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MEMORANDUM

To: Brett W. Lear, Chair
NORTHNET LIBRARY SYSTEMS
From: Isabel C. Safie
Date: August 17, 2017
Re: CalPERS Obligations of Legacy Systems

BACKGROUND

NorthNet Library System (“NorthNet”) is a joint powers authority formed pursuant to the Joint Powers Agreement of the NorthNet Library System on May 8, 2009 (“NorthNet JPA Agreement”). NorthNet is a regional library network whose members include cooperative library systems that are organized as joint powers authorities or joint resolution agencies. The individual members that comprise the cooperative library systems (“constituent members”) are not members of NorthNet, although they have voting authority on NorthNet’s Administrative Council. NorthNet’s members are the Mountain-Valley Library System (“Mountain-Valley”), North Bay Cooperative Library System (“North Bay”), and the North State Cooperative Library System (“North State”) (collectively, the “legacy systems”).

North Bay was formed pursuant to a JPA agreement entitled “In re North Bay Cooperate Library System” effective April 1960 (“North Bay JPA Agreement”), which agreement was supplemented and amended effective May 13, 1964 and January 9, 1979. North Bay’s members include various libraries, cities, counties, and school districts. North Bay originally contracted with the California Public Employees’ Retirement System (“CalPERS”) effective January 1, 1965, and amended its contract effective July 1, 1966, May 1, 1973, June 11, 1983, May 11, 1985, December 20, 1997, September 2, 1999, June 8, 2001, and November 8, 2002. North Bay’ employer contribution for CalPERS unfunded liability for fiscal year 2017-2018 is \$20,584. If North Bay remains on a 30 year amortization period, it will be liable for a total of \$1,196,064 in unfunded liability payments, with payment completed in 2046. North Bay has no active employees, and has 5 transferred members, 5 separated members, and 18 retired members covered under its CalPERS contract as of June 30, 2015.¹

North State was formed pursuant to joint resolution, rather than a joint exercise of powers, in 1966. North State does not have a JPA Agreement, but does have bylaws and separate resolutions for each joining member. North State’ bylaws state that it will accomplish

¹ <https://www.calpers.ca.gov/docs/actuarial-reports/2015/north-bay-cooperative-library-system-miscellaneous-2015.pdf>.
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its purposes consistent with the Joint Exercise of Powers Act.² North State' members include counties, library districts, and cities. North State originally contracted with CalPERS effective January 1, 1978, and amended its contract effective February 17, 1978, February 1, 1979, January 27, 1990, and June 26, 1992. North State' employer contribution for CalPERS unfunded liability for fiscal year 2017-2018 is \$36,973. If North State remains on a 30 year amortization period, it will be liable for a total of \$1,077,835 in unfunded liability payments, with payment completed in 2046. North Bay has no active employees, and had 6 transferred members, 3 separated members, and 13 retired members covered under its CalPERS contract as of June 30, 2015.³

Mountain-Valley was also formed by joint resolution, rather than a joint powers agreement, in 1968. Mountain-Valley' members include counties, schools, and cities. Mountain-Valley originally contracted with CalPERS effective March 21, 1992, with no amendments. Mountain-Valley' employer contribution for CalPERS unfunded liability for fiscal year 2017-2018 is \$22,786. If Mountain-Valley remains on a 30 year amortization period, it will be liable for a total of \$455,718 in unfunded liability payments, with payment completed in 2036. Mountain-Valley has no active employees, and had 1 transferred member and 5 retired members covered under its CalPERS contract as of June 30, 2015.⁴

NorthNet does not have employees and does not contract with CalPERS. NorthNet provides accounting services to the legacy systems through its contract with Pacific Library Partnership. NorthNet also acts as a custodian of the fund balance for North Bay and Mountain-Valley and makes any necessary payments, including CalPERS payments, on behalf of those systems. North State has no funds remaining, so past practice has been to invoice North State member libraries for their share of North State's CalPERS obligations. It is our understanding that payments collected from the North State member libraries are then remitted by NorthNet's contracted accounting department to CalPERS on North State's behalf.

QUESTIONS PRESENTED

1. Does NorthNet have any legal responsibility with regard to the legacy systems' CalPERS obligations? If so, what are its roles and responsibilities?
2. Can the constituent members of each legacy system be held responsible for their share of the CalPERS obligations moving forward?
3. What are the consequences of the dissolution of a legacy system and/or the failure of a legacy system to pay its CalPERS obligations?

² Bylaws, Article II.

³ <https://www.calpers.ca.gov/docs/actuarial-reports/2015/north-state-cooperative-library-system-miscellaneous-2015.pdf>.

⁴ <https://www.calpers.ca.gov/docs/actuarial-reports/2015/mountain-valley-library-system-miscellaneous-2015.pdf>.



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SHORT ANSWERS

1. Unless NorthNet has affirmatively assumed the legacy systems' CalPERS obligations pursuant to a contract approved by its governing board, it is not legally responsible for such obligations. We have seen no evidence of such assumption. Rather, each legacy system retains legal responsibility for its CalPERS obligations pursuant to each system's CalPERS contract. NorthNet currently provides accounting services to the legacy systems and acts as a custodian of funds for North Bay and Mountain-Valley. These obligations do not, however, subject NorthNet to any legal responsibility for the legacy systems' CalPERS obligations.

2. Only North State's constituent members are responsible for their share of North State's CalPERS obligations, since North State's bylaws subject it to the shared liability provisions of the Joint Exercise of Powers Act. The constituent members of North Bay and Mountain-Valley are not liable for the legacy systems' CalPERS obligations under operative documents or applicable law.

3. If a legacy system fails to pay its CalPERS obligations, whether or not as a result of dissolution, CalPERS may involuntarily terminate its CalPERS contract. This could result in termination liability being due, which is estimated to be between \$1.7 Million and \$4 Million dollars, depending on the legacy system in question. Additionally, former employees of the legacy systems could have their pension benefits reduced substantially. Termination liability will also be assessed and, if the termination liability is not paid in full, benefit reductions will be applied if the legacy systems' CalPERS contracts are voluntarily terminated. The CalPERS Board of Administration will have a lien upon the assets of the legacy systems if their CalPERS contracts are terminated. However, NorthNet will not have any legal obligation to pay the termination liability or liens against the legacy systems. Note, however, that if two or more of the legacy systems dissolve, NorthNet will also cease to exist.

ANALYSIS

I. NorthNet's Responsibility for Legacy Systems' CalPERS Obligations

A. NorthNet JPA Agreement, Joint Exercise of Powers Act and Tort Liability

NorthNet was formed pursuant to the California Joint Exercise of Powers Act, as codified at Government Code §§ 6500 et seq. JPAs are separate legal entities from their member agencies. The NorthNet JPA Agreement provides that the assets and property of each party to the agreement shall remain its own, except for required member seed contributions to fund NorthNet.⁵ Further, the NorthNet JPA Agreement states that the debts and obligations of NorthNet shall not be the debts and obligations of the parties to the NorthNet JPA Agreement, except to the extent required to indemnify the parties for negligent acts or omissions.⁶ This

⁵ NorthNet JPA Agreement, Article VIII.

⁶ NorthNet JPA Agreement, Article XX.



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provision is necessary in order to supersede the default provision under Government Code §6508.1 which states that “the debts, liabilities, and obligations of [a joint powers authority] shall be [the] debts, liabilities, and obligations of the parties to the agreement, unless the agreement specifies otherwise.” However, neither the NorthNet JPA Agreement nor the Bylaws of the NorthNet Library System include a provision which imposes upon NorthNet an affirmative obligation for the liabilities of the legacy systems. More importantly, there is no provision under the Joint Exercise of Powers Act (“Act”) that states that the debts, liabilities, and obligations of the member entities are the debts, liabilities and obligations of the joint powers authority. This omission is significant in light of Government Code §6508.1 which affirmatively imposes the liabilities of a joint powers authority unto its member agencies unless the joint powers agreement states otherwise. That is, if the Legislature intended to impose an obligation upon a joint powers authority related to the liabilities of its member agencies, it would have affirmatively done as it did with Government Code §6508.1.

In this regard, we draw your attention to Government Code §895.2 which states, in part, that “[w]henver any public entities enter into an agreement, they are jointly and severally liable upon any liability which is imposed by any law other than this chapter upon any one of the entities or upon any entity created by the agreement for injury caused by a negligent or wrongful act or omission occurring in the performance of such agreement.” The term “agreement” is defined by Government Code §895 to include a joint powers agreement. That is, Government Code §895 imposes liability on each of the parties to a joint powers agreement to an injured party for any tort that may occur in the performance of the agreement for which any one of the entities, or the entity created by the agreement is otherwise liable under the law. Aside from the scope of this section, which applies only with respect to a liability arising from the performance of such agreement, it has been interpreted to only apply to tort liabilities not contractual obligations.⁷ The CalPERS obligations of each legacy system are not tort liabilities but contractual obligations of the legacy system undertaken pursuant to a contract to which the legacy system and CalPERS are the only parties. Further, even if we were to entertain the possibility that the scope of Government Code Section §895 was broad enough to encompass contractual obligations, we see no evidence that the CalPERS obligations of each legacy system arose from the performance of the NorthNet JPA Agreement. In fact, those obligations were created decades before NorthNet was formed and were unrelated to the purpose for which NorthNet was created – the provision of library services.

Aside from Government Code §§ 895.2 and 6508.1, we have found no other statutory provision or judicial decision that addresses the sharing of liabilities between a joint powers authority and its member entities.

On the totality of the preceding, it is our conclusion that each of NorthNet’s and the legacy systems’ assets and liabilities remain separate, with no obligations accruing to the

⁷ Tucker Land Co. v. State of California (2001) 94 Cal. App. 4th 1191, 1199.



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other parties. NorthNet thus has no responsibility for the legacy systems' CalPERS liabilities under the NorthNet JPA Agreement, the Act or Government Code § 895.2.

B. CalPERS Law

CalPERS, codified in the Public Employees' Retirement Law ("PERL") at California Government Code §§ 20000 et seq., and as modified by the Public Employees' Pension Reform Act of 2013 ("PEPRA"), is a defined benefit retirement system for members of state and local governmental agencies and schools that is designed as a qualified pension plan under Internal Revenue Code ("IRC") § 401(a). CalPERS is administered by a Board of Administration ("CalPERS Board"), which has broad discretion to interpret and apply the statutory provisions of the PERL and accompanying regulatory and administrative guidance. A public agency may enter into a contract with CalPERS to provide retirement benefits for its employees.⁸ Each of the legacy systems has an active contract with CalPERS, even though the legacy systems no longer have active employees.

Each contracting agency must make ongoing contributions to CalPERS to fund the retirement benefits of their employees.⁹ These contributions are calculated by CalPERS' actuarial services department based on the benefit formulas the agency provides under its contract and the employee groups covered, and include "unfunded accrued liability" payments to fund past service liability.¹⁰ Additionally, each contracting agency must pay any administrative costs assessed by CalPERS.¹¹ The statutory provisions requiring payment of a contracting agency's CalPERS obligations are imposed on the contracting agency itself. They do not impose that liability on any other agency, unless the contracting agency is succeeded by another agency that establishes its own CalPERS contract, in which case the assets and liabilities of the former agency are transferred to the successor agency.¹² In this case, NorthNet does not act as a successor agency to the legacy systems, and does not have its own CalPERS contract. Therefore, it is not responsible for the legacy systems' CalPERS obligations under PERL. Put another way, CalPERS has no mechanism, statutory or otherwise, by which it could collect from NorthNet any unpaid liabilities of the legacy systems because NorthNet is not a party to any legacy system's contract with CalPERS.

C. NorthNet's Roles and Responsibilities

Because NorthNet has no legal responsibility for the CalPERS obligations of the legacy systems, its roles and responsibilities with respect to the CalPERS obligations are limited to providing accounting services to the legacy systems and acting as a custodian of funds for North Bay and Mountain-Valley. Neither of those duties subjects NorthNet to legal

⁸ Gov't. Code §§ 20022 and 20460.

⁹ Gov't. Code § 20532.

¹⁰ Gov't. Code § 20534.

¹¹ Gov't. Code § 20536.

¹² Gov't. Code § 20508.



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responsibility for the CalPERS obligations. NorthNet provides accounting services as an independent contractor separate from the legacy systems, and thus does not assume any liability for their existing obligations. As custodian of funds, NorthNet is arguably acting as an agent of North Bay and Mountain-Valley since it is representing each of those legacy systems in dealings with third persons with respect to disbursement of funds.¹³ However, even if NorthNet is an agent of the legacy systems, all rights and liabilities accruing from transactions within the scope of its authority over the legacy systems' funds accrue to the legacy systems rather than NorthNet,¹⁴ so NorthNet will not incur responsibility for the CalPERS obligations of the legacy systems by virtue of acting as a custodian of the legacy systems' funds.

II. Responsibility of Constituent Members for Legacy Systems' CalPERS Obligations

As noted in Section I.B above, the contracting agency alone is responsible for CalPERS obligations under PERL. However, the constituent members may be liable for the legacy systems' obligations under the Act, unless their respective JPA agreements or bylaws state otherwise. Government Code §6508.1 provides, "the debts, liabilities, and obligations of the agency shall be debts, liabilities, and obligations of the parties to the agreement, unless the agreement specifies otherwise." Therefore, whether the constituent members are responsible for the legacy systems' CalPERS obligations depends on the terms of each legacy systems' formative documents.

The North Bay JPA Agreement specifically provides that North Bay is established as a separate public agency,¹⁵ and that North Bay may incur debts, liabilities, or obligations "which do not constitute the debt, liability or obligations of any of the parties to this instrument."¹⁶ Therefore, North Bay's own CalPERS obligations are not passed onto any of its constituent members under the North Bay JPA Agreement. North Bay may request payment from its constituent members as part of their normal member contributions to further the purposes of the North Bay JPA Agreement.¹⁷ Alternatively, under the Joint Exercise of Powers Act, North Bay may separately contract with any constituent member to have the member assume responsibility for the CalPERS obligations of North Bay.¹⁸ The constituent members are not, however, legally obligated to fund North Bay' CalPERS obligations under the current North Bay JPA Agreement or to agree to a separate contract assuming all or a portion of such obligations.

The North State bylaws voluntarily subject North State to the Joint Exercise of Powers Act despite its formation by joint resolution. There are no provisions in the formative resolutions or the bylaws that specify that the constituent members are not responsible for the debts, liabilities, and obligations of the parties to the agreement. Therefore, pursuant to its bylaws and

¹³ Cal. Civ. Code § 2295.

¹⁴ Cal. Civ. Code §2330.

¹⁵ Supplement to North Bay JPA Agreement, Article II.

¹⁶ Supplement to North Bay JPA Agreement, Article III(e).

¹⁷ Supplement to North Bay JPA Agreement, Article VII.

¹⁸ Gov't. Code § 6508.1.



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Government Code §6508.1, North State's constituent members are responsible for North State's CalPERS obligations. According to the Siskiyou County November 4, 2014 Agenda Worksheet related to North State's CalPERS liabilities, 8 of 12 constituent members have paid North State's CalPERS expenses historically. North State can continue to invoice its constituent members for their share of its CalPERS obligations.

The Mountain-Valley bylaws make no reference to the Joint Exercise of Powers Act. Therefore, Mountain-Valley is not subject to the assumed liability provisions of Government Code Section 6508.1. Additionally, neither the formative resolutions nor the bylaws include provisions requiring Mountain-Valley's constituent members to be responsible for Mountain-Valley's debts or obligations. Mountain-Valley is thus solely responsible for its CalPERS obligations under PERL. Mountain-Valley may request payment from its constituent members as part of their normal member fees and dues. However, the constituent members are not legally obligated to fund Mountain-Valley's CalPERS obligations under the operative documents and applicable law.

III. Consequences of Legacy Systems' Failure to Pay CalPERS Obligations and/or Dissolution

If a contracting agency fails to pay any required contribution within 30 days of a demand by the CalPERS Board, or dissolves and does not voluntarily terminate its CalPERS contract, then the CalPERS Board may involuntarily terminate the agency's contract.¹⁹ However, even when an agency's CalPERS contract is terminated, whether voluntarily²⁰ or involuntarily, it continues to be liable to CalPERS for any deficit in funding of benefits, interest, and costs of collection.²¹ These termination costs can amount to millions of dollars. The hypothetical termination liability for each legacy system, based on the June 30, 2015 CalPERS actuarial reports and variable based on the applicable rate of return at the time of termination, are as follows:

- North Bay: \$4,271,870 - \$4,901,374
- North State: \$3,423,145 - \$3,864,850
- Mountain-Valley: \$1,508,946 - \$1,701,248

If the legacy systems dissolve, then they will be liable for these termination costs. Additionally, NorthNet will cease to exist should two or more of the legacy systems dissolve.²²

The CalPERS Board has the authority to reduce benefits for retirees if a legacy system fails to pay any termination liability.²³ However, the CalPERS Board may elect not to reduce

¹⁹ Gov't. Code § 20572.

²⁰ Gov't. Code § 20570.

²¹ Gov't. Code § 20574.

²² NorthNet JPA Agreement, Article IX.

²³ Gov't. Code § 20577.



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benefits or to make a lesser reduction in the case of an involuntary termination in which the Board has made all reasonable efforts to collect the amounts due and not collecting will not impact the actuarial soundness of the terminated agency pool of CalPERS.²⁴ This authority is discretionary, however, and given the Board’s recent stance on liabilities of JPAs, it is not likely to forgive outstanding termination liability without a reduction of benefits.²⁵ It may be possible to negotiate the terms of payment for termination liability, but it will still likely wipe out a large portion of the legacy systems’ remaining assets.²⁶

Lastly, if the legacy systems dissolve and/or their CalPERS contracts terminate, whether voluntarily or not, the Board will have a lien on the assets of the legacy systems, secondary only to any prior liens for unpaid wages, “in an amount equal to the actuarially determined deficit in funding for earned benefits of the employee members of the agency, interest, and collection costs.”²⁷ Although NorthNet will not be legally responsible for such a lien, it would likely take priority over any debts that may otherwise be owed to NorthNet.

²⁴ Gov’t. Code § 20577.5.

²⁵ A recent example may be taken from the East San Gabriel Valley Human Services consortium, a joint powers authority, whose CalPERS contract was involuntarily terminated by CalPERS earlier this year after the consortium failed to pay their its contributions. As a result, pension benefits were reduced by approximately 63% percent for 191 “classic” retirees and 24% for six “new member” retirees effective July 1, 2017.

²⁶ Gov’t. Code § 20573.

²⁷ Gov’t. Code § 20574.