, as in *TWU, Local 290*, that the program was subject to change, including discontinuance. Indeed, the very sentence in that paragraph that reserves the right to amend specifically provides that DROP will continue indefinitely, unless and until further amended by City Council. The juxtaposition of these words leads reasonably to the interpretation that DROP may not continue indefinitely if City Council decides to amend, thus limiting the legitimate expectations of the employees. In light of this language, we believe that a court could find that the legitimate expectations of employees were that DROP might not continue indefinitely (the magnitude of employees now applying for DROP may indicate that employees recognize it could be discontinued). Conversely, in *TWU, Local 290*, there were additional "warnings" to employees in the act by which the plan was authorized, not present in the DROP ordinance, regarding the right to discontinue, suspend or reduce the governmental authority's contribution or to terminate the Plan.

IV. Analysis of Categories of Employees Identified

In analyzing each category of employee below, I have focused on the following potential grounds for repeal:

1. The pension contract incorporates a reservation of rights clause as to DROP that allows changes in benefits that have not vested.

2. The DROP enrollment provisions constitute a separate offer to contract that can be revoked. Vesting of DROP does not occur until enrollment.

3. The contract impairment is not substantial, or if substantial, can be justified by the underfunded state of the Plan.

A. Those employees currently enrolled in DROP. Participants currently in DROP have entered into a separate contract with the City that other employees have not. This

contract has consideration from each of the contracting parties. The employee has taken action in reliance on the agreement to provide DROP benefits and has satisfied the plan requirements for vesting of DROP: age, service, and enrollment. As to this category of employees, under the authority cited above, if litigated, I believe that a court would hold that repealing DROP as to these enrolled participants would result in an actionable breach of contract claim. In addition, any impairment of the DROP contract as to this category of employees may be declared unconstitutional by the Pennsylvania Supreme Court.

While the original DROP ordinance specifically provided that if the program automatically terminated at the end of the test period then "no member currently enrolled in the plan shall be divested of any rights under the DROP Plan," it seems reasonable that a court would infer that this anti-divestment provision would equally apply to DROP even after the test period ended. The central issue is then what does the term "enrolled" mean? Based on Board Regulation No. 6, §6.13, it appears that enrollment consists of a least two parts: (i) submission of a DROP application ("DROP application") by the participant to the Board; and, afterwards (ii) the participant's execution of a memorandum of intent to enter DROP (the "Memorandum of Intent") as prepared by the Board, within 90 days of the participant's submission of the DROP application to the Board. Therefore, it appears that those participants who have merely submitted the DROP Application, but not yet signed the Memorandum of Intent, may have no vested interest in DROP, if the text of the regulation is strictly construed. Conversely, once a DROP Application has been filed with the Board and a Memorandum of Intent signed by the participant and timely returned to the Board, such a participant would seem fully vested in DROP and DROP participation cannot be repealed with respect to such individual, even if Board acceptance has not technically occurred. I note that the Mayor's proposed ordinance recently transmitted to City Council **(Bill No. 100542)** would grandfather those members whose application to participate in DROP is pending when the repeal becomes law, which as described above is before one is fully enrolled.

B. **Those employees who have met all DROP eligibility requirements, but who are not yet enrolled in DROP.** The ability to repeal DROP for this category will depend on whether the courts would consider DROP to be a vested benefit for employees meeting the age and service requirements, but who have not yet enrolled in DROP. Enrollment, however, can only be accomplished if the employee gives up certain employment rights, including the accrual of certain future pension benefits, the irrevocable selection of a benefit option (individual, joint and survivor, or other), and also the commitment to retire by a certain date. Thus, there is still an element of conditional acceptance and performance that has not yet occurred, and under that analysis, the DROP benefit has not yet vested. Supporting this conclusion is the fact that for one who has not yet enrolled in DROP and terminates service, there is no accrued DROP benefit to vest, so the employee is not entitled to any financial benefit from the mere existence of the DROP option.[15] If not vested, the reservation of the right to

[15] In addition, Code §22-1305 provides that on the termination of a plan, "all members hereunder affected by such . . . termination shall be fully vested in their accrued benefits as of the date of termination to the extent the benefits are then funded." An accrued benefit is only that portion of a member's prospective retirement benefit that has been earned or accrued to the date of reference. Code §22-105(1). Despite these termination provisions, there is no vesting of DROP benefits for one who has not yet enrolled. *See*

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amend and general contract law may support repeal. See Restatement (Second) of Contracts §42 (an offeree's power of acceptance is terminated when the offeree receives from the offeror a manifestation of an intention not to enter into the proposed contract). The reservation of rights clause, in my view, provides the ultimate authority for the repeal of unvested pension benefits such as DROP, providing a distinguishing factor from the case law that is protective of pension benefit plans.

The Third Circuit, as noted above, has determined that a reservation of rights to modify or amend the terms of a pension plan allows the municipality to unilaterally modify or amend terms to the financial detriment of current employees whose benefits have not yet vested. Thus, as to this category of employees, if litigated, I believe a court could determine that enrollment in DROP is a requirement for vesting of DROP, and therefore, DROP can be repealed as to those who have not yet enrolled in DROP. However, I must advise that I have found no case on point dealing with the facts and circumstances of any DROP program. A court could find vesting simply means meeting the age and service requirements that makes one eligible to enroll in DROP and there are cases that have so found as to normal retirement benefits.[16] The unique argument as to DROP is that there is an additional vesting "requirement" beyond age and years of service, i.e., entering into the DROP contract and foregoing certain rights. Under the more basic years of service interpretation of vesting, the repeal of DROP in this category may impair a contract in violation of the Contract Clause.

Whether the impairment is substantial or whether the impairment would be permitted would require a factual analysis as to whether the repeal (and replacement with the prior system) increases the actuarial soundness of the Plan, and whether repeal has a legitimate and important public purpose, and is a reasonable and appropriate response in light of that purpose. The court's determination of this could be influenced by the City's financial condition, the underfunding of the City's pension fund, and other public policy considerations.

C. **Those employees who are "vested" in the City's pension system but are not yet eligible for DROP.** This category initially needs to be defined. Code §22-105(47) defines a "vested member" as "[a]ny member who has the necessary service under the Retirement System, as provided for in §22-302 (Separation Retirement Benefits), to be vested." Code §22-302(1) provides that "[a]ny member who separates from service after ten (10) or more years of credited service, or such lesser vesting period as is authorized by §22-301(1)(c) or (d),[17]

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also Section 411(e)(2) of the Internal Revenue Code of 1986, as amended (100% vesting on termination of governmental plan).

[16] *Retirement Board of Allegheny County v. McGovern*, 316 Pa. 161, 174 A. 400 (1934) ("until an employee has earned his retirement pay, or until the time arrives when he may retire, his retirement pay is but an inchoate right; but when the conditions are satisfied, at that time retirement pay becomes a vested right of which the person entitled thereto cannot be deprived; it has ripened into a full contractual obligation.").

[17] These sections provide for five-year vesting in the case of exempt civil service employees who are not entitled to be represented by a union; and the lesser of two (2) full terms in elected office or eight (8) years for elected officials.

but before attaining minimum retirement age, is a vested member of the Retirement System and is entitled to separation retirement benefits." Separation retirement benefits are calculated in the same manner as service retirement benefits in Code §22-301, which does not reference a DROP benefit. Code §22-302(3). From the plain language of these provisions, it is reasonable to conclude that the vesting provisions of the Code only address the annual benefits based upon average final compensation and years of service as set forth in Code §22-301(3), and not DROP benefits. This interpretation would be consistent with the view that DROP is an isolated additional pension program with no direct connection to the definitions of "accrued benefits" or "vesting" under the Code. As to this category of employees, for reasons similar to category B above, including, in particular, the reservation of rights clause, I believe, if litigated, a court could determine that the DROP benefit can be repealed because the employee has not met the age and service requirements, is not yet even eligible to enroll in DROP, and is therefore not vested in DROP.[18]

D. Those employees who are not yet vested in the Retirement System. This category would include those who have not satisfied their requisite service requirement (generally 10 years) for vesting of normal retirement benefits. This category of employees is not vested in retirement benefits of any kind under the most liberal definition of vesting, providing an even stronger position that the reservation of rights clause allows repeal as to this group. As to this category of employees, for reasons similar to categories B and C above, I believe, if litigated, that a court should conclude that there is no impediment to repealing DROP.

This category could also include those hired after the effective date of a repeal. We know of no authority that would prevent repeal for those not yet hired.

E. Union employees. The above analysis would appear to apply equally to employees in a collective bargaining unit, if the repeal of DROP is an item that need not be bargained. The question of whether a unilateral change to a benefit is subject to bargaining when that item has not been the specific subject of prior bargaining is a complex one, depending, as to the City unions, on the specific facts and circumstances of the collective bargaining agreement ("CBA"), past practices of the bargaining parties and the actual record of negotiations. As a matter of law, there is a general requirement to bargain terms and conditions of employment with City unions, including pension benefits. Pennsylvania Act 111 (fire and police)[19] and Act 195 (all other public sector employees)[20] cover the unions that collectively bargain with the City. Both Act 111 and Act 195 give union members the right to bargain retirement benefits collectively with their public employers.[21] A municipal employer commits an unfair labor

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[18] My opinions herein are not dependent on any distinction between exempt and non-exempt (civil service) City employees. I note only that an additional argument can be made as to exempt employees that they are at-will employees with less reasonable expectations as to pension benefits.

[19] 43 P.S. §§ 217.1-217.10.

[20] 43 P.S. § 1101.101 *et seq.*

[21] *Borough of Ellwood City v. Ellwood City Police*, ___ A.2d ___ (Pa. Cmwlth. 2010) at *13 (2010 Pa. Commw. LEXIS 320) (quoting 43 P.S. § 217.1).

practice if it refuses to collectively bargain with a union over a mandatory subject of collective bargaining.[22]

Based on statutory and case precedent, absent a common law exception, a municipal employer may not unilaterally change pension terms without first negotiating with the union.[23] This holds true with respect to future bargaining unit members since a collective bargaining agreement applies to all those who are members of the bargaining unit during the term of the agreement.[24]

There are, however, two recognized common law exceptions in Pennsylvania that relieve a municipal employer of a duty to bargain with a union over pension changes, which may apply in the current situation, as discussed below.

1. The "Plainfield Township" exception

The Commonwealth Court recognized the first exception in *Plainfield Twp. Policemen's Ass'n v. PLRB.*[25] However, as described below, the exception is very fact-specific.

Based on the facts of this case, the court held that Plainfield Township did not have to collectively bargain with the union before it unilaterally changed its pension ordinance. The court offered as its primary justification that the union could have incorporated, but failed to incorporate, the ordinance's provisions regarding police pensions into the collective bargaining agreement; so it could not complain about later Township changes.

The City's circumstances here may not fit squarely within the *Plainfield Twp.* mold in each instance. The current Act 111 arbitration awards between the City and its Police and Fire Unions make reference to the Code specifically. Neither of the current AFSCME agreements reference pensions specifically, although both include integration clauses, which incorporate non-conflicting terms and conditions from the prior agreement. To the extent that those prior agreements reference pension benefits, they may be considered incorporated by reference.

However, the mere mention of the Code – as opposed to DROP or a specific incorporation of the governing ordinance – in certain City agreements may provide a basis to argue that the City has no duty to bargain with some or all of the unions under *Plainfield Twp.* Both Pennsylvania courts and the Pennsylvania Labor Relations Board have recognized that a CBA reference to an ordinance governing pension benefits generally creates a duty to bargain

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[22] 43 P.S. § 211.1, *et seq.*; 43 P.S. § 1101.1201; *Ellwood City*, at *11 (quoting 43 P.S. § 211.6(1)(e)).

[23] *Plumstead Twp. v. PLRB*, 713 A.2d 730, 733 (Pa. Cmwlth. 1998). *See also NLRB v. C & C Plywood Corp.*, 385 U.S. 421, 428 (1967). Among the factors the *C & C* court contemplated in determining whether bargaining was required were the parties collective bargaining history and the regulatory scheme underlying that context. *Ibid.*

[24] *City of Allentown v. Local 302, Int'l Assoc. of Fire Fighters*, 512 A.2d 1175, 1181, n4 (Pa. 1986).

[25] *Plainfield Twp. Policemen's Ass'n v. PLRB*, 695 A.2d 984 (Pa. Cmwlth. 1997).

subsequent pension changes.[26] In order to fall within *Plainfield Twp.*, the City would have to argue that, notwithstanding explicit CBA references to pensions in at least some of the contracts, the failure to even reference DROP specifically in agreements other than the Police Award,[27] plus no past practice of negotiating DROP, creates an understanding that the CBAs do not cover DROP. The analysis contained in an unreported non-precedential opinion of a 3-judge Commonwealth Court panel (reversing a PLRB decision and expanding *Plainfield*), *City of Erie v. PLRB*, No. 652 C.D. 2008 (March 5, 2009), supports such a position. In that case, the Commonwealth Court panel held that because there was no evidence that the parties "explicitly bargained over" the pension option (a DROP-like benefit) nor that the pension option was included in the relevant CBA, the City of Erie was free to repeal the pension option without bargaining with the Union despite a CBA provision stating that pension benefits were governed by the present statutes and ordinances.[28] Because the issue is so highly fact intensive, and due to the absence of explicit precedent on the unique circumstances present in this matter, it is difficult to predict how a court would rule.

2. The "Contractual Privilege" exception

Under the "contractual privilege" exception, an employer may unilaterally change a term or condition of employment if the employer believes that it has a sound arguable basis to do so under the language of the contract.[29] To apply this exception to a pension change, I believe an

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[26] *City of Allentown*, 512 A.2d at 1181 (a unilateral change in pension benefits constituted a breach of a CBA where the CBA merely made reference to the plan created by ordinance); *City of Erie v. FOP, Lodge 7*, 977 A.2d 3, 7-8 (Pa. Cmwlth. 2009) (distinguishing *Plainfield Twp.* and prohibiting a unilateral change where the FOP's CBA provided "The City and the [Union] have agreed that the present pension plan as operated by the [Pension Board] is to continue according to the provisions as set forth by separate agreement," which in this case was nothing more than the pension ordinance).

[27] Although the most recent interest arbitration award between the City and the police union mentions DROP, it does not do so in the context of awarding pension benefits. Rather, it mentions DROP only in connection with the residency requirement. That award and the supplemental award issued for the police union in March 2010, which establishes new pension terms for new hires, incorporate the terms of the existing pension plans but do not specifically address DROP. It is not clear whether a court would find that the reference to DROP in the residency terms of the award is enough to incorporate DROP into the collective bargaining agreement and prevent the City from unilaterally repealing the benefit.

[28] In *City of Erie v. PLRB,* the panel found that there was not substantial evidence to support the PLRB's finding that the pension provision in question was a term negotiated by the parties and then placed in the CBA, despite a general incorporation of the plan ordinances in the CBA. The full court was evenly divided on the panel's holding, which while ostensibly relying on *Plainfield Twp.*, seems to expand it beyond the existing precedent cited in footnote 29 above. Allocatur was granted by the Pennsylvania Supreme Court on July 7, 2010, and argument is set for October 20, 2010. If affirmed, the holding may strengthen the applicability of the *Plainfield* exception, as applied to the repeal of DROP.

[29] *Wilkes-Barre Twp. v. PLRB*, 878 A.2d 977, 983 (Pa. Cmwlth. 2005); *Montgomery Twp. Police Officers v. Montgomery Twp.*, Case No. PF-C-06-1-E (PLRB 2006).

employer must establish three elements:

1. The CBA can only incorporate by reference a pension plan or city ordinance or be silent altogether;

2. The employer must comply with the pension plan/ordinance; and

3. The pension changes must not conflict with explicit CBA pension terms.[30]

The reservation of rights language in the DROP ordinance may empower the City to amend DROP unilaterally pursuant to its contractual right to reasonably amend the DROP without bargaining with the unions, provided that the amendment does not otherwise contravene a specific CBA term,[31] and provided that there is not a past practice of including DROP in the negotiations.[32] A review of the cases indicates that Pennsylvania courts are generally reluctant to stray from the general statutory requirement that pension changes be bargained collectively. It is unclear to what extent a court may treat the DROP ordinance as part of the CBAs, including its reservation of rights language, so that the City could be deemed to have a sound arguable basis to make a unilateral change based on the contractual privilege exception.

V. Collective Bargaining Process for City Unions

With respect to the process regarding bargaining to repeal DROP, if it were required, there is one guiding principle. If a contract is in place, the union has no obligation to bargain with the City over any other changes during the term of the contract. Although the City could ask the union to bargain over the pension change prior to the end of a contract, the union can refuse until the expiration of that contract.

A. **Police.** A contract is in place until 2014.

B. **Fire.** The parties have completed interest arbitration hearings and are awaiting the issuance of an award. At this time, neither party may be permitted to introduce a new issue.

C. **DC 33 and DC 47.** The parties are currently in the bargaining process and the City likely would be legally permitted to add elimination of DROP as an additional proposal.

D. **Local 810 (Courts), Local 159 (Corrections Officers), Deputy Sheriffs.** The parties are currently in interest arbitration hearings. The City arguably would be legally permitted to add elimination of DROP as an additional proposal if it did so before the hearings concluded.

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[30] *Id.*

[31] *Wilkes-Barre Twp. v. PLRB*, 878 A.2d at 983.

[32] *Id.; Plumstead Township v. PLRB, supra.*

VI. State Law Claims for Breach of Contract, Misrepresentation and Equitable Estoppel

Although the City may have the power and authority to repeal DROP as to certain classes of employees, any decision to repeal DROP must also take into account other possible legal challenges to exercising this right, such as state law claims for breach of contract, misrepresentation and equitable estoppel. Such claims might be predicated on language in the pension handbooks distributed by the Board (which state that DROP is "an enhancement to" current pension benefits), the Pennsylvania Municipal Pension Handbook, past practices, and other representations, which might be viewed as representations that DROP would not be repealed. This would depend on the factual analysis of all materials made available to the employees concerning DROP, the past practices of the parties, and whether there is any evidence of detrimental reliance.[33] Consequently, since these factual issues depend upon the individualized circumstances, including the existence of detrimental reliance, there are strong legal defenses to treating these claims as class actions and there is, therefore, no *per se* legal impediment to City Council's ability to repeal DROP on account of such claims.

VII. Conclusion

To conclude, I believe the foregoing analysis addresses the questions raised. I would be pleased to provide any additional analysis you may request.

Sincerely,

Shelley R. Smith
City Solicitor

cc: All Members of City Council

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[33] The elements of a claim for a retirement benefit misrepresentation were recently set forth in *In re Unisys Corp. Retiree Medical Benefits Litigation*, 579 F.3d 220 (3d Cir. 2009), where plaintiffs made claims for breach of fiduciary duty under ERISA to restore promised post-retirement medical benefits that were terminated. After determining that the matter did not qualify for a class action, the Third Circuit found for such a claim to survive, the plaintiff must demonstrate: (1) the defendant was acting in a fiduciary capacity; (2) the defendant made affirmative misrepresentations or failed to adequately inform plan participants; (3) the misrepresentation was material; and (4) the plaintiff detrimentally relied on the misrepresentations or inadequate disclosure.