Case No. S239958 No Fee (Gov. Code § 6103)

In The Supreme Court Of The State Of California

CAL FIRE LOCAL 2881 (formerly known as CDF Firefighters), et al.

Petitioners and Appellants,

v.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CalPERS)

Defendant and Respondent,

and

THE STATE OF CALIFORNIA,

Intervener and Respondent.

SUPREME COURT
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ON REVIEW FROM THE COURT OF APPEAL FOR THE FIRST APPELLATE DISTRICT, DIVISION THREE, CIVIL NO. A142793

AFTER AN APPEAL FROM THE SUPERIOR COURT FOR THE STATE OF CALIFORNIA, COUNTY OF ALAMEDA, CASE NUMBER RG12661622, HON. EVELIO GRILLO, PRESIDING JUDGE

APPLICATION FOR PERMISSION TO FILE AMICUS BRIEF AND AMICUS BRIEF OF THE LEAGUE OF CALIFORNIA CITIES

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APPLICATION FOR LEAVE TO FILE AMICUS BRIEF

TO THE HONORABLE CHIEF JUSTICE:

Pursuant to California Rules of Court, Rule 8.520(f), the amicus curiae identified below respectfully requests permission to file the attached brief in support of State of California. This application is filed within 30 days after the filing of the reply brief on the merits and is therefore timely pursuant to Rule 8.520(f)(2).

THE INTEREST OF *AMICUS CURIAE*

The League of California Cities

The League of California Cities (the "League") is an association of 475 California cities dedicated to protecting and restoring local control to provide for the public health, safety, and welfare of their residents, and to enhance the quality of life for all Californians. The League is advised by its Legal Advocacy Committee, comprised of 24 city attorneys from all regions of the State. The Committee monitors litigation of concern to municipalities, and identifies those cases that have statewide or nationwide significance. The Committee has identified this case as having such significance.

League members include cities that are members of the California Public Employees' Pension System ("CalPERS") and those with their own pension systems. The elected officials and managers of California cities are grappling with an unprecedented increase in retirement costs due in significant part to unfunded liabilities for benefits that cost more than anticipated. Vital city services are at risk, including the ability to provide adequate police and fire protection. Some cities have become insolvent and others are on the brink.

Although the recent pension cases may appear to pit public sector employers against public sector employees, the ultimate goal of all the parties is the same – the preservation of a sustainable pension system for public employees and retirees. The concern of public employers stems from a first-

hand understanding of the precarious state of our pension systems, and what it will take to stabilize them. A reexamination of the law governing the creation and modification of pension benefits must happen now, so that cities and their leaders will have the tools to protect pensions for employees and retirees.

THE NEED FOR FURTHER BRIEFING

The League represents the interests of cities throughout California, and is therefore uniquely situated to present its views and analysis related to this case.

ABSENCE OF PARTY ASSISTANCE

Pursuant to California Rules of Court, rule 8.520(f)(4), the amicus confirms that no party or its counsel authored this brief in whole or in part. Nor did any party, their counsel, person, or entity make a monetary contribution to the preparation or submission of this brief.

CONCLUSION

The League respectfully requests that the Court grant this application for leave to file an amicus curiae brief.

Dated: February 21, 2018

Respectfully submitted,

RENNE SLOAN HOLTZMAN SAKAI LLP
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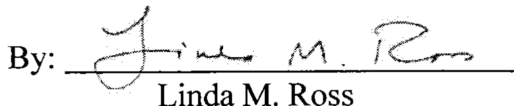
By: 
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BRIEF OF AMICUS CURIAE LEAGUE OF CALIFORNIA CITIES

I. INTRODUCTION

In California, the principles for determining whether pension and other retirement benefits are "vested rights" have developed through case by case adjudication. As a result, it is not surprising that, over time, those principles have evolved. As this Court has previously observed: "The nature of the common law requires that each time a rule of law is applied, it be carefully scrutinized to make sure that the conditions and needs of the times have not so changed as to make further application of it the instrument of injustice." (*Rodriguez v. Bethlehem Steel Corp.* (1974) 12 Cal.3d 382, 394 [en banc].)

Facing the greatest pension crisis of our generation, the League of California Cities urges the Court to revisit the so-called "California Rule" in the context of the modern age. Much has changed since this Court last visited the question of when a "vested" retirement benefit may be altered. The unfunded liabilities of pension plans have soared, and are now at levels that barely cover the liabilities for those who have already retired. Employer pension costs have increased rapidly, and are anticipated to grow by another fifty percent, in some cases doubling, in the next few years. Employee contributions to pensions, intended to pay half of pension costs, now cover less than one fifth of the cost in many cases. Public sector collective bargaining has blossomed, but is handicapped by the assumption that pension modification, even for prospective service, cannot be on the table.

Contrary to conventional wisdom, if pension modification is not adequately addressed, the risk is not to the pension systems. Rather, it is to retirees and to the public. If cities cannot make their pension contributions, it is the retirees who will face harsh consequences as CalPERS will cut their pensions. Additionally, federal courts have found that pension vesting rules provide no immunity from reducing pensions in bankruptcy. As for the tax-

paying public, the pension crisis has resulted in the "hollowing out" of city services, with parks, libraries, after-school programs and social services often being the first to go, and police and fire services following. Even cities that are technically solvent have become "service insolvent," unable to afford the basic services they were created to provide.

With so much at stake, the League urges this Court to closely examine the following elements of vested rights jurisprudence before issuing an opinion in this case.

The "unmistakability" doctrine. In *Retired Employees Association Of Orange County, Inc. v. County of Orange* (2011) 52 Cal.4th 1171, 1186-1197 (*REAOC*), this Court confirmed that there must be "clear and convincing" evidence of legislative intent to create a vested right. *REAOC* is in accord with many other federal and state courts that have required "unmistakable" evidence before finding that a legislative body has relinquished its constitutional power to modify legislation.

The League asks this Court to confirm that the unmistakability doctrine must be rigorously applied, and reject the Petitioner's contentions that it does not apply to pension benefits or applies only to "implied" benefits. Here, the Court of Appeal correctly held that, under the unmistakability doctrine, the option to purchase "air-time" is not vested.

Prospective versus retrospective vesting. The League also urges this Court to follow the lead of the appellate courts that have gone a step further, attempting to make sense of the concept of "vesting" as applied to benefits for future service not yet rendered. Here, and in *Marin Association of Public Employees v. Marin County Employees' Retirement Association* (2016) 2 Cal.App.5th 674, the Courts of Appeal upheld pension modifications based in part on the prospective nature of the changes.

Pension benefits have long been characterized as a form of "deferred compensation." As with other forms of compensation, there is a high bar to

changing pension benefits attached to time already worked. However, for benefits attached to time not yet worked, there must be a different standard, because the benefits have not yet been earned.

Courts nationwide recognize this distinction. This Court too has repeatedly stated that, for active employees, "reasonable" modifications may be made "before the pension becomes payable" and until then "the employee does not have a right to any fixed or definite benefits but only to a substantial or reasonable pension." (E.g., *Miller v. State of California* (1977) 18 Cal.3d 808, 816.) However, Petitioner contends, based upon dicta in a number of decisions before and after *Miller*, that this flexibility is for all practical purposes illusory.

"Comparative advantage" for every disadvantage. Petitioner contends that for every disadvantageous change to a pension benefit, an equivalent advantageous change "must" be granted. In practice this argument would prevent any correction of past abuses or unforeseen burdens. To the extent that a change is based upon an abuse or unanticipated burden, it simply makes no sense to require the benefit be replaced by an equivalent benefit. The standard Petitioner proposes is self-cancelling: changes to benefits for prospective service can be made, but only if each and every person affected is made whole, meaning the change is illusory.

Three appellate courts, including the Court of Appeal in this case, in *Marin*, and in the recently decided *Alameda Deputy Sheriffs' Association v. Alameda County Employees' Retirement Association* (2018) 19 Cal.App.5th 61, have recognized this "strait jacket." These courts have held that under this Court's jurisprudence, an equivalent benefit "should" be granted, but is not always required. The League agrees with the State that whether an "equivalent benefit" is granted is only one of a number of factors that should be considered in determining whether a change to a benefit for prospective service is reasonable.

Unforeseen advantages and burdens. A benefit that is offered when an employee first comes to work, and potentially lasts until they or their beneficiary die, will be subject to changing conditions. There is a significant benefit to both employee and employer to modifying these benefits for future service yet to be rendered. Modification protects critical public services, allowing a city to continue employing workers; it protects the ability to pay benefits that employees have already earned; and it protects retirees whose pensions could be threatened by city insolvency. Petitioner's rigid position leaves no room for these countervailing advantages rooted in sound public policy.

This court has long held that vested benefits, particularly for service not yet rendered, "may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system." (*Betts v. Board of Admin.* (1978) 21 Cal.3d 859, 863.) "Constitutional decisions 'have never given a law which imposes unforeseen advantages or burdens on a contracting party constitutional immunity against change.'" (*Allen v. Board of Admin. Of the Public Employees' Retirement System* (1983) 34 Cal.3d 114, 120, [citations omitted].)

In accord with this Court's continuing review of judge-made doctrine, the League identifies a test drawn from existing case law in California and elsewhere, for evaluating changes to pension benefits. The factors to be considered include:

- Whether the modification affects only service yet to be rendered, or service already rendered. Modification of benefits tied to future service is subject to a lesser standard because they have not yet been earned.
- The extent of the modification. This factor includes whether the benefit change is to an ancillary benefit, such as air-time,

or a more central component of the pension scheme. The lesser the modification, the more latitude the legislature and local legislative bodies have in making changes. Modifications are permitted so long as a "substantial and reasonable" pension remains.

- The public policies to be served. Whether the modification bears "a material relation to the theory of a pension system and its successful operation...." This includes the need to adapt to changing conditions, in order to protect against abuses that have arisen or burdens that were unforeseen. Tying the hands of government for nearly a century based on outdated assumptions proven incorrect over time endangers both the public and the rights of employees who have completed the pension bargain through their service.

In applying these standards there can be no rigid requirement of retirement system insolvency or public emergency. Such a requirement misunderstands the structure of pension systems. Long before a pension system goes broke, cities will become insolvent, potentially resulting in retiree pensions being cut by CalPERS or in bankruptcy. Moreover, once pension funding drops below a critical level, it is practically impossible to return to full funding. That CalPERS is only 68% funded, after the equity markets have dramatically recovered from the Great Recession, shows the difficulty of recovering from large accrued liabilities.

The League asks the Court to clarify the standard for changes to benefits not yet earned to reflect the principles discussed above and in this brief. Clarification of the law is not only critical to cities' sustainability, it is critical to ensuring the future of pensions for retirees, current employees, and even future employees.

II. BACKGROUND

A. California's Cities Are Facing An Unprecedented Financial Crisis Due To The Unsustainable Rise In Pension And Retiree Health Costs

Seven years ago, the Little Hoover Commission sounded the alarm. In an oft-quoted sentence, the Commission reported: "California's pension plans are dangerously underfunded, the result of overly generous benefit promises, wishful thinking and an unwillingness to plan prudently." (Little Hoover Commission, Public Pensions For Retirement Security, February 2011 ("Little Hoover Report").)

The Little Hoover Report demonstrated that, "[t]he 10 largest pension systems in California – encompassing 90 percent of all assets and members in the state's defined benefit systems – faced a combined shortfall of more than $240 billion in 2010." (Little Hoover Report at ii.)[1] These systems were only 58% to 74% funded, when an 80% funded status "is considered the low threshold for a stable system." (*Ibid.*)

The Report found that "pension costs will crush government. "Government budgets are being cut while pension costs continue to rise and squeeze other government priorities." (*Id.* at iii.)

[1] See also, "The Pension Gap," Los Angeles Times, September 18, 2016.

B. Public Employers, Such As Cities, Bear The Cost Of Pension Unfunded Liabilities.

The state has 85 "defined-benefit" plans, including six state plans, 21 county plans, 32 city plans and 26 specific district and other plans. (Little Hoover Report at 4.)[2]

The largest plan, indeed the largest pension plan in the nation, is the California Public Employees' Retirement System ("CalPERS"). Although most California cities are members of CalPERS, some cities, including Los Angeles, San Francisco and San Jose, manage their own pension funds. (*Ibid.*)

Typically pension systems are governed by a board of officials, some elected by employees and retirees and others appointed by government bodies. The retirement boards manage the fund investments and, with the assistance of actuaries, set the amounts that employers must contribute to the system. (*Ibid.*)

Pension contributions are charged as a percentage of payroll. Typically, public *employee* contributions are limited by statute or cover only the employee's share of "normal cost" which is the cost for the current year. Public *employer* contributions, on the other hand, are potentially unlimited, because employers are responsible for not only the employer share of "normal cost" but also the total cost of any "unfunded liabilities."

As a result, public employers, and thus taxpayers, are the guarantors of pensions. In a typical example, employees pay only 11% of their salaries

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[2] CalPERS includes all state workers, some university employees, judges, some legislators, and public agencies and school districts who contract with CalPERS. (Little Hoover Report at 4.) The California State Teachers' Retirement System ("CalSTRS") is the nation's second largest pension system. (*Ibid.*) Under the County Employees' Retirement Law ("CERL"), 20 counties operate retirement plans independent of CalPERS. (*Id.* at 5.) The University of California operates its own pension system. (*Ibid.*)

towards their pensions (the normal cost), whereas the city, because it pays for both normal cost and unfunded liabilities, pays 61% of payroll – in other words an additional $61 for every $100 in salary.

C. Since The Little Hoover Commission 2011 Report, City Pension Costs Have Skyrocketed

In 2011, the Little Hoover Commission stated that: "In another five years, when pension contributions from government are expected to jump 40 to 80 percent and remain at those levels for decades … there will be no debate about the magnitude of the problem." (Little Hoover Report at 22.) It stated:

> Across the state, governments will be forced to sacrifice schools, public safety, libraries, parks, roads and social services – core functions of government – and the public jobs that go with them, to pay the benefits that have been overpromised to current workers and retirees.

(*Id.* at 43.) That prediction has come true.

CalPERS is only 68% funded.[3] Based on recent rate hikes, local government employers owe CalPERS $5.3 billion this year, and that amount will almost double to $10.1 billion in 2024." ("California Pension Contributions to Double by 2024 – Best Case," California Policy Center, Jan. 31, 2018.) Statewide, the public employer contribution "will double, from $31 billion in 2018 to $59 billion by 2024." (*Ibid.*)

For example, in late 2016, the Los Angeles Times reported that Los Angeles's "general fund payments for pensions and retiree healthcare reached $1.04 billion last year, eating up more than 20% of operating revenue – compared with less than 5% in 2002." ("Paying for public retirees has never cost L.A. taxpayers more. And that's after pension reform," Los Angeles Times, November 18, 2016.)

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[3] See CalPERS 2016-2017 Comprehensive Annual Financial Report For Fiscal Year Ending June 30, 2017, p. 4.

Los Angeles is not alone. "L.A.'s pension burden, while severe by national standards, is not unusual for California. Six of the state's 10 largest cities – Los Angeles, San Diego, San Jose, Sacramento, Oakland and Bakersfield – devoted more than 15% of their general fund budgets to pensions and retiree healthcare during the 2015 fiscal year, The Times found. San Jose contributed the greatest share – almost 28%." (*Ibid.*)[4]

The Times also looked at the City of Richmond, where payments for employee pensions and retiree healthcare "have climbed from $25 million to $44 million in the last five years, outpacing all other expenses." ("Cutting jobs, street repairs, library books to keep up with pension costs," Los Angeles Times, February 6, 2017.)

The Times concluded: "Richmond is a stark example of how pension costs are causing fiscal stress in cities across California." The Times noted that municipalities, including Vallejo, Stockton, and San Bernardino had filed for bankruptcy. (*Ibid.*)

D. California Cities Are Facing Increases In Pension Costs That They Cannot Meet Without Cutting Vital City Services, Or Even Becoming Insolvent

In 2017, the League commissioned an actuarial study to address the impact of increased CalPERS contributions on the League's members ("Retirement System Sustainability, A Secure Future For California Cities," League of California Cities Retirement System Sustainability Study and

[4] According to the Times, the percentages of the general fund during 2014-2015 (spent on pensions and retiree health benefits) are as follows: San Jose (27.86%), Oakland (20.78%), Los Angeles (20.70%), Bakersfield (10.46%), San Diego (19.30%), Sacramento (17.38%), Anaheim (13.11%), Fresno (12.15%), Long Beach (11.62%), San Francisco (8.13%).

Initial Findings, January 2018) (http://www.cacities.org/pensions) ("League Study").)[5] The Study reported the following.

1. City Pension Costs Are Dramatically Increasing To Unsustainable Levels

According to the League Study, between fiscal years 2018-19 and 2024-25, cities' dollar contributions for annual pension costs will increase more than 50%. For example, if a city will pay $5 million in 2018-19 then the city is expected to pay more than $7.5 million in 2024-25. (League Study at 2, and Slides 18 & 19.)

By fiscal year 2024-25, the average projected city contribution rate is 34.6% of salary for miscellaneous employees and 60.2% for safety (police officers and fire fighters) employees. This means for every $100 in pensionable wages for miscellaneous employees, cities would pay on average *an additional* $34.60 to CalPERS for pensions alone. For every $100 in pensionable wages for safety employees, cities would pay on average *an additional* $60.20 to CalPERS for pensions alone. These amounts do not include the costs of retiree health care. (League Study at 2, 3, Slide 20.)

2. Rising Pension Costs Will Require Cities To Nearly Double The Percentage Of Their General Fund Dollars They Pay To Calpers

As part of its study, the League surveyed its members, asking what portion of City general fund budgets were devoted to paying pension costs to CalPERS. These percentages are for CalPERS costs only, over and above the cost of salaries – and do not include the cost of retiree healthcare.

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[5] The League study analyzes cities who are members of CalPERS, and does not include those with their own pension systems, such as Los Angeles, San Jose or San Francisco. However, like members of CalPERS, those cities, as demonstrated by the Los Angeles Times articles cited above, are being required to devote an unsustainable percentage of their general fund resources to retirement costs.

The League Study concluded that in fiscal year 2006-07, the average city spent 8.3% of its general fund budget on CalPERS pension costs, but that average increased to 11.2% in fiscal year 2017-18, and is anticipated to increase to 15.8% in fiscal year 2024-25. (League Study at 4, and Slide 33.)

In fiscal year 2024-25, 25% of cities are anticipated to spend more than 18% of their general fund budget on CalPERS pension costs with 10% of those cities anticipated to spend 21.5% or more. (League Study at 4 and Slide 33.) These cities are located all over the state. (League Study at 4, and Slides 34, 35, 36.)

Cities are limited in their ability to raise revenue and by law must balance their annual budgets. (Cal. Const., art. XVI, sec. 18.) Accordingly, as pension contributions rise, local agencies are forced to reduce or eliminate critical programs such as fire protection, law enforcement, parks services, and other municipal services.

3. Snapshots Of Individual Cities Tell The Story

The overall statistics are dire, but the plight of individual cities brings them to life.

The City of Corona recently wrote CalPERS to seek help in meeting its pension obligations. Since 2003, the City's annual employer contribution to CalPERS increased from $5.5 million to $23.8 million, more than 300%, with an expected increase to $40.3 million in the next seven years. The City reported it was "on a path to insolvency" with its reserves depleted by fiscal year 2020-21. Already Corona has cut 28% of its workforce, including police and fire personnel, and must make additional cuts "across the City including Fire, Police and Parks and Recreation." (Letter to Rob Feckner, President, CalPERS Board of Administration, from City of Corona, November 10, 2017.)

The California Policy Center recently published a list of the cities that would be hit hardest by CalPERS rate hikes. ("How Much More Will