Case No. S247095

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

SUPREME COURT
FILED

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Deputy

ALAMEDA COUNTY DEPUTY SHERIFFS' ASSOCIATION et al.,
Plaintiffs and Appellants,
v.
ALAMEDA COUNTY EMPLOYEES' RETIREMENT ASSN. AND BD. OF THE ALAMEDA COUNTY EMPLOYEES' RETIREMENT ASSN. et al.,
Defendants and Respondents;

SERVICE EMPLOYEES INTERNATIONAL UNION, LOCAL 1021, et al.,
Interveners;

BUILDING TRADES COUNCIL OF ALAMEDA COUNTY et al.,
Interveners and Appellants.

After an Order by the Court of Appeal, First Appellate District, Case No. A141913, Contra Costa County Superior Ct. Case No. MSN12-1870 (Coordinated with Alameda Superior Ct. Case No. RG12658890 and Merced Superior Ct. Case No. CV003073)

PETITIONERS, ALAMEDA COUNTY DEPUTY SHERIFFS' ASSOCIATION, ET AL.'S REPLY BRIEF ON THE MERITS

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Pensions will be 'on the chopping block' in next recession, Jerry Brown says, Sacramento Bee, January 12, 2018,
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Given the dearth of relevant precedent supporting the State's effort to overturn decades of this Court's vested rights jurisprudence, it is not surprising that the State dedicated much of its Answer Brief to discussing supposed evidentiary and procedural defects in the Petitioners' case. However, there is no merit to these surface level attacks.

The State claims there is insufficient evidence to show the Petitioners had vested rights to pension benefits that included the pay items at issue in this case[1]. The plain language of the court-approved settlement agreement[2] the Alameda County Employees' Retirement Association ("ACERA") executed after this Court's ruling in *Ventura County Deputy Sheriffs' Association v. Board of Retirement* (1997) 16 Cal.4th 483 ("*Ventura*"), as well as ACERA's subsequent representations and conduct are indisputable evidence that Petitioners had vested pension rights to the at issue pay items.

Moreover, the State ignores the procedural posture of this case. The trial court bifurcated the case into phases, with the first phase limited to deciding the strictly legal questions of whether County Employees' Retirement Law ("CERL") allowed retirement boards to include the disputed pay items in members' pension benefits, and whether it was *possible* to have a vested right

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[1]A full list of the pay items at issue is set forth in the Petitioner's Opening Brief ("POB"), pp. 16-17.

[2]This settlement agreement is hereafter referred to as the Alameda Settlement Agreement.

to the inclusion of such pay items even if the CERL prohibited it. After deciding these issues, the trial court disposed of the case. The parties were not given the opportunity to create a factual record relating to ACERA members' vested rights. Petitioners contend the Alameda Settlement Agreement is enough evidence to support their vested rights claim on its own. However, if the Court disagrees, it should remand the case back to the trial court to develop the record, not reject the Petitioners' claim in its entirety.

Likewise, the Court should reject the State's attempt to avoid the issue of whether ACERA had discretion to include forms of compensation in pension benefits beyond those explicitly required by the CERL. This issue is properly before the Court. The parties are entitled to argue any issues raised in the petitions for review, the answers, and any issues fairly included within those issues. (See California Rule of Court 8.516.) The issue of whether ACERA had the discretion to include the disputed pay items in pension benefits is necessarily included in the issue of whether the Legislature could impair vested rights to benefits including the pay items without providing a new comparable advantage. The vested rights at issue arose from ACERA's exercise of that discretion. Moreover, the issue must be decided to answer the questions raised in the State's petition for review - namely, whether applying equitable estoppel to require ACERA to include pay items beyond those named

in the CERL would violate the law.

For these reasons, the Court should reject the State's procedural arguments, and issue a ruling affirming its longstanding vested rights doctrine, the "California Rule."

A. THE STATE'S EVIDENTIARY ARGUMENTS IGNORE THE PROCEDURAL POSTURE OF THIS CASE

The State incorrectly claims Petitioners failed to cite evidence in the trial record of promises to include the disputed pay items in pensionable income. Simultaneously, the State ignores the procedural posture of the case, namely the trial court deferred such factual disputes. (*See* State's Answer Brief ("SAB"), pp. 21-27) The State fails to acknowledge the trial court divided the case into several phases. (*See* 16 CT 4681-84 (Case Management Order No. 1.)) The bifurcated proceedings allowed the parties to brief and argue the overarching legal framework of the CERL without deluging the court with factual disputes over the existence of a vested right to the inclusion of each pay item. Thus, the State's arguments about the adequacy of the Petitioners' evidence are irrelevant distractions from the core legal issues.

The trial court limited the First Phase to two questions. First, whether the retirement associations were required or authorized, under the CERL, to include in compensation earnable, accrued leave greater than that which was earned and payable in the final compensation period, compensation previously

provided in kind to members by the employer which was converted to cash and received by the member in the final compensation period, and one-time or ad hoc payments to members. (16 CT 4682.) Second, whether it would be *possible* for any employees to have a vested right to the pension benefits that included any pay items the court determined the retirement boards were not required or authorized to include in compensation earnable. (*Id.*)

The trial sought to avoid having to resolve factual disputes about each pay item before deciding the issues outlined above. Indeed, the court said "I'm comfortable with people raising these hypotheticals and these facts, but only for the purpose of making the legal question of whether the case laws that exist today allows or doesn't allow that vesting." (7 RT 254-55 (Transcript from July 9, 2013 Hearing.)) The posture of this case, in the appellate court and before this Court, is comparable to the certified issue this Court decided in *Retired Employees Association of Orange County v. County of Orange* (2011) 52 Cal.4th 1171 ("*REAOC*"). This Court was asked to determine "[w]hether, as a matter of California law, a California county and its employees can form an implied contract that confers vested rights to health benefits on retired county employees" in REAOC. (*Id.* at 1176.)

The parties were not afforded the opportunity to develop a factual record before this phase of the litigation, regarding whether ACERA's

promises created a vested right to the inclusion of each pay item at issue. The trial court assumed the existence of a contractual promise and simply addressed whether such a promise was permissible under the CERL, without getting mired in a factual dispute over whether a vested right actually existed. This is analogous to *REAOC* where, after holding an implied contractual term could exist, this Court remanded the matter back to the trial court to determine whether such an implied term actually existed.

Similarly, the appellate court concluded that, had the specific pay items been promised, their inclusion in pensionable compensation may have been allowed before PEPRA's enactment. However, it also recognized the parties were never given an opportunity to develop a factual record about the promises ACERA and the County of Alameda made about which pay items would be included in members' compensation earnable. The court explained:

> Although it implicitly found a vested rights violation with respect to on-call pay, the trial court below never conducted the systematic vested rights analysis needed. Nor did it consider the impact of both detrimental changes we have identified. Moreover, the parties have not had the opportunity to brief and argue these issues. We are therefore without sufficient information to resolve these vested rights disputes on appeal and must remand the matter for further consideration in light of the guidance provided in this opinion. (*Alameda County Deputy Sheriff's Assn. v. Alameda County Employees' Retirement Assn.* (2018) 19 Cal.App.5th 61, 123 ("*ACDSA*."))

This statement is an implicit acknowledgment of the bifurcated nature of the proceedings, and that the existence of such promises would be decided by the trial court in a subsequent phase of the litigation.

At issue in the instant appeal is whether Petitioners *could* have a vested right to pension benefit that included the disputed pay items, and whether any detrimental change in that right must be offset by a new advantage. As such, the State's arguments regarding whether the terms of ACERA's Settlement Agreement, or the representations in ACERA's publications, were sufficient to create vested rights to have leave cash outs and the other disputed pay items included in compensation earnable are premature. If this Court cannot determine whether vested rights existed as a matter of law, it should remand the case for a factual determination of the scope of Petitioners' vested rights.

B. NOTWITHSTANDING THE PROCEDURAL POSTURE OF THIS CASE, PETITIONERS HAVE PRODUCED EVIDENCE SHOWING THEY HAD A VESTED RIGHT TO PENSION BENEFITS THAT INCLUDED THE DISPUTED PAY ITEMS

Petitioners seek to enforce their vested right to have their leave cash outs and compensation received for various other pay codes (e.g. Standby and On Call Pay) included in the compensation earnable used to calculate their pension benefits. As discussed in Petitioners' Opening Brief, as well as Petitioners' Answer to the State's appeal in this case, the CERL did not prohibit ACERA from including these items in Petitioners' pension

calculations before PEPRA was enacted. Thus, there is no merit to the State's claim that including such items of compensation in Petitioners' compensation earnable was unlawful before PEPRA's enactment.

1. THE ALAMEDA SETTLEMENT AGREEMENT EXPRESSLY PROMISES THAT LEAVE CASH OUTS WILL BE INCLUDED IN COMPENSATION EARNABLE

The Alameda Settlement Agreement and ACERA's publications repeatedly informed ACERA members that leave cash outs and the other disputed pay items would be included in their compensation earnable.

The State's assertion that the Alameda Settlement Agreement contains no promise to include leave cash outs in compensation earnable is meritless. (SAB, p. 21.) Petitioners cited many of these representations in their Opening Brief. (*See, e.g.* POB, pp. 32 (citing provisions of the Alameda Settlement Agreement providing that leave paid as salary or lump sums in lieu of paid leave would be compensation earnable, up to the the amount of leave the member could earn in their final compensation period), 34 (citing ACERA Handbook provision promising vacation and sick leave cash outs would be included in members' benefit calculations.))

The Alameda Settlement Agreement, states:

> "Compensation earnable," for the purposes of calculating pensionable compensation, shall include . . . leave paid as salary or as lump sum(s) in lieu of paid leave. . . "Final compensation" . . . shall be the average compensation earnable by a

> Member during the period determined to be the Member's final compensation period as elected by the Member, that is, the average annual compensation during the one year, or averaged over three years where applicable, except that vacation leave and/or sick leave paid as a lump sum shall be recognized as final compensation only to the extent that it is earned during the final compensation only to the extent that it is earned during the final compensation period, shall be the annual average of leave earned. (23 CT 6770.)

In fact, the appellate court specifically noted the promise to include leave cash outs in the Alameda Settlement Agreement:

> Pursuant to the terms of the settlement, compensation earnable was defined as 'all items of remuneration paid ... in cash for services rendered or special skills,' including, among other things, 'pay premiums that recognize special duties' and 'leave paid as salary or as lump sum(s) in lieu of paid leave.' However, the definition of final compensation was expressly limited such that 'vacation leave and/or sick leave paid as a lump sum shall be recognized as final compensation only to the extent that it is earned during the final compensation period and, in the case of a three-year final compensation period, shall be the annual average of the leave earned." (*ACDSA*, *supra* 19 Cal.App.5th at 82-3.)

The Alameda Settlement Agreement also calls for lump sum payments of the leave accrued in the final compenation period to the included. Similarly, the State incorrectly claims the handbook does not evidence any promise. (SAB, p. 23.)

Moreover, ACERA has not disputed Petitioners' interpretation of the Alameda Settlement Agreement or the representations ACERA made in its publications over the years.

Any factual dispute the State may have about the meaning of the Alameda Settlement Agreement or ACERA's publications is not ripe for adjudication, given the posture of this case. The trial court did not reach the issue of whether ACERA's members could show ACERA promised to include the disputed pay items in compensation earnable, because it disposed of the case at the first phase of the litigation. That phase was focused on whether the retirement boards were *allowed* to include those pay items in compensation earnable, and whether it was *possible* for a vested right to the inclusion of such items to exist regardless of whether it was allowed under the CERL. If this Court determines ACERA could include such pay items in Petitioners' compensation earnable, it should remand the matter back to the trial court to determine whether Petitioners had a vested right to the inclusion of those items.

2. ACERA NEVER INCLUDED IN COMPENSATION EARNABLE LEAVE CASH OUTS IN EXCESS OF THE AMOUNT MEMBERS COULD EARN DURING THEIR FINAL COMPENSATION PERIOD

The leave cash outs at issue in Alameda County are different than those in the other counties involved in this litigation; ACERA did not allow

members to include leave cash outs beyond what they could earn in their final compensation period. The State's repeated assertion that ACERA allowed members to include cashouts for leave in excess of those amounts lacks merit. (SAB, pp. 13, 20, 23.) Petitioners certainly do not make such a claim, and the appellate court recognized that the definition of final compensation in Alameda was "expressly limited to such that 'vacation leave and/or sick leave paid as a lump sum . . . only to the extent that it [was] earned during the final compensation period and, in the case of a three-year final compensation period, shall be the annual average of the leave earned." (*ACDSA*, *supra* 19 Cal.App.5th at 82 (citing the Alameda Settlement Agreement.)) As such, Petitioners' leave cash outs were pensionable under the pre-PEPRA definition of compensation earnable in Government Code section 31461, which did not include the requirement that employees had to be able to cash out the leave during their final compensation period to have it included in their pension benefits.

3. ON CALL AND STANDBY PAY ARE NOT PAID FOR SERVICE RENDERED OUTSIDE WORKING HOURS

The State's assertion that Standby and On Call pay were always excluded from compensation as pay for work outside normal working hours ignores what those pay items actually are. (SAB, p. 29.) Neither pay items are compensation for *work* outside normal working hours. As set forth in

Petitioners' Opposition to the State's Opening Brief, these pay items are not for hours worked - they are pay for being available to work. (POB, p. 38.) If employees were actually called in to work, they were paid overtime for the time they spent working. This distinction resolves the State's confusion over differences in the treatment of Standby pay and overtime. (*See* SAB, p. 28.)

As a preliminary matter, the Petitioners agree with the State's assertion that the appellate court did not address the issue of whether ACERA promised legacy employees the pay items excluded under Government Code section 31461 subsections (b)(1) and (b)(3). (SAB, p. 28.) The procedural posture of the case precluded such an analysis, as the trial court never gave the parties an opportunity to develop a factual record on that issue.

The law does not support the State's characterization of On Call and Standby pay as payments for services rendered outside normal working hours. (*See SAB*, p. 29.) On Call and Standby pay are not payments for work performed outside normal working hours, as explained in Petitioners' Answer Brief. The Fair Labor Standards Act is dispositive on this point - if On Call time was pay for irregular hours of work, it would have to be compensated at the overtime rate of pay (or the straight time rate for non-overtime hours). Rather, on call/standby pay is not compensation for hours of work but instead additional compensation for the inconvenience of an assignment that requires

officers to be available to be called back to work. (29 C.F.R. § 7778.223; *Acton v. City of Columbia* (8th Cir. 2006) 436 F.3d 969.) If the Petitioners actually performed work, they would be entitled to overtime, which no one in this litigation claims should be included in pensionable compensation. (*See Berry v. County of Sonoma* (9th Cir. 1994) 30 F.3d 1174.)

The State's claim that the CERL prohibited ACERA from including these pay items in Petitioners' pensionable compensation lacks credibility. (POB, p. 30.) The State's argument relies on a mischaracterization of what those pay items are for, and it assumes facts not in evidence - namely, that ACERA members could volunteer for extra standby/on call shifts to increase their pensionable income. In Alameda County, individuals who received On Call pay were assigned to on call positions based on their assignments and the need for 24-hour coverage. (42 CT 12102, ¶ 7 (Declaration of Rocky Medeiros in Support of Petitioners' Objections and Proposed Modifications to Tentative Combined Decision ("Medieros Dec.")) On Call shifts were assigned a year in advance. (*Id.* at ¶ 8.) Employees assigned on call positions are scheduled for on call assignments on a rotational basis depending on the number of people assigned to the on call position. (*Id.* at ¶ 9.) Rotations ranged from every week to every sixth week. (*Id.* at ¶ 9.) As law enforcement officers, the nature of their work and the Department's needs required them to be on call.

There is no evidence in the record to support the State's assertion that Standby and On Call pay were pay for work performed outside normal working hours, much less pay meant to enhance ACERA members' retirement benefits. (PAB, pp. 13, 44.) As such, these pay items were includible in employees' pensionable income before PEPRA's enactment.

4. ACERA WAS ALLOWED TO INCLUDE THESE DISPUTED PAY ITEMS IN COMPENSATION EARNABLE

a. ACERA's Authority to Determine Whether Pay Items Are Compensation Earnable is Properly Before the Court

Seeking to avoid a merits based determination, the State erroneously argues Petitioner's appeal did not raise the issue of whether the CERL prohibits inclusion of leave accruals during the final compensation period that are not payable until retirement. (SAB at pp. 10, 30, 43.) However, the determination of whether ACERA could include such pay items in compensation earnable is derivative and intrinsic to this appeal. Petitioners appealed on the grounds that the "California Rule" did not allow the State to impair employees' vested pension rights without providing a corresponding new advantage. An integral aspect of the appeal is the existance of a vested right that is being impaired. The State tacitly recognizes the interconnected nature of these subissues in claiming Petitioners cannot show the elimination of the pays was a substantial impairment on the grounds they did not

specifically appeal whether the CERL allowed their inclusion.

It is beyond dispute that the Court is empowered to decide issues necessary for the proper resolution of the case before it. (*See Broughton v. Cigna Healthplans of California* (1999) 21 Cal.4th 1066, 1078.) The retirement boards' authority to determine whether to include items of special compensation in members' pension benefits is clearly an issue it must decide in its consideration of whether the Legislature impaired members' vested right to have pension benefits that included those pay items.

Moreover, the State raised the issue in its own petition for review, by claiming the retirement boards' supposed lack of authority to include such pay items in compensation earnable precluded the application of equitable estoppel. (*See* Petition for Review, filed by the State of California on February 20, 2018, p. 29 (claiming the retirement boards' "lack of authority alone should have as a matter of law precluded using estoppel to require the retirement boards to include terminal pay in pensionable compensation.")

As set forth in Rule of Court 8.516(a), the parties are limited to the issues the Court orders reviewed and any issues "fairly included in them." The issue of whether ACERA had the authority to include the disputed pay items in compensation earnable before PEPRA's enactment is included within the issue of whether the Contracts Clause prohibited the Legislature from

eliminating these pay items from compensation earnable without providing a corresponding new advantage. Likewise, the retirement boards' authority to include terminal pay in compensation earnable is fairly included in the State's appeal of the appellate court's estoppel ruling.

Moreover, the Court is empowered to decide any issue the case presents if it gives the parties reasonable notice and an opportunity to brief and argue it. Here, the State dedicated several pages of its Answer to arguing this issue - it cannot credibly claim it was not on notice that the issue was before the Court. Thus, the issue is properly before the Court.

b. The Retirement Boards Had Discretion to Include Pay Items Not Specifically Set Forth in the CERL

Government Code section 31461 has always outlined the basic parameters of compensation earnable, and stated that a members' compensation earned ultimately is "determined by the board" of the retirement association. Before PEPRA's enactment, the CERL did not require that leave accrued during the final compensation period also be payable. Thus, the plain language of the statute contradicts the State's claim that ACERA lacked any discretion to decide whether to include leave cash outs or the other disputed pay items in the compensation earnable used to calculate its members' pension benefits.

Courts have consistently declined to rule the CERL prohibited

retirement associations from including various pay items in members' retirement calculations. Contrary to the State's assertion,[3] neither *In re Retirement Cases* nor *Salus v. City of San Diego* stand for the principle that the CERL *prohibited* retirement boards from determining that compensation earnable for their members could include leave cash outs - or any other form of compensation. The court in *In re Retirement Cases* said it was not deciding whether the terminal pay at issue in that case was prohibited from being included in compensation earnable. (*In re Retirement Cases, supra* 110 Cal.App.4th at 472, footnote 20 ("Because we are considering what *must* be included under the statute, and we conclude that the items requested by plan members do not *have to be included* under CERL, we need not consider L.A. County's argument that these items *cannot* be included.")(Emphasis added.)) Likewise, the court in *Salus* was not called upon to determine whether retirement boards had discretion to include pay items in members' pensionable income. Rather, it decided the issue of whether a retirement board was required include terminal pay in compensation earnable. These cases do not support the State's assertion that ACERA was not allowed to include the disputed pay items in members' compensation earnable. (*Consumers Lobby Against Monopolies v. Public Utilities Commission* (1979) 25 Cal.3d 891, 902

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[3]SAB, p. 30.

(holding cases are not authority for issues not decided.))

Before PEPRA's enactment, the CERL did not require that leave accrued during the final compensation period also be payable to be included in employees' pension calculations. Relying on the state of the law in 1999, and the Settlement Agreement, ACERA determined leave accruals during the final compensation period would be included in members' compensation earnable regardless of whether they were also payable prior to retirement. The State cites no law expressly holding that ACERA was not empowered to make such a determination.

The arbitrariness of PEPRA's new "payable" requirement is illustrated by the fact that the ACDSA and the County could restore the pre-PEPRA leave cashout by simply agreeing to allow members to annually cash out all the leave they earn each year. Thus, PEPRA's new requirement that leave cash outs be earned *and* payable during the final compensation upended ACDSA members' reasonable expectations. Because ACERA only included leave accruals during the final compensation period, the entire amount of pre-PEPRA leave cash outs can be restored simply by increasing the annual cash out amount. This easy fix calls into question the State's assertion that the CERL always prohibited ACERA from including this amount of leave cash outs in compensation earnable. This fact also belies the State's contention that the

impairment was necessary.

C. PEPRA SUBSTANTIALLY IMPAIRED PETITIONERS' VESTED RIGHTS

Notwithstanding the State's assertions to the contrary, PEPRA substantially impaired Petitioners' vested pension rights by changing the definition of compensation earnable. The exclusion of 120 hours of Petitioners' leave cash outs and the other disputed pay items from the compensation earnable used to calculate their pentions is substantial. PEPRA reduced Petitioners' pension benefits by as much as fifteen percent. The State's representation that PEPRA only applied prospectively is simply not true. By changing the definition of compensation earnable, PEPRA reduced the value of all the years of service Petitioners performed for the County of Alameda. There can be no dispute about whether such a massive reduction in benefits rises to the level of a substantial impairment.

1. PEPRA APPLIES RETROACTIVELY, NOTWITHSTANDING THE STATE'S CLAIMS TO THE CONTRARY

The Court should reject the State's argument that PEPRA only applies prospectively. (*See* SAB, p. 36 (claiming PEPRA's provisions "only operate prospectively.")) Changes to the terms of a pension formula, by their nature, are retroactive in application because they change the value of compensation

already earned. The Court should disregard the State's unsupported assumption that none of the pays PEPRA excluded were earned before PEPRA excluded them.

Each ACERA member's pension benefits are based on the compensation earnable the member received during his or her final compensation period, the members' years of service, and the applicable multiplier. The definition of compensation earnable in place at the time of the member's retirement thus applies to every year of the Petitioners' employment. Thus, PEPRA changed the definition of compensation earnable for every year of Petitioners' employment.

If PEPRA was actually applied only prospectively, it would have required ACERA to calculate pension benefits on a blended formula, using the pre-PEPRA final compensation formula for all pre-PEPRA years of service, (i.e. including the compensation Petitioners earned for leave and the other disputed pay items for pre-PEPRA years of service), and only apply the new reduced definition of compensation earnable to years the Petitioners worked after PEPRA's enactment. The State has never advocated for such an application of the law in this case, and Section 31461 does not contain any language supporting such an interpretation.

Because many of the incentives and pays PEPRA excluded were earned

throughout a member's employment, this change necessarily operates retroactively. Self-serving labels and argumentative descriptions of the pays at issue, such as "payments made to enhance a member's retirement benefit," elevate form over substance to justify the impairment. A detective who earned standby for 20 years will be divested of having the pay included in her final compensation earnable for all years of service, even if her final compensation period includes a year where Standby Pay was earned.

Similarly, there is no merit in the State's claim that PEPRA did not recharacterize the pensionability of any item that was earned and already included in an employee's final pensionable compensation. (SAB, p. 37.) Many of ACERA's members were already in their final anticipated compensation period when PEPRA was enacted. (*See, e.g.* 35 CT 10424 (Declaration of Robert Brock in Support of Ex Parte Application for TRO, filed December 13, 2012, ¶ 8 (planned retirement for 2014, two years after PEPRA's enactment)[4]

Likewise, there is no merit to the State's attempt to conflate changes to the pension formula with changes to future wages. (*See* SAB, p. 38.) The State fails to acknowledge the distinction between unearned future wages and

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[4]As Petitioner Brock's pension benefits were calculated based on a three year final compensation period, he had already earned leave and various other disputed pay items during his planned final compensation period when PEPRA changed the definition of compensation earnable.

deferred pension benefits. Pension benefits are deferred compensation for services rendered. (*In re Marriage of Brown* (1976) 15 Cal.3d 838, 845.) They are earned immediately upon the performance of services for a public employer and cannot be destroyed without impairing a contractual obligation. (*Miller v. State of California* (1977) 18 Cal.3d 808, 814.) By contrast, the cases the State relies on dealt with changes to the wages to be paid for work that had not been performed. They are inapposite.

D. THE STATE CANNOT REFUTE AUTHORITY FINDING LESSER IMPAIRMENTS WERE SUBSTANTIAL

The State failed to respond to the authorities Petitioners cited in their Opening Brief - resorting instead to conclusory statements that the impairments were not substantial. The State's inability to refute Petitioners' position is not surprising. The impairments at issue are substantial under any analysis.

The undisputed evidence submitted in this case shows PEPRA severely reduced the Petitioners' pension benefits. Implementing PEPRA's "earned and payable" requirement for leave cash outs, ACERA reduced the vacation cash outs included in pensionable compensation from five weeks per year to two weeks per year, and completely excluded sick leave cash outs from Petitioners' pension calculations. These changes reduced Petitioners' pension benefits by as much as fifteen percent. (35 CT 10420, ¶ 8 (Declaration of James T. Nelson

in Support of Ex Parte Application for Temporary Restraining Order, filed December 13, 2012); 35 CT 10424, ¶ 7 (Declaration of Robert Brock in Support of Ex Parte Application for Temporary Restraining Order, filed December 13, 2012); 35 CT 10428, ¶ 10 (Declaration of Rocky Medeiros in Support of Ex Parte Application for Temporary Restraining Order, filed December 13, 2012.))

There is no doubt that a unilateral reduction in the financial terms of a contract is a substantial impairment for Contract Clause purposes. (*Sonoma County Organization of Public Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 308-09 ("*Sonoma*"), *University of Hawai'i Professional Assembly v. Cayetano* (9th Cir. 1999) 183 F.3d 1096, 1104 ("*Cayetano*".)) In fact, merely postponing the payment of wages can be a substantial impairment. (*Id.* at 1105.)

The State's effort to characterize PEPRA's changes to the definition of compensation earnable as "mild" and "hardly burdensome" lacks merit (SAB, p. 45.) Indeed, the case the State cites to for the proposition that any changes to Petitioners' benefits were "mild" and "hardly burdensome" is inapplicable - it involved the forfeiture of public land sale contracts for the nonpayment of interest. (*See* SAB, p. 45 (*citing City of El Paso v. Simmons* (1965) 379 U.S. 497.))

Courts have routinely found substantial impairments in cases involving much smaller reductions in promised compensation. In fact, merely delaying the payment of public employee wages can give rise to a substantial impairment. (*Cayetano, supra* 183 F.3d 1096, 1104.) Likewise, the courts have regularly recognized that even the loss of a dollar is "not a trivial matter to a working man." (*See Glenn L. Martin Nebraska Co. v. Culkin* (8th Cir. 1952) 197 F.2d 981, 987, cert denied 344 U.S. 866 (1952.))

PEPRA's changes to the definition of compensation earnable reduced Petitioners' pension benefits by as much as 15%. Accordingly PEPRA's impairment of Petitioners' vested rights is substantial.

E. THE IMPAIRMENT WAS NOT REASONABLE UNDER THIS COURT'S JURISPRUDENCE

As discussed in Petitioners' Opening Brief, PEPRA's impairment of Petitioners' vested rights was not reasonable and therefore violated this Court's longstanding vested rights precedent. The State joins with the First Appellate District's criticism of this Court's ability to interpret and apply its own precedent, yet fails to identify which revision of the "California Rule" it wants the Court to adopt - the *MAPE* standard or the *ACDSA* standard. Instead, the State advocates for a broad and radical position that future benefit accruals and the pension formulas may be reduced. Both impermissibly erode the constitutional protections of the Contracts Clause.

Arguing this Court's precedent would "effectively block the State from exercising its general police and regulatory powers" the State conflates police powers cases with impairment of financial terms to avoid strict scrutiny. (SAB, pp. 46-47.) The Supreme Court's opinion in *City of El Paso, supra*, on which the State relies, is not applicable to the issues in this case. That case dealt with a law restricting the right of redemption for land purchasers who defaulted on payments to the most recent purchaser of the land, and required purchasers to exercise their redemption right within five years of default. Before the state enacted these restrictions, prior owners could exercise their redemption rights at any time. As a result, people began buying property and immediately defaulting on it, so they could become entitled to redeem the right and take the land if oil or minerals were found on it later. The Court ruled this did not unconstitutionally impair the state's contractual obligations because purchasers did not reasonably expect to have a right of redemption into perpetuity, and the restrictions were necessary to address rampant property speculation. The Ninth Circuit has expressly rejected attempts to extend *El Paso* to justify the direct impairment of financial terms. (*Southern California Gas Co. v. City of Santa Ana* (9th Cir. 2003) 336 F.3d 885, 896.)

In the context of public employee pension rights, this Court has repeatedly held that any changes must be material to the theory of a pension

and any detrimental changes must be offset by corresponding new advantages. (*See Allen v. City of Long Beach* (1955) 45 Cal.2d 128 ("*Allen I*"); *Legislature v. Eu* (1991) 54 Cal.3d 492; *Protect Our Benefits v. City and County of San Francisco* (2015) 235 Cal.App.4th 619.)

While courts have interchanged "must" and "should" when requiring detrimental change to be offset by new advantages, the cases applying the California Rule have used the terms synonymously to indicate a legal *obligation* to offset pension reductions with new advantages.

The cases upon which the State relies either do not support its position or are cases currently pending this Court's review. The Court in *Terry v. City of Berkeley* (1953) 41 Cal.2d 698, 702, for example, did not rule that such changes could be valid without corresponding new advantages. In fact, the Court found the detrimental change at issue could not be applied to the plaintiff. "The pension payments are in effect deferred compensation to which the petitioner becomes entitled upon the fulfillment of the terms of the contract which may not be changed to his detriment by subsequent amendment." (*Id.* at p. 703.)

The State itself cannot decide whether to accept the appellate court' s interpretation of the "California Rule" in this case, or the court's interpretation in *MAPE*. (*See SAB*, p. 48, stating detrimental changes to pension benefits are

permissible if they do not alter an employee's right to a "reasonable pension" (*i.e.* the *MAPE* rule) or if it is reasonable to serve an important public purpose (*i.e.* the *ACDSA* rule.)) Neither interpretation is consistent with the Court's repeated assertions that detrimental changes to public employees' pensions cannot be sustained as reasonable unless they are offset by comparable new advantages. The court erred in failing to follow this court's binding precedent.

F. ACERA MEMBERS CONTRIBUTED TOWARDS BENEFITS THAT INCLUDED THE DISPUTED PAY ITEMS

The State's claim that ACERA members did not contribute towards the cost of including the disputed pay items in their pension benefits is incorrect. (SAB, pp. 33-35.) Despite the fact that the trial court never reached the phase of the litigation where such evidence would be needed, the record shows ACERA's members paid to have their retirement benefits calculated based on a definition of compensation earnable that included the disputed pay items. As set forth in Petitioners' Opening Brief (POB, p. 36), the cost of including the disputed pay items was included in ACERA's actuarial assumptions. This infused the funding of those pay items into the normal costs used to set employer and employee contribution rates. This is a basic principle of the contribution rate setting process that the State cannot deny.

The *initial* funding source for including these pay items in compensation earnable was the superfunding of ACERA in the 1990s. Over

time, however, the cost of including these pays was built into the normal rate along with all the other cost assumptions paid by both the employees and the County. Indeed, ACERA itself acknowledged in its answer brief in this case that the Alameda Settlement governed ACERA's "payments of benefits and collections of contributions on an actuarially sound basis for over a dozen years." (ACERA's Answer Brief ("AAB"), p. 12.)

The fact that ACERA maintained an actuarially accrued unfunded liability (UAAL) does not establish that ACERA members and their employers failed to contribute towards the cost of including the disputed pay items in their pensionable income. The State offered no evidence to show any part of ACERA's UAAL can be attributed to the cost of including the disputed pay items in Petitioner's pension benefits.

G. THE LEGISLATURE'S JUDGEMENT IS NOT ENTITLED TO DEFERENCE

The State erroneously asserts this Court must defer to its legislative judgment that PEPRA is reasonable and necessary "[e]specially because the State has not impaired any of its own financial obligations." (SAB p. 21) To the contrary, PEPRA impaired the State's contractual pension obligations to its employees, thereby reducing its financial obligations. Not being a party to its political subdivision's Settlement Agreement does not justify the State's attempt to end-run around the Contract Clause.

The State's denial of its financial interest in upholding and enforcing reductions in its financial obligations strains credulity. Assembly Bill No. 340, by its plain terms amended the pension rights of the entire "public retirement system" including state, county, city, and district employees by making uniform modifications to all retirement benefit systems. If any PEPRA changes are deemed unconstitutional, this Court's holding will be applied to the State's direct financial obligations to its current and future pensioners. The State's direct financial interests are unequivocally exposed in the related appeal, *Cal Fire Local 2881 v. California Public Employes' Retirement System* (Cal. 2017) 216 Cal.Rptr.3d 119. That case involves a similar legal challenge to another aspect of PEPRA by state employees. In both cases, the State advocates for overturning decades of vested rights jurisprudence to uphold PEPRA. Furthermore, the Governor has expressly threatened that, if the State prevails in these appeals, in the future the State will"have the option of considering pension cutbacks for the first time in a long time." (Pensions will be 'on the chopping block' in next recession, Jerry Brown says, Sacramento Bee, January 12, 2018, (http://www.sacbee.com/news/politics-government/the-state-worker/article194434479.html.)

Moreover, even if the State did not have a financial interest in this appeal, the Court should apply strict scrutiny and afford the State's legislative determinations no deference. Affording deference to the State regarding the reasonableness and necessity of its impairments would permit governmental entities to avoid Contracts Clause scrutiny by using the State as a proxy to enact impairing legislation.

Thus, the Court should not grant any deference to the State's actions in enacting PEPRA just because the State was not Petitioners' employer. "[T]he protections afforded by the Contracts Clause could be undermined by a state arbitraging the difference between state and local governments to erect a legal system in which emergency manager powers could at will mow down local government public contracts that the local governments could not themselves touch." (*NCO Acquisition, LLC v. Roberts* (E.D. Mich., May 31, 2013, No. 12-10122) 2013 WL 2393237, at 5.) Dispatching a similar plea for deference, the Second Circuit explained:

> Our initial comment is that the presence or absence of a state as a party to the contract is not determinative of the deference issue. Defendants ignore that a public contract is in fact being impaired albeit through state rather than local law. Were we to adopt defendants' reading, state legislatures could delegate to an agency the power to impair a public contract of a government subdivision that the subdivision itself would have more difficulty impairing. Lawmakers could

> fashion the powers delegated to the agency in a manner to insulate the agency's actions from constitutional attack. We decline to open such an end-run around Contracts Clause law. The better rule therefore calls for focusing on whether the contract-impairing law is self-serving, where existence of a state contract is some indicia of self-interest, but the absence of a state contract does not lead to the converse conclusion.

Here, the State seeks to conceal its self-interest by myopically focusing on the fact it was not a party to the Alameda Settlement Agreement, thereby evading strict scrutiny and procuring an opinion upholding PEPRA. The State could then cite a favorable determination in PEPRA challenges where the State is party to the impaired contract. This Court should decline the State's attempt to insulate itself from the Constitution and apply the appropriately rigorous strict scrutiny Contact Clause analysis.

H. THE STATE IS UNABLE TO RESPOND TO BINDING CALIFORNIA PRECEDENT REQUIRING IMPAIRMENTS TO BE TEMPORARY IN ORDER TO BE REASONABLE.

The State cannot credibly dispute that California law requires an impairment to be temporary to be sustained as reasonable. In a footnote, the State instead dismisses this Court's holding in *Olsen v. Cory* (1980) 27 Cal.3d 532, 539, that an impairment must be temporary, with interest running, by citing *Energy Reserves Group, Inc. v. Kansas Power and Light Co.* (1983) 459

U.S. 400. (SAB p. 55, fn 14.) Tellingly, the State's citation is merely a boilerplate recitation of federal Contracts Clause cases holding that the public purpose need not address an emergency or temporary situation, where the state was exercising general police powers over economic and social regulation. In California, this Court established a four prong test for evaluating governmental impairments of its own financial terms which requires "(4) the enactment is designed as a temporary measure, during which time the vested contract rights are not lost but merely deferred for a brief period, interest running during the temporary deferment." (*Olson v. Cory* (1980) 27 Cal.3d 532 at 539 (*citing, Sonoma County Organization of Public Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 305-6.) The State's silence in the face of this fourth factor is an admission PEPRA fails the temporary test and is therefore unconstitutional.

I.

CONCLUSION

For the foregoing reasons, Petitioners ask the Court to vacate the appellate court's ruling, affirm the principle that vested pension rights may not be detrimentally changed without offsetting new advantages, and remand this case back to the trial court for further proceedings consistent with this Court's ruling.

Respectfully Submitted:

Dated: August 22, 2018

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CERTIFICATE OF WORD COUNT

Pursuant to Rule 8.204(c)(1) of the California Rules of Court, I certify that this brief consists of 9,234 words, as counted by the computer program used to generate the document.

Respectfully Submitted:

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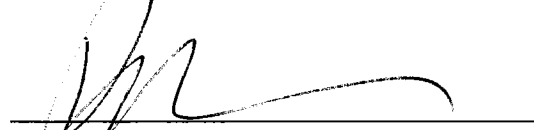

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SUPREME COURT CASE NO.: S247095
COURT OF APPEAL CASE NO.: A141913

I am employed in the County of Sacramento, State of California. I am over the age of eighteen years and not a party to the above-entitled action. My business address is 1912 I Street, Sacramento, California 95811-3151. On the date below, I served the following document(s):

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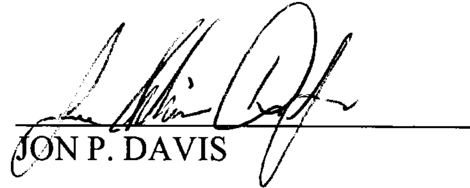

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