

MEMORANDUM

TO: Michael Doweary, Receiver for the City of Chester

FROM: John P. McLaughlin, Esquire, Counsel to Receiver

DATE: October 25, 2021

RE: Review and Analysis of City of Chester's Police Pension Formula

During a recent discussion of the significant benefit costs and enormous funding hurdles facing the City of Chester (the "City") and its Police Pension Plan (the "Plan"), a question arose regarding how pension benefits are currently being calculated for police retirees receiving a normal pension benefit. This is a critical issue that should be resolved to help the City, the Receiver, and the police union address the dire funding issue facing the Plan and the reduction of pension costs. The Plan faces a dire funding crisis and steps must be taken to limit and control the Plan's benefit costs if the Plan is going to survive and be able to provide future benefits to current and future retirees.

Due to the importance of this issue to the City, its taxpayers and to the City's current and future police retirees, we conducted a review of all the relevant collective bargaining agreements (CBAs), Memoranda of Understandings (MOUs) and Act 111 interest arbitration awards between the City and Lodge No. 9, Fraternal Order of Police (the "FOP" or the "Union"), which is the union that represents most of the sworn police personnel employed by the City since 1988, to determine the correct benefit formula and track its history.

Based on our review of the relevant documents, the City is utilizing the incorrect final salary formula of the last twelve (12) months of the retiree's earnings (the 12 Month Formula) and has been for some time for police officers hired after January 1, 1988 and prior to February 1, 2017¹. The correct formula that should have been utilized is the average earnings of the retiree's last three (3) years of the retiree's earnings (the 3 Year Formula)². The difference between the 12 Month Formula and the 3 Year Formula is significant as the 12 Month Formula easily lends itself toward the "spiking" of retiree benefits because the retiring officer can increase the overtime he or she works in the final year of employment, a practice known in Chester as "making their run."

¹ The issues discussed in this memorandum do not apply to police officers who were hired after February 1, 2017, nor those who were hired prior to January 1, 1988.

² As discussed later, I also believe that there may be an issue regarding the types of compensation to be included in the calculation based on language in subsequent collective bargaining agreements. At this time, however, I cannot conclude that the City is utilizing the incorrect types of compensation in the salary calculation for this group.

*The Correct Formula Based on an
Historical Review of the CBAs*

Our review of the CBAs dating back to 1988 reveals that the correct pension benefit formula is the 3 Year Formula for police officers hired after January 1, 1988 and prior to February 1, 2017. That is the formula that is currently provided in the Ordinance and that was contained in the last codified CBA signed by the City and the Union. Our review did not uncover any history where the 12 Month Formula was collectively bargained for employees hired after January 1, 1988 and prior to February 1, 2017 or any other type of agreement signed by the City and the Union to that effect.

The relevant history regarding this issue starts with the 1987-1988 CBA. Article XXI (3) of that CBA contains the 12 Month Formula for all officers. That provision also mandated that an officer may retire after 20 years of service but cannot start collecting a pension benefit until the officer reaches the age of 50.

In 1989, the City and the Union executed a Memorandum of Understanding dated November 1989 (the “1989 MOU”) in which they adopted a two-tiered pension benefit formula. Pursuant to that two-tiered system, officers hired after May 19, 1988 are entitled to a normal retirement benefit after 25 years of service and reaching the age of 53. An officer who met the 53/25 age and service requirements was entitled to a pension benefit equal to 50% of the officer’s average pay for the highest three calendar years. This appears to be the genesis of the 3 Year Formula concept. The 1989 MOU did not change the benefit for officers hired prior to January 1, 1988. Those officers were still entitled to a benefit based on the 12 Month Formula if they met the 50/20 age and service requirement.³

In June 1992, the City and the Union were parties to an Act 111 interest arbitration hearing which resulted in an award which was joined by all three arbitrators: the partial arbitrators for the City and the Union and the neutral arbitrator James C. Duff, Esq. The award was dated October 29, 1992. The October 29, 1992 award did not change any pension benefits, but it did provide for a pension reopener to take place in June 1993. While the Union, on May 20, 1993, submitted a plethora of pension issues to be addressed in the reopener arbitration, there is no award or conclusion from that proceeding. It is telling that one of the issues submitted by the Union was that all police officers “hired after January 1, 1988 shall receive the same pension benefits as Officers hired prior to 1988.” However, it does not appear that the Union’s request was granted in the reopener arbitration.

³ In February 1992, an unidentified person attempted to create a new codified CBA. The first page of that CBA, however, states that it is “not an official document between the parties.” Instead, it was intended to be a “compendium of all written agreements and Act 111 Awards” up until 1989. This “compendium” contained Article XXI (4) which provides for the 3 Year Formula applicable to officers hired after 1988 but in a handwritten note next to that section, however, handwriting which again is not initialed provides “new? not found”. There is no further explanation of the handwriting or why the person who wrote the note apparently overlooked the clear provisions of the 1989 MOU. This “compendium” is not an official or signed CBA or other negotiated document. It is also contrary to the provisions of the fully executed 1998-2002 CBA, discussed below, which does not contain any such language.

It thus appears that even after the 1992 interest arbitration and the 1993 reopener, the 3 Year Formula created in the 1989 MOU was still in place and effective for officers hired in 1988 and thereafter. Indeed, the next two codified CBAs, which spanned the years 1994-1997⁴ and 1998-2002, expressly contained the 3 Year Formula. Those two CBAs both expressly provided that the 53/25 age and service requirement and the 3 Year Formula applied to all officers hired after January 1, 1988. [1994-1997 CBA, Article XXI (4) (A); 1998-2002 CBA, Article XXI (4) (A).]

On May 25, 2005, the City and the Union entered into another MOU signed by then-Mayor Wendell N. Butler, Jr. [the “2005 Butler MOU”]. Paragraph 18 of that MOU only changed pension benefits to provide officers who retire on or after January 1, 2004 “with a full unreduced pension upon the completion of 20 years of service, with no minimum age requirement.”⁵ While this language eliminated the age and service requirement for officers who retired on or after January 1, 2004, it did not change or even reference the pension benefit calculation formula, the 3 Year Formula, applicable to post-1987 hires, including those who retired on or after January 1, 2004. That calculation formula is clearly memorialized in the prior CBAs noted above and was not changed in the 2005 Butler MOU.

Based on the foregoing, the two-tiered pension structure, in which the 3 Year Formula applied to officers hired after January 1, 1988 was created in the 1989 MOU. That pension calculation formula, the 3 Year Formula, is still in place for all such officers hired after January 1, 1988 and prior to February 1, 2017 and has not been changed. The 2005 Butler MOU eliminated the age requirement and reduced the service requirement for all such officers who retired after January 1, 2004, but did not even mention, let alone change, the 3 Year Formula that was mandated by previous agreements applicable to officers hired after January 1, 1988. The last codified CBA signed by both parties confirms that point because it contains the 3 Year Formula and there is no signed agreement between the parties since that time stating the contrary. Thus, the 3 Year Formula still applies to police officers hired after January 1, 1988 and prior to February 1, 2017.

I note that there is an unsigned purported CBA for the years 2008-2011 that was drafted by counsel for the Union that does not contain the reference to the 3 Year Formula that existed in the last codified CBA. A pamphlet purporting to contain the terms of a 2012-2016 CBA also does not contain the 3 Year Formula. Both the 2008-2011 and the 2012-2016 purported CBAs are contrary to the foregoing history, and neither was signed by the City.

Equally troubling is the fact that a pension cost study was never performed by the City or the Plan regarding any change to the 3 Year Formula for all officers hired after January 1, 1988 and prior to February 1, 2017 to the 12 Month Formula. Such a study is required before any pension modification becomes effective pursuant to the Pennsylvania Municipal Pension Funding Standard and Recovery Act (“Act 205”). The actuary at the time the purported change was made

⁴ The 1994-1997 CBA was preceded by an Act 111 interest arbitration proceeding and award dated June 12, 1995. That arbitration award did not change any pension benefits.

⁵ This was an extremely costly and significant change to the pension structure as it both eliminated the age requirement for all officers and reduced the years of service requirement to 20 for those officers hired after 1988 which allowed officers to begin to retire in their 40s starting in 2004.

could not locate any such study⁶. The lack of such a study is further evidence that such a change was never intended or negotiated.

In addition to reviewing all CBAs, settlement agreements and Act 111 Interest arbitration awards dating back to 1998, we also reviewed the current Police Pension Ordinance (the “Ordinance”) and Department of the Auditor General Compliance Audit Reports created under Act 205 (DAG Compliance Reports”). Article 143.03(b)(1) of the Ordinance contains the 3 Year formula for all officers who are hired on or after January 1, 1988. Likewise, in 2007, the Plan’s actuary at the time, produced an Act 205 Actuarial Valuation Report as of January 1, 2007. That study’s listing of the Plan’s benefit provisions included the 3 Year Formula for officer’s hired after January 1, 1988. That listing is consistent with the pension provisions of the last CBA signed by both parties.

A review of the DAG’s Compliance Audits since 2007⁷ further confirms the existence of the 3 Year Formula even in the current Ordinance, but at some point in time after 2009, the 3 Year Formula inexplicitly changed to the 12 Month Formula even though the 3 Year formula still existed in the Ordinance and in the last codified and signed CBA. The DAG Compliance Audits noted the following:

- All the foregoing DAG Compliance Audits noted the discrepancy between the Ordinance, which contained the 3 Year Formula and the Third Class City Code, which does not authorize such a benefit calculation formula.
- The 2013-2015 and 2018-2019 DAG Compliance Audits also expressly noted a discrepancy between the Ordinance and the applicable CBA with respect to the benefit calculation as well. Both noted that the Ordinance applied the 3 Year Formula to the benefit calculation while the CBA applied the 12 Month Formula.⁸

The DAG noted that the unauthorized and conflicting benefit provisions could increase the Plan’s costs and reduce the funds available for investment purposes or the payment of authorized benefits. The DAG further directed the City to take action to restrict the Plan’s benefits only to those authorized by the Third Class City Code (the “Code”) for all employees who began employment as of January 24, 2001 and to make all Plan documents and the CBA consistent. While neither the 12 Month Formula nor the 3 Year Formula complies with the pension provisions of the Third Class City Code (the “Code”),⁹ the latter formula would result in a lower

⁶ The actuary did locate an actuarial study for the DROP benefit which was included in the 2005 Butler MOU.

⁷ The DAG Audits that we reviewed included the 2007-2008, 2009-2010, 2011-2012, 2013-2015 and 2018-2019 audits.

⁸ It appears, however, that in its 2021 Compliance Audit Report, the DAG was reviewing the wrong CBA, one that was not signed by both parties but is merely a draft codification by the Union. The existence of that document was previously discussed.

⁹ The language contained in the 2017 Memorandum of Agreement (MOA) applicable to all officers hired after February 2017 complies with the Code.

pension benefit for the retiree, even if the officer engaged in the practice of “spiking” in his or her final year of employment.

In addition to the foregoing, we reviewed the pension valuations conducted pursuant to Act 205. Although such reports are not evidence of any agreement to change the pension calculation formula, as part of our due diligence on this issue before issuing this order, we reviewed all pension valuations. We discovered that all such valuations prior to 2015, list the 3 Year Formula as the pension calculation formula for all officers hired after January 1, 1988. In 2015, however, the formula changed to the 12 Month Formula, but it is not clear why that change was made. There is no CBA, MOU or interest arbitration award to support that change. The pension valuation form is unilaterally completed by the City and its actuaries and does not constitute an agreement with the police union to change the formula. Indeed, the current pension ordinance to this day still contains the 3 Year Formula.

To complete our review of this matter, we spoke with a number of individuals who could reasonably be expected to have knowledge of the existence of an agreement to change the pension formula if such an agreement ever existed. Those individuals included the City’s former Coordinator under Act 47, a member of the former Coordinator’s legal team, counsel for the Union, and the Plan’s pension administrator. No one had any knowledge of any agreement to change the pension calculation from the 3 Year Formula to the 12 Month Formula.

I trust that the foregoing fully explains the discrepancy between the pension calculation formula being used by the City and the formula that should be used. Based on the foregoing, it appears that the genesis of the City’s application of the current 12 Month Formula could be the 2008-2011 purported CBA that was drafted by the Union and not signed by the City or the Union. That document erroneously and inexplicably omits the 3 Year Formula that existed in the last codified CBA and was never changed and for the reasons stated above is not evidence of any agreement between the City and the Union to change the formula.

The foregoing history, particularly in light of the dire fiscal condition of the Plan, provides more than just a solid basis for the Receiver to exercise his powers under Act 47 to correct this error; the foregoing establishes that based on the current available information, the wrong pension calculation formula is being used which arguably obligates the Receiver to take action to correct the error for the benefit of not only the City and its taxpayers but also all current retirees and all current and future participants in the police pension plan. I recommend that the Receiver immediately take action under Act 47 to order the Pension Board to calculate pension benefits for officers hired after January 1, 1988 and prior to February 1, 2017 by using the 3 Year Formula and to investigate how many current police retirees are receiving an improperly calculated benefit.

In addition to the foregoing, there also appear to be two other significant issues, one dealing with the type of compensation to be included in the calculation of a retiree’s pension benefit and the other with a reduction of the disability benefit at a recipient’s normal retirement age. Both of these issues will be discussed below but need further investigation before any final action should be taken.

Article XXI (4) of the 1994-1997 and 1998-2002 collective bargaining agreements defined the 3 Year Formula as “the average annual *salary* of such member which he or she received during the last three (3) years of service immediately preceding retirement.”¹⁰ (emphasis added). The use of the term “salary” for the 3 Year Formula which applied to those hired after January 1, 1988, differs significantly from the 12 month definition found in Article XXI (3) which refers to “[P]olice officer earnings reportable on I.R.S. Form W-2 in the twelve (12) month period prior to his or her election to retire.”¹¹ The term “salary” commonly refers to base salary plus longevity and, in any event, is not “W-2 earnings.”

However, I note that the Ordinance was changed on October 10, 1996 to define “salary” as including “regular wages (including personal, sick and vacation days), overtime wages, longevity wages, holiday pay, education benefits and any payment for reimbursement of health premiums.” Additionally, I understand that the City has taken out employee pension contributions on more than just base salary and longevity. Consequently, at this time, I cannot conclude that the City is including the incorrect types of compensation in the salary calculation for this group. This is a very important issue, however, and further investigation will be conducted.

Also, importantly, both the 1994-1997 and the 1998-2002 collective bargaining agreements excluded the following language which was awarded in the 1987 interest arbitration award that converted the 100% service connected disability benefit to a regular retirement benefit (50%) when the officer would be eligible for a full regular retirement benefit:

Effective January 1, 1987. The existing service-connected disability retirement shall be amended to provide that when an officer shall be eligible for a full regular retirement benefit, his service-connected disability benefit shall be converted to a regular retirement at the appropriate benefit level. [1987-1988 Interest Arbitration Award, Article 7.]

The question of why the service connected disability language awarded in the 1987 interest arbitration award did not appear in the 1994-1997 and 1998-2002 collective bargaining agreements needs additional investigation. I recommend that you reserve the right in any order to issue another order regarding the calculation of service connected disability pensions.

¹⁰ The 1994-1997 CBA was adopted by resolution by the City on May 23, 1996, but does not appear to have been signed by the FOP. The 1998-2002 collective bargaining agreement is the last signed consolidated collective bargaining agreement between the City and the FOP. Both documents, however, contain the language discussed in the body of the memorandum.

¹¹ The 1994-1997 and 1998-2002 CBAs also appeared to modify the 1989 MOU by utilizing the last three (3) years of service immediately preceding retirement rather than the highest three years.