IN THE SUPREME COURT

OF THE STATE OF CALIFORNIA

Cal Fire Local 2881, et al.,

Petitioners and Appellants,

vs.

California Public Employees' Retirement System (CalPERS),

Defendant and Respondent,

and

The State of California,

Intervenor and Respondent.

Case No. S239958

First Appellate District Division Three Case No. A142793

Alameda County Superior Court Case No. RG12661622 Hon. Evelio Grillo, Presiding Judge

PROPOSED BRIEF OF *AMICI CURIAE* OF ORANGE COUNTY ATTORNEYS ASSOCIATION AND ORANGE COUNTY MANAGERS ASSOCIATION IN SUPPORT OF PETITIONERS AND APPELLANTS

*MARIANNE REINHOLD (106568),
LAURENCE S. ZAKSON (119435) &
AARON G. LAWRENCE (258813),
of REICH, ADELL & CVITAN
A Professional Law Corporation
2670 N. Main Street, Suite 300
Santa Ana, California 92705
Telephone: (800) 386-3860
Facsimile: (714) 834-0762
marianner@rac-law.com;
laurencez@rac-law.com; &
aaronl@rac-law.com
Attorneys for *Amici Curiae*

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marianner@rac-law.com;
laurencez@rac-law.com; &
aaronl@rac-law.com
Attorneys for *Amici Curiae*

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I. INTRODUCTION

Petitioners have presented three issues:

1. Was the option to purchase additional service credits a vested pension right or benefit?
2. Was the repeal of section 20909 necessary to preserve and maintain PERL?
3. Did the repeal of section 20909, without providing disadvantaged employees with an offsetting pension advantage, violate the Contracts Clause?

[Opening Brief on the Merits, at p. 10.] We agree with this framing of issues and note that Respondent California Public Employees' Retirement System (CalPERS) and Intervenor/Respondent State of California have not contested it.

This brief is addresses the Contracts Clause questions raised in issue 3, above, by showing that the requirement that there be offsetting with comparable advantages of individually disadvantageous changes in a pension system is simply a fact-specific application of core constitutional principles long recognized by the courts.

II. IDENTITY AND INTEREST OF THE *AMICI*

The Orange County Attorneys Association ("OCAA") and the Orange County Managers Association ("OCMA") (collectively "*Amici*"), are employee organizations, recognized by the County of Orange (the "County") as exclusive bargaining representatives of certain units of County employees pursuant to the Meyers-Milias-Brown Act ("MMBA"),

Gov. Code § 3500 (?YEAR?) OCAA represents employees in the County's "Attorney Unit," consisting of attorneys in the offices of District Attorney, Public Defender, Alternate Defender, Associate Defender, County Counsel, and Child Support Services. OCMA represents managers assigned to the County's various departments and agencies. As set forth in greater detail in the Petition to File *Amici Curiae* Brief, filed concurrently hereto, the interest of *Amici* in this case derives from their representation of public employees whose pension rights may be affected by the Court's ruling on the scope and application of the vested benefits doctrine.

The proposed *amici curiae* brief was authored by Marianne Reinhold, Laurence S. Zakson, and Aaron G. Lawrence, of Reich, Adell & Cvitan, A Professional Law Corporation. No party, person, or entity other than the *Amici* made a monetary contribution to fund the preparation of the proposed brief.

III. ARGUMENT

A. Background on the Vested Rights Doctrine

Any inquiry into the vested benefits doctrine must start with the Contracts Clauses of the U.S. and California constitutions, Contract Clause, U.S. Const. art. I, § 10, cl. 1; Cal. Const., art. I, § 9, each of which protects against any law impairing the obligation of contracts. This is a significant limitation on sovereign authority, but one with deep and abiding roots in

our form of government. Indeed, the *Federalist Papers* described these limits as rooted in "the first principles of the social compact," and as reflecting an important "constitutional bulwark in favor of personal security and private rights." See The Federalist No. 44 (James Madison); see also *Fletcher v. Peck* (1810) 10 U.S. 87, 137-38, 3 L.Ed. 162.[1] This is especially true when what is at issue is not the incidental effects of legislation of general application, but, rather, attempts by states to wipe out their own contractual obligations towards creditors (see *United States Trust Co. v. New Jersey* (1977) 431 U.S. 1, 17 97 S.Ct. 1505, *citing* *Fletcher v. Peck* (1810) 10 U.S. 87, 3 L.Ed. 162 (1810); *Dartmouth College v. Woodward* (1819) 17 U.S. 518, 4 L.Ed. 629)—the type of state action where the state's own self-interest is inevitably at issue. See, e.g. *United States Trust Co. v. New Jersey* (1977) 431 U.S. at 29 ("A governmental

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[1] Whatever respect might have been felt for the state sovereignties, it is not to be disguised that the framers of the constitution viewed, with some apprehension, the violent acts which might grow out of the feelings of the moment; and that the people of the United States, in adopting that instrument, have manifested a determination to shield themselves and their property from the effects of those sudden and strong passions to which men are exposed. The restrictions on the legislative power of the states are obviously founded in this sentiment; and the constitution of the United States contains what may be deemed a bill of rights for the people of each state.

No state shall pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts...

Id., at 137-38 (rejecting argument that exception existed "in favour of the right to impair the obligation of those contracts into which the state may enter").

entity can always find a use for extra money, especially when taxes do not have to be raised. If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all.")

Because "[c]ontract rights are a form of property," under the Takings Clause of the Fifth Amendment, they only may "be taken for a public purpose ***provided that just compensation is paid***." United States Trust Co., supra, 431 U.S. at 19 n.16 (*emphasis added*); see also West River Bridge Co. v. Dix (1848) 47 U.S. 507, 538, 12 L.Ed. 535 (exercise of state power to appropriate property, with just compensation, is not unconstitutional impairment of contract); see also Cal. Const., art. I, § 19 ("Private property may be taken or damaged for public use only when just compensation ... has first been paid to, or into the court for, the owner.").

Thus, public employees' contractual right to their promised pension benefits is protected both as a property right[2] and under the Contracts Clause.[3] Viewed in this context, the question whether the State must

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[2] In re Marriage of Brown (1976) 15 Cal.3d 838, 845, 126 Cal.Rptr. 633 ("Since pension benefits represent a form of deferred compensation for services rendered ... the employee's right to such benefits is a contractual right, derived from the terms of the employment contract. Since a contractual right is ... a form of property (see Civ. Code, § 953; Everts v. Will S. Fawcett Co. (1937) 24 Cal.App.2d 213, 215 [74 P.2d 815]), ... an employee acquires a property right to pension benefits when he enters upon the performance of his employment contract.").

[3] See, e.g. Kern v. City of Long Beach (1947) 29 Cal.2d 848 (Kern).

provide a comparable advantage when disadvantageously altering the terms governing public employee pension benefits is not a *sui generis* problem inherent to public employee pension, but, rather, an issue-specific application of core constitutional principles. And the answer—that the State may not "take" constitutionally guaranteed contract/property rights without just compensation in the form of offsetting individual advantage(s)—is relatively straightforward.

Applying these principles, California courts have consistently recognized that the principle that contract rights are a form of property shielded from government taking without just compensation (*see* *United States Trust Co.*, *supra*, 431 U.S. at 19 n.16) requires public employers making any alteration to pension rights that causes employees a constitutionally-cognizable impairment to offset those alterations with a comparable new advantage. *Allen v. City of Long Beach* (1955) 45 Cal.2d 128, 131, 287 P.2d 765 (*Allen I*) ("To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages.")

Thus, *Allen I* articulates a two-part test—where there is a constitutionally-cognizable impairment of reasonably expected pension benefits (1) there must be legitimate public purpose (*United States Trust*

Co., *supra*, 431 U.S. at 19 n.16; *see also* *West River Bridge Co. v. Dix* (1848) 47 U.S. at 5380); and (2) there must be some sort of compensation in the form of comparable advantage (*Abbott v. City of Los Angeles* (1958) 50 Cal.2d 438, at 449).

With respect to the public purpose, notwithstanding the unequivocal language in the Contract Clauses, courts have long recognized that merely incidental effects on a party's contractual rights of laws of general application frequently may not run afoul of the Contracts Clause.[4] However, as discussed, the calculus is different where the law is directly aimed at altering public employees' pension benefits and, thus, the state actor has a self-interest in minimizing its obligations to its creditors. Nevertheless, courts have found that because promised pension benefits that are intended to extend over decades, public employers retain some flexibility in altering the terms of the pension benefits available to their employees, and they need not maintain indefinitely the exact rules and

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[4] This sort of "innocent purpose" is directly relevant to whether a modification falls within the State's flexibility to make minimal changes:

> [C]ase law has given rise to the concept of permitted impairments as "minimal impairments." (*See e.g. Valdes*, *supra*, 139 Cal.App.3d at p. 789.) That is to say, the criterion of innocent purpose is that only the minimal impairment needed to attain the tendered legitimate public end has been visited upon the contracting parties. The concept of "minimal impairments" has no proper application as a vague license for the state to impair its obligation so long as it is only "a little bit."

Cal. Teachers Ass'n v. Cory (Ct.App. 3d Dist. 1984) 155 Cal.App.3d 494, 511, 202 Cal.Rptr. 611.

benefits with literal exactitude. *See, e.g. Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 854–55, 179 P.2d 799 ("[P]ension systems must be kept flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system and carry out its beneficent policy... [A]n employee may acquire a vested contractual right to a pension but that this right is not rigidly fixed by the specific terms of the legislation in effect during any particular period in which he serves."); *see also Allen I*, 45 Cal.2d at 131 (rights may be modified "to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system."). As a result, a finding that a particular modification furthered a legitimate government interest and had only a minimal or technical effect on contract rights along these lines may not raise constitutional concerns and, therefore, allow a reviewing court to forego the analysis articulated in *Allen I*. *Valdes v. Cory* (1983) 139 Cal.App.3d 773, 789, 189 Cal.Rptr. 212 ("[A] finding that there has been a technical impairment is merely a preliminary step in resolving the more difficult question whether that impairment is permitted under the Constitution... ." And a "[minimal] alteration of contractual obligations may end the inquiry at its first stage").

Thus, where the government is making a purely technical or otherwise minimal change that bears some material relation to the operation of a pension system, the inquiry is usually at an end. But, as we discuss

more fully below, if the impairment is constitutionally-cognizable, a comparable offsetting advantage is required.

B. Public Employers Must Provide an Offsetting Benefit When Implementing a Constitutionally-Cognizable Impairment of Employees' Contract Rights

In determining whether an offsetting benefit is required, the critical question is whether the modification of pension rules resulted in a sufficiently significant adverse effect on employees' contract rights to constitute a constitutionally-cognizable impairment. For the reasons which follow, this inquiry must: (1) be individually-focused (looking concretely at the impact on those affected), and (2) turn upon whether the alteration was sufficiently significant to disrupt the reasonable expectations of those adversely affected. Upon a showing that individuals' rights were so impaired, the deprivation of constitutional rights demands redress through (3) some form of just compensation—to wit, an offsetting advantage.

1. In determining whether an impairment is constitutionally cognizable, the focus must be on the individualized adverse impacts on those affected

Claims of impairment of constitutional rights, by their nature, must be analyzed with a view towards the concrete concerns of the individuals

whose rights have been implicated. The individualized nature of this inquiry manifests itself in two important respects:

First, the inquiry into the ***impairments*** caused by pension modifications must be individually-focused—that is, it must look to the deprivation suffered by particular employees. *Abbott v. City of Los Angeles* (1958) 50 Cal.2d 438, at 449 ("[I]t is advantage or disadvantage to the particular employees whose own contractual pension rights, already earned, are involved which are the criteria by which modifications to pension plans must be measured"); *see, e.g. Miller v. State of California* (1977) 18 Cal.3d 808, 811 (no actual modification to plaintiff's pension rights had occurred, so no need for analysis under *Allen I* or *Abbott*); *accord Packer v. Board of Retirement* (1950) 35 Cal.2d 212 (following individualized finding that officer had received offset, the Supreme Court found permissible a pension modification which permitted a "widow's pension" only if the husband agreed to take a lesser pension for himself). While the adverse effect must be analyzed in terms of its effect on individuals, individual public employees do not exist in a vacuum and the modification may affect them as part of a collective bargaining unit in their collective relationship with their public employer rather than in their capacity as individuals.[5]

[5] Thus, public employees often deal with their employer collectively through the meet and confer process under such statutes as the Meyers-Milias-Brown Act, Gov. Code Section 3500 *et seq.* And the disadvantage they experience as a result of the modification of a pension system may be

Second, the inquiry into the ***justification*** proffered for a pension modification—whether it bears a "material relation to the theory of a pension system" as a whole (*see* *Allen I*, *supra*, 45 Cal.2d at 131) must also be evaluated on an individualized basis. That means that the court must look at the ***particular impairments*** suffered by very employees who are adversely affected.[6] While *Amici* disagree with the holding, on this point, the First Appellate District got it right when it said, in its recent *Alameda County Deputy Sheriff's Association* decision, that the impairment analysis:

> . . . must focus on the impacts of the identified disadvantages on the specific legacy members at issue... And, if the justification for the changes is the financial stability of the specific CERL system, the analysis must consider whether the exemption of legacy members from the identified changes would cause that particular CERL system to have "difficulty meeting its pension obligations" with respect to those members... In this regard, mere speculation is insufficient... Moreover, generally speaking "[r]ising costs alone will not excuse the city from meeting its contractual obligations, the consideration for which has already been received by it." ... Under this analysis, and contrary to the holding in *Marin*, the fact that the modifications here at issue may be relatively modest looking at a system's pension costs as a whole may actually argue in favor of finding an impairment, as the continuation of such benefits solely for legacy members may not have a significant impact on the system, especially if such benefits have been already actuarially accounted for and treated as pensionable.

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as a result of tradeoffs made in the compensation package as a result of that process. *See* discussion *infra* at Section B(2).

[6] *See, e.g. Cal. Teachers Ass'n v. Cory* (1984) 155 Cal.App.3d 494, 511, 202 Cal.Rptr. 611 ("An issue of prohibited impairment arises when the scope of the legislative impairment is not narrowly tailored ...").

Alameda County Deputy Sheriff's Ass'n v. Alameda County Emples. Ret. Ass'n & Bd. Emples. Ret. Ass'n (Feb. 5, 2018, No. A141913), at *62, ___Cal.App.5th___, 2018 Cal. App. LEXIS 95; *see also id.*, at 60-61 (criticizing *Marin* decision for "impermissibly focusing on the unfunded pension liability crisis in general" instead of "specifically weigh[ing] the financial implications for Marin CERA if legacy members were exempted from those modifications ...").

2. A constitutionally-cognizable impairment has occurred if the change disrupts individuals' reasonable expectations regarding retirement income

"Laws which restrict a party to those gains reasonably to be expected from the contract are not subject to attack under the contract clause ... notwithstanding that they technically alter an obligation of a contract." *El Paso v. Simmons* (1965) 379 U.S. 497, 498 n.14, 85 S.Ct. 577; *Allen v. Board of Administration* (1983) 34 Cal.3d 114, 124 (*Allen II*). In the pension context, in light of the need for "pension systems [to] be kept flexible," *Kern*, 29 Cal.2d at 854-55, courts have read into the Contract Clauses the concept that "minimal alterations" of pension benefits need not be subjected to the same scrutiny as substantial impairments when it comes to legislative purpose and offsetting benefits. *See Valdes*, 139 Cal.App.3d at 789; *see also Energy Reserves Group, Inc. v. Kansas Power & Light Co.* (1983) 459 U.S. 400, 411, 103 S. Ct. 697 (impairment of contract must be

"substantial" for it to violate Contract Clause). Thus, the proper measure for whether an impairment is "minimal" or "substantial" is the extent to which it affects the terms upon which the parties have reasonably relied:

> In focusing on '*reasonable* pension expectations' in Betts (italics added), we implicitly affirmed the well established constitutional principle that 'Laws which restrict a party to those gains reasonably to be expected from the contract are not subject to attack under the Contract Clause, notwithstanding that they technically alter an obligation of a contract." ... 'The Constitution is 'intended to preserve practical and substantial rights, not to maintain theories.' ...'

Allen v. Board of Administration (1983) 34 Cal.3d 114, 124 (Allen II) (no unconstitutional impairment because retirees could not "reasonably" "expect under the terms of their employment contract to obtain retirement allowances computed on the basis of the unique salary increase accomplished by the constitutional revision of 1966 which expressly negated such expectations."); see also Pasadena Police Officers Assn. v. City of Pasadena (Ct.App. 2 Dist. 1983) 147 Cal.App.3d 695, 195 Cal.Rptr. 339 (ability of board to change actuarial assumptions did not impair vested rights because it had been contemplated "at all pertinent times").

When an employee accepts public employment, and renders his or her labor in service thereto, he or she does so reasonably expecting to receive not only the current wages and benefits, but also deferred benefits under the terms promised by the employer. Claypool v. Wilson (Ct.App. 3 Dist. 1992) 4 Cal.App.4th 646, 662, 6 Cal.Rptr.2d 77 ("The contractual

basis of a pension right is the exchange of an employee's services for the pension right offered by the statute."). These "expectations are measured by benefits which are in effect not only when employment commences, but which are thereafter conferred during the employee's subsequent tenure." *Betts v. Board of Administration* (1978) 21 Cal.3d 859, 866.

These expectations extend not only to the explicit text of the applicable Memoranda of Understanding (MOUs) or statutes, but may also include terms that have been implied by practice, usage, and custom. *See Retired Employees Assn. of Orange County, Inc. v. County of Orange* (2011) 52 Cal.4th 1171, 134 Cal.Rptr.3d 779 (*REAOC*) ("circumstances accompanying" statutory framework may create vested rights).[7] Included in employees' constitutionally-protected reasonable expectations are the terms of their promised pension benefits. *See Kern*, *supra*, 29 Cal.2d at 853 ("[P]ension laws ... establish contractual rights."). Indeed, "under California law there is a strong preference for construing governmental pension laws as creating contractual rights for the payment of benefits, and

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[7] *See also Board of Administration v. Wilson* (Ct.App. 3d Dist. 1997) 52 Cal.App.4th 1109, 1133, 61 Cal.Rptr.2d 207 ("[T]he PERS statutes set up a retirement system to pay pension rights of state employees. Actuarial soundness of the system is necessarily implied in the total contractual commitment, because a contrary conclusion would lead to express impairment of employees' pension rights."); *Valdes v. Cory* (Ct.App. 3d 1983) 139 Cal.App.3d 773, 786, 189 Cal.Rptr. 212 (looking beyond statutory language to determine that "the Legislature intended to create and maintain the PERS on a sound actuarial basis.").

when feasible to do so[,] such laws should be construed as guaranteeing full payment to those entitled to its benefits 'with the provision of adequate funds for that purpose.'" *Board of Administration v. Wilson* (Ct.App. 3d 1997) 52 Cal.App.4th 1109, 1131, 61 Cal.Rptr.2d 207 (pension laws imply a vested contractual right to an "actuarially sound" retirement system).

Public employees— who make an explicit tradeoff by choosing the "job security and employment benefits enjoyed by public employees" rather than the "higher wages" available in the private sector (*see generally Lusardi Construction Co. v. Aubry* (1992) 1 Cal.4th 976, 987, 4 Cal.Rptr.2d 837) quite literally build their careers and their economic lives around these sorts of expectations, which is why it is so critical that there be an offsetting benefit when these expectations are disrupted.

Public sector collective bargaining reflects this same dynamic. Thus, during collective bargaining, each economic item serves as a lever against everything else in the context of a broad give-and-take negotiation over the terms and conditions of employment. When the bargaining parties negotiate a Memorandum of Understanding (MOU), if they understand a retirement benefit to be guaranteed, it is accounted for and valued in a certain way during that give-and-take. *Amicus curiae* OCAA explicitly engaged in this sort of tradeoff in negotiating its 2004-2007 MOU with the County of Orange ("County"). There, OCAA made significant sacrifices in exchange for the County's agreement to an enhanced "2.7% at 55" pension

benefit formula.[8] Employee organizations routinely engage in this sort of long-term sacrifice of other priorities to obtain pension concessions. It is extremely disruptive of reasonable expectations for a public employer to extract such concessions and, then, to unilaterally change the terms of a pension benefit.

The concern with reasonable expectations also flows from the nature of the underlying constitutional norms protected by the vested benefit doctrine. Thus, as this Court has previously recognized, changes that adversely affect the public employee's "gains reasonably to be expected from the [employment] contract" are constitutionally significant

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[8] OCAA expressly engaged in the following tradeoffs to obtain this enhancement:

- Elimination of Preferred Provider Medical coverage;
- Reduction in lifetime medical cap from $2,000,000 to $1,000,000;
- Increased co-pays for medicine and office visits;
- Increased medical premium payments, including a 5% premium pick up by single employees who had previously never contributed;
- Elimination of the County's $100/month contribution to employee 401a account;
- Reduction in Attorney Optional Benefit from $2,700 to $1,500;
- Payment of the difference between the employees' normal contribution rate calculated pursuant to Government Code sections 31621.5 and 31621, and section 31621.8;
- An additional employee contribution to the retirement system in an amount equal to 0.54% of compensation earnable;
- Elimination of lump sum payment worth approximately 1% of salary; and
- Foregoing salary increases entirely for two years, with a salary reopener in lieu of a fixed increase in the final period of the agreement.

impairments under the Contract Clauses. *Allen II*, *supra*, 34 Cal.3d at 124, *quoting* *El Paso v. Simmons* (1965) 379 U.S. 497.[9]

3. Where the individualized inquiry reveals a constitutionally-cognizable impairment, the affected employees must receive just compensation

The California Rule—requiring public employers to provide a comparable new advantage when pension modifications impair employees' contract rights—is consistent with constitutional jurisprudence that views contract rights as a form of property that may not be taken without just compensation. *See* *United States Trust Co.*, *supra* section B(1), 431 U.S. at 19 n.16. This is how California courts have consistently dealt with

[9] Amici note that, in applying this "reasonable expectations" analysis to the present case, the "circumstances accompanying" the statutory framework (*REAOC*, *supra*, 52 Cal.4th at 1187) include a CalPERS publication provided to employees entitled "Vested Rights of CalPERS Members: Protecting the Pension Promises Made to Public Employees." While Respondents have questioned the level of deference to which this CalPERS analysis is due under *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, given that it assertedly is not the result of a "formal agency process," [Intervenor and Respondent State of California's Answer Brief on the Merits, at 34-35], this misses its significance. Employees form their expectations based upon (and plan their economic lives around) employer promises of future benefits. These promises help determine the scope of vested rights and whether an impairment is "substantial" and therefore constitutionally cognizable. An official CalPERS communication such as the one at issue here is predictably likely to be relied upon to form the basis for an employee's expectations concerning the nature, value and scope of her/his retirement benefits—an evidentiary value totally separate and apart from whatever weigh is due under *Yamaha* to the legal analysis underlying the document.

significant impairments of contract rights—and how they should continue to do so.

As this Court articulated in *Allen II*:

> [A]ny modification of vested pension rights must be reasonable, must bear a material relation to the theory and successful operation of a pension system, and, when resulting in disadvantage to employees, ***must be accompanied*** by comparable new advantages.

34 Cal.3d at 120 (*emphasis added*). This formulation is not a drafting anomaly, but, rather, an accurate reflection of a consistent constitutional standard. While the exact phrasing has varied, courts have repeatedly used mandatory language to describe the need for a comparable offsetting advantage. *See, e.g.* *Abbot v. Los Angeles* (1958) 50 Cal.2d 438, 454, 326 P.2d 484 ("[T]he substitution of a fixed for a fluctuating pension is ***not permissible unless accompanied*** by commensurate benefits..."); *Legislature v. Eu* (1991) 54 Cal.3d 492, 529, 286 Cal.Rptr. 283 ("[T]he state ***cannot*** ... abandon that plan as to incumbent legislators ***without providing them comparable new benefits***."); *Phillis v. City of Santa Barbara* (Ct.App. 2 Dist. 1964) 229 Cal.App.2d 45, 66, 40 Cal.Rptr. 27 ("There is no merit in respondents' claim that the rule of the *Allen* and *Abbott* cases, ***requiring equal advantages*** to offset disadvantageous amendments to a pension plan, is confined in its application to employees who have fully earned their pension."].); *In re Retirement Cases* (Ct.App. 1 Dist. 2003) 110 Cal.App.4th 426, 448, 1 Cal.Rptr.3d 790 (disadvantageous