Court of Appeal Ends Decade-Long Dispute and Upholds Board's Fiduciary Decisions Regarding Funding of Retirement System

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On March 27, 2024, after nearly a decade of dispute and five years of litigation, the First District Court of Appeal unanimously rejected all claims that a participating employer brought against the Alameda County Employees' Retirement Association (ACERA), its Board of Retirement (Board) and its Chief Executive Officer (CEO). (*Alameda Health System*, et al. v. *Alameda County Employees' Retirement Association, et al.* (First DCA, Div. 2, A165587) (*AHS* decision).)

In the *AHS* decision, the Court upheld the ACERA Board's fiduciary authority and discretion to maintain its longstanding Percentage of Payroll methodology for funding the retirement system. The Court also affirmed the Board's right not to continue to study how much its participating employers *might* have paid to ACERA in the past, or *may* pay to it in the future, using a different funding methodology that the Board has not adopted.

In 2015, the employer—Alameda Health System (AHS)—began challenging the actuarial methodology employed by the ACERA Board as "unfair" to AHS and accused the system of "overcharging" AHS for its share of employer contributions. AHS is one of seven participating employers in ACERA's multiple-employer defined benefit retirement system. As the Court observed in the *AHS* Decision: "This dispute concerns ACERA's method for determining the annual contributions participating employers must make toward unfunded liability to ensure the retirement system will be able to fund the pensions the employers have promised their employees."

The Court then provided a detailed description of the history of ACERA's funding of the retirement system, noting that

> The method ACERA has used since its inception in 1948 to calculate annual contributions for unfunded liabilities among its participating employers is known as the 'Percentage of Payroll' method. It is a common and well-accepted cost-sharing actuarial methodology for funding multi-employer defined benefits plans nationally and in California. The Percentage of Payroll method involves pooling of actuarial risk to reduce volatility in employer and employee contribution rates, reduce complexity in calculation of contributions and ensure sufficient funds are contributed to the retirement system on a timely basis."

AHS first raised concerns to ACERA about the Percentage of Payroll method of determining employer contributions in 2015, asserting, based on a study ACERA's actuary performed that year at AHS's request, that AHS "might have contributed considerably less to ACERA in 2014 had a different method, known as 'Percentage of Liability,' instead been used to determine employer contributions." Based on that study, AHS argued that "it had 'subsidized' the cost of participation by other plan members in the retirement system for over a decade 'without measurable benefit.'" AHS requested that ACERA change its methodology to the Percentage of Liability method, claiming that it would result in AHS paying $12 million less in contributions every year going forward, and retrospectively to reallocate to the other participating employers contributions that AHS had previously made of "approximately $65 million (before any adjustments for investment earnings)."

ACERA considered AHS's request for a second study in detail by: (i) holding numerous meetings of ACERA staff with AHS and with ACERA's largest participating employer, the County of Alameda (County); (ii) reviewing presentations by ACERA's consulting actuary, as well as by AHS and the County, to ACERA's Actuarial Committee and its Board regarding AHS's proposal; (iii) considering objections ACERA received from the County to AHS's demands; and (iv) considering views that ACERA's staff, advisors, and Committee and Board members articulated regarding the topics presented during such meetings. Significantly, this prudent process was documented and presented to the trial court in ACERA's motion for summary judgment and its specifics were repeated, verbatim in some instances, in the Court's comprehensive analysis of the issues.

In a unanimous decision affirming the trial court's grant of summary judgment for ACERA, the Court reached four holdings regarding both the fiduciary authority and discretion of public retirement boards in California over the actuarial funding of the retirement systems they govern and the standards by which courts will evaluate challenges to those decisions:

- AHS had sought a writ of mandate to force the Board to change its actuarial methodology or to order an additional actuarial study using AHS's preferred methodology, Percentage of Liability. The Court held that the standard governing writs of mandate seeking to force a public retirement board to take a discretionary action, even where that action implicates the board's fiduciary responsibilities, is deferential to the "quasi-legislative decisions" of the board "out of the recognition of the 'high degree of expertise' often developed by 'agencies to which the Legislature has delegated regulatory authority in particular areas.'"
- AHS had claimed that ACERA abused its discretion because "(1) its Board is 'dominated' and 'influenc[ed]' by the County and (2) its reasons for declining to change its methodology to conduct a further actuarial study were 'pretextual.'" The Court rejected those claims, concluding, based on the comprehensive record presented as well as applicable law regarding the mandated composition of county retirement boards, that "[n]either contention has merit." The Court observed:

The undisputed evidence presented by ACERA in support of summary judgment demonstrated that ACERA engaged in an extended process to consider AHS's requests. Over a year and a half, its staff conferred with AHS about the requests on multiple occasions and arranged meetings of participating employers, and its Board and Actuarial Committee each held multiple public meetings to consider AHS's requests. The

evidence also showed that ACERA had been using the same percentage of payroll methodology consistently for nearly six decades, and that methodology pools pension obligations, assets and actuarial risk “so as to reduce volatility in both employer and active member contribution rates,” “reduce complexity in the calculation of contributions” and “ensure that sufficient funds are contributed to the retirement system on a timely basis.” Further, it showed that most other county retirement systems used the same methodology, and that it was a ’common and well-accepted ‘cost-sharing’ actuarial methodology for funding multi-employer defined benefit[] plans’ in California and nationally.

Summarizing its conclusions, the Court stated, “In short, the record contains substantial evidence that ACERA carefully considered AHS’s requests and made decisions supported by recommendations of its actuary and its staff based on legitimate reasons.”

- In response to AHS’s claims that “extra-record” evidence, in the form of “behind the scene” and “back-channel” emails between County staff and ACERA Board members, supported “an inference that ACERA’s staff and Board members were working to assuage the County’s strenuous opposition to AHS’s request for a study,” the Court concluded, “the argument is unpersuasive both on its merits and because it exceeds the bounds of writ of mandate review.” Namely, taking those emails into account and construing them would, according to the Court, “entail[] precisely the kind of assessment of quasi-legislative actors’ motives that is barred by [binding case law].” Furthermore, the Court noted that there is nothing improper about *ex parte* communications in a retirement board’s quasi-legislative proceedings like those at issue here.
- Finally, on the topic of ACERA’s fiduciary compliance, the Court observed that while “ACERA has a fiduciary duty to its members that takes precedence over any other duties (Cal. Const. art. XVI, §17, subd. (b)),” the primary duty to members “does not preclude it from considering how administration of the system will affect the interests of participating employers, including the County, … and of the ACERA members who work for them.”

While disagreements between retirement boards and retirement system stakeholders over what constitutes prudent administration of retirement systems will undoubtedly continue to exist, this decision provides important confirmation of retirement board fiduciary discretionary authority to administer the plans they govern.

Namely, when retirement boards engage in deliberate and prudent processes to address input they receive from their stakeholders, when they consult with their own expert advisors with respect to those inputs, and the record and law supports the rationale that the board uses when engaging in that quasi-legislative decision-making, courts will uphold their discretionary actions that are made in the best interests of their members. This judicial support and deference allows public retirement boards and system staff and advisors in California to do the critical job that the state constitution both permits and requires of them, to properly fund public retirement systems so that they may timely pay the vested benefits due to retirement system members and beneficiaries.

Nossaman represented ACERA through the superior and appellate court proceedings. ***Ashley Dunning****, co-chair of the Pensions, Benefits & Investments (PB&I) Group, was lead trial and appellate counsel.*