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**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.

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

PETITIONERS AND APPELLANTS' CONSOLIDATED ANSWER TO AMICI CURIAE

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TABLE OF CONTENTS

Page

I. INTRODUCTION 8

II. THE COURT SHOULD INVALIDATE THE REPEAL OF ARSC BECAUSE RESPONDENTS HAVE NOT DEMONSTRATED SUFFICIENT NECESSITY 10

III. THE CALIFORNIA RULE IS A WELL-DEFINED, LONG-STANDING JUDICIAL REQUIREMENT, AND AS SUCH HAS GENERATED SIGNIFICANT RELIANCE INTERESTS 12

- A. The California Rule 13
  - 1. The 'Comparable New Advantage' Test Is Not Redundant 15
    - (a) Amicus PRI's Argument 16
    - (b) Amicus California Business Roundtable's Argument 18
    - (c) Amici's Arguments Prevent Employees from Benefitting from Their Bargain 19
  - 2. Foreseeability 21
- B. ARSC Is a Pension Right that Benefitted Both Individuals and the State 24
- C. The Removal of ARSC Was neither Reasonable nor Necessary 27
- D. The California Rule Was Not an Accident, Contrary to Amici's Briefing 28
- E. Statutory *Stare Decisis* and Legislative Reliance 32
  - 1. Repealing Section 20909 Was Not Necessary, and Other Legislative Fixes that Do Not Violate Stare Decisis Are Available 39
- F. Legislatures May Bind Future Legislatures 41
- G. *Stare Decisis* Respects Individuals' Reliance 42
- H. *Stare Decisis* Respects Unions' and Employee Organizations' Reliance 43

TABLE OF CONTENTS
(Continued)

Page

IV. AMICI APPLY THE WRONG BLACK LETTER CONTRACT LAW 44

V. CALIFORNIA PUBLIC EMPLOYEES ARE NOT A NEFARIOUS, UNDIFFERENTIATED, ANTI-DEMOCRATIC DEEP STATE 47

A. Non-Public Employee Citizens Are Not a Discrete and Insular Minority 47

VI. AMICI PRESENT INCOMPLETE SURVEYS OF SOCIAL SCIENCE DATA AND ANECDOTES 49

A. Additional Relevant Context About Public Pension Recipients 58

VII. OTHER STATES' DECISIONS ARE NOT PERSUASIVE IN THIS CONTEXT AND ARE CERTAINLY NOT CONTROLLING 61

VIII. CONCLUSION 64

TABLE OF AUTHORITIES

Page

CASES

Abbot v. City of Los Angeles
(1958) 50 Cal.2d. 438 19

Allen v. Board of Admin.
(1983) 34 Cal.3d 114 .... 14, 17, 63

Allen v. City of Long Beach
(1955) 45 Cal.2d 128 .... 14, 29, 30, 63

American River Fire Protection Dist. v. Brennan
(1997) 58 Cal.App.4th 20 24

Betts v. Board of Administration
(1978) 21 Cal.3d 859 .... 14, 15, 31, 45

City of Oakland v. Pub. Employees' Ret. Sys.
(2002) 95 Cal.App.4th 29 42

City of Torrance v. Workers' Comp. Appeals Bd.
(1983) 32 Cal.3d 371 34

Cnty. of Orange v. Ass'n of Orange Cnty. Deputy Sheriffs
(2011) 192 Cal.App.4th 21 .... 24, 47

Fourth La Costa Condominium Owners Ass'n v. Seith
(2008) 159 Cal.App.4th 563 16

Int'l Assn. of Firefighters v. City of San Diego
(1983) 34 Cal.3d 292 .... 36, 37, 38

Kern v. City of Long Beach
(1947) 29 Cal.2d 848 .... 30, 31

Legislature v. Eu
(1991) 54 Cal.3d 492 .... 15, 19, 55

Marin Association of Public Employees v. Marin County Employees Retirement Association
(2016) 2 Cal.App.5th 674 29

McGlynn v. State of California
(2018 WL 1391909) p. *5–*6 13

Miller v. State of California
(1977) 18 Cal.3d 808 13

TABLE OF AUTHORITIES
(Continued)

Page

Olson v. Cory
(1980) 27 Cal.3d 532 .... 15, 17, 28

People v. Garcia
(2017) 2 Cal.5th 792 15

Wallace v. City of Fresno
(1954) 42 Cal.2d 180 31

FEDERAL CASES

Baker v. Oklahoma Firefighters Pension & Retirement System
(Okla. 1986) 718 P.2d 348 62

City of Louisville v. Bd. of Educ.
(Ky. 1942) 163 S.W.2d 23 63

Denning v. Kan. Pub. Emp. Ret. Sys.
(Kan. 2008) 180 P.3d 564 63

El Paso v. Simmons
(1965) 379 U.S. 497 20

Hansen v. Pub. Emp. Ret. Sys. Bd. of Admin.
(Utah 1952) 246 P.2d 591 63

In re Vallejo
(9th Cir. 2009) 408 B.R. 280 54

Kimble v. Marvel Entertainment, LLC
(2015) 135 S.Ct. 2401 33

McGrath v. Rhode Island Ret. Bd.
(1st Cir. 1996) 88 F.3d 12 .... 35, 44

New State Ice Co. v. Liebmann
(1932) 285 U.S. 262 62

Peterson v. Sweetwater Cnty. Sch. Dist. No. One
(Wyo. 1996) 929 P.2d 525 64

Tait v. Freeman
(S.D. 1953) 57 N.W.2d 520 63

Taylor v. State & Education Employees Group Insurance Program
(Okla. 1995) 897 P.2d 275 62

TABLE OF AUTHORITIES
(Continued)

Page

Transp. Workers Union of Am., Local 290 v. Se. Penns. Transp. Auth.
(3d Cir. 1998) 145 F.3d 619 45

U.S. Trust Co. of New York v. New Jersey
(1977) 431 U.S. 1 .... passim

United States v. Carolene Products Co.
(1938) 304 U.S. 144 .... 47, 48

STATUTES

California Government Code section 11340 *et seq* 36
section 20575 40
section 20909 .... passim
section 20909(b) 45
section 21020 *et seq.* 25
section 21052 .... 36, 38
section 21076 37
section 21076.5 37
section 31699.4 38
section 7522.52 51

California Education Code section 22002.5 38

OTHER AUTHORITIES

California Constitution Article XVI, § 17(b) 42

San Jose Municipal Code section 3.28.710(B) 36

RULES

California Rules of Court, Rule 8.252 49

TREATISES

Restatement of Contracts (Second) § 45(1) 45

MISCELLANEOUS

Adam Ashton, *Public workers from two more towns expected to lose CalPERS pensions*
Sacramento Bee (Sept. 13, 2017) 53, 54

Dale Kasler and Ryan Sabalow, *Southern California water agency backs 2 Delta tunnels in breakthrough vote*
The Sacramento Bee (April 10, 2018) 57

Page

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The Mercury News (Mar. 9, 2018)..57

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Working Paper No. 17-023, SIEPR (October 2, 2017)..50, 51, 54, 59

John Myers, *Gov. Jerry Brown proposes topping off California's rainy-day fund in his new state budget*
L.A. Times (January 10, 2018)..56

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(2012) 45 Ind. L. Rev. 413 47

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L.A. Times (Aug. 6, 2017) 52, 53

I.

INTRODUCTION

The California Rule is a clear, long-standing judicial rule that is straightforward to apply and sets the baseline for how and when pension rights vest. Principles of *stare decisis* strongly support the Court leaving this Rule in place. Individuals, legislatures, pension managers, and unions have all relied on it when negotiating, budgeting, and making important life-decisions. Although the California Rule sets a baseline, the California Legislature and all relevant parties knew at all times how a legislature could create pension rights that vest later, conditionally, or not at all.

The Legislature created a vested pension right when it granted employees the right to purchase Additional Retirement Service Credit ("ARSC") by passing Government Code section 20909. Therefore, its subsequent repeal of the right to purchase ARSC in 2012 violated the Contract Clause. Public employees who were eligible to purchase ARSC after five years of service had agreed on the first day of their service that every day thereafter (as long as they were still employed), part of their compensation would be the value of the State holding open the option to make a one-time election to purchase ARSC before retirement at a time of their choosing.

To the extent changes to vested pension rights can be justified under certain circumstances, those circumstances do not exist here. First,

concerning ARSC specifically, the State cannot bear its burden of proving that the impairment is necessary. The benefit at issue was established to be cost-neutral to the State, and there is no evidence that the ARSC benefit had any significant impact on the financial stability of the State. Second, and more generally, there are many ways that local governments and the State can ensure that they have the funds to discharge their current pension obligations without impinging on the vested rights of employees and pensioners, and they must do so.

Forty-seven amici have filed fourteen briefs providing supplemental information and arguments in this case. Six of these briefs support Respondents.[1] Respondents' amici attempt to over-complicate the California Rule, exaggerate how dire the financial circumstances are, and hope this Court doesn't realize that they are asking for a second bite at the apple after failing to persuade the political branches through the normal course of policy debates.

Amici provide no arguments in support of Respondents that survive serious scrutiny, and therefore this Court should reverse the lower courts and remand with instructions that reaffirm the California Rule and invalidate the repeal of California Government Code section 20909 for employees hired before January 1, 2013.

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[1] Amici's Briefs are referred to in this Answer by the first named amicus appearing on the brief.

II.

THE COURT SHOULD INVALIDATE THE REPEAL OF ARSC BECAUSE RESPONDENTS HAVE NOT DEMONSTRATED SUFFICIENT NECESSITY

Among other requirements, in order to survive scrutiny under the Contract Clause, Respondents must demonstrate that the impairment of a vested contractual right is necessary. (*See U.S. Trust Co. of New York v. New Jersey* (1977) 431 U.S. 1, 25.) Although amici seek to embroil this Court in a much broader and more dramatic reversal of the California Rule (*see infra* section III), this Court need not even reach that question.

The facts of this case cannot support a finding of necessity. There are a limited number of parties involved in this dispute: the union (and named members of the union), CalPERS, and the State. ARSC is the only benefit at issue here, and it was designed to be cost neutral to the State. To the extent it was priced erroneously in the past, the Legislature already reserved to CalPERS the authority to correct that error without violating the California Rule. (*See* Joint Appx., at pp. 312–321.) ARSC, even if it was temporarily priced erroneously, had such a marginal impact on the State's financial situation that the State cannot bear its burden of proving necessity. CalPERS may not be fully funded, but it recently released a report showing that it increased from 68.3% funded in 2015–2016 to 71.0% funded as of December 31, 2017 because of a series of good management and fund allocation decisions. (CalPERS, *A Solid Foundation for the Future*,

[December 31, 2017] at p. 3, available at https://www.calpers.ca.gov/docs/forms-publications/solid-foundation-for-the-future.pdf.)

Therefore, there was no necessity. The repeal is unconstitutional. Petitioners win.

The only burden on the State that Respondents or their amici have pointed to is the difference between the erroneous price and the proper price, (Amicus Pacific Research Institute ["PRI"], at p. 23; Amicus California Business Roundtable, at pp. 28–30; Amicus City of Pacific Grove, at pp. 15–16; Amicus Association of California School Administrators, at p. 14), and they have failed to introduce evidence as to how many people purchased ARSC at an erroneous price, how many were likely to purchase it at an erroneous price in the future, and how these facts specifically would cause critical damage to the financial health of the State.

As discussed in more depth below, public employers in California are continuing to spend money on their political priorities while pleading poverty when pensioners return to collect their due. The relative merits of particular policy preferences (such as high-speed rail, water tunnels, or keeping billions of dollars in the State's rainy-day fund) are not before this Court. However, as *U.S. Trust Co. of New York v. New Jersey*, *supra*, 431 U.S. at p. 24, ["*U.S. Trust*"] explains, this Court has the institutional and structural responsibility of making sure that the word of our Legislature can

be trusted going forward. The ability of government employers to spend money chasing their current policy goals is not absolute, and these employers cannot displace their responsibility to pay for the very contractual obligations they have accrued that enabled them to achieve their *past* policy goals.

Although a number of amici supporting Respondents turn straight to challenging the California Rule, the fact that a pension change must be "necessary" is a dispositive test that Respondents fail. The bulk of this Brief responds to amici's attacks on the other aspects of the California Rule, but this fact should not be lost amidst all the confusion amici sow.

III.

THE CALIFORNIA RULE IS A WELL-DEFINED, LONG-STANDING JUDICIAL REQUIREMENT, AND AS SUCH HAS GENERATED SIGNIFICANT RELIANCE INTERESTS

Amici have offered many different novel formulations of what constitutes the California Rule – hanging ornaments off of it, mashing together steps, and adding hurdles and qualifiers pulled from any number of adjacent areas of law. (*See, e.g.*, Amicus League of California Cities, at pp. 16–17 [laying out a free-floating test consisting of merely "factors to be considered"], Amicus California Business Roundtable, at pp. 33, 36, 15, 21, 43, 49, 71 [claiming that Rule makes it "virtually impossible" to change benefits, which the employer "can never reduce" because impairments "automatically" violate the Contract Clauses], Amicus PRI, at p. 40

[requiring statutory text to "clearly and unequivocally express[]" intent to make offer irrevocable], Amicus Association of California School Administrators, at p. 14 [permitting changes to pension laws if they are "not operating as originally designed"], Amicus Howard Jarvis Taxpayers Association, at p. 23 [claiming that Petitioners' description of the California Rule is a "modern-day version of *Lochnerism*"].)

The California Rule is a judicially-created doctrine that is based on black letter contract law principles. There will always remain questions concerning its application around the edges,[2] but amici have taken aim at the core of the California Rule, which is and has been well defined for decades.

A. The California Rule

As described in our prior briefing, California courts considering challenges to vested pension rights use a straightforward, three part analysis. (Petitioners' Opening Br., at pp. 21–22.) Due to the unique reliance interests inherently present in the pension context, the California

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[2] Just last month, a California Court of Appeal addressed the question of whether a first day of employment for an elected judge under the Public Employees' Pension Reform Act of 2013 was measured from the date of election or the date of ascension. (*McGlynn v. State of California* (March 20, 2018, A146855) __ Cal.App.5th__ [2018 WL 1391909], at pp. *5–*6.) It is noteworthy that the *McGlynn* Court, while considering this question, treated the claim that "the right to pension benefits vests upon the acceptance of employment" as settled law – which it is. (*Id.* at *6 [citing *Miller v. State of California* (1977) 18 Cal.3d 808, 815].)

Supreme Court has adopted special rules for these pension cases, defining which contractual impairments are unreasonable or unnecessary. Although not every court dwells on each step in every case, the three hurdles that have characterized the courts' application of the California Rule for over fifty years are:

> With respect to active employees . . . any 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 a disadvantage to employees, must be accompanied by comparable new advantages.

(*Allen v. Board of Admin.* (1983) 34 Cal.3d 114, 120.)

A failure on any of these three hurdles will invalidate a proposed pension modification. Therefore, it is not surprising that courts regularly spend the majority of their decisions analyzing whichever hurdle is the easiest to apply in that case. (*See, e.g.*, *Allen v. City of Long Beach* (1955) 45 Cal.2d 128, 131–133 [spending almost the entirety of the Court's analysis on the dispositive "material relation" test].)

It is further predictable that the hurdle Courts often choose in this respect is the clearest and easiest to apply: the 'Comparable New Advantage' Test.

In *Betts v. Board of Administration* (1978) 21 Cal.3d 859, for example, this Court considered a proposed change to a pension formula for a former California Treasurer. It found that the State had changed the

Treasurer's pension formula to his detriment, and had failed to provide a comparable new advantage. (*Id.* at pp. 868–869.) It then announced that "[t]he result we reach herein makes it unnecessary to consider petitioner's additional contentions." (*Id.* at p. 869.) Similarly, in *Olson v. Cory* (1980) 27 Cal.3d 532, 540–542, the Court invalidated the law at issue based on the dispositive 'Comparable New Advantage' Test, and spent no time analyzing whether the change was "reasonable." More recently, in *Legislature v. Eu* (1991) 54 Cal.3d 492, 529–531, the Court did not perform any analysis of the "material relation" hurdle, instead invalidating the relevant law purely based on an analysis of the 'Comparable New Advantage' Test.

1. The 'Comparable New Advantage' Test Is Not Redundant

Amici attack the 'Comparable New Advantage' prong of the California Rule, claiming that it cannot be compulsory because it is necessarily irrelevant by the time a court reaches it. Their arguments fail to account for the fact (discussed *supra* section III.A) that this Court's past pension cases have considered the dispositive and most relevant questions first. (*See People v. Garcia* (2017) 2 Cal.5th 792, 804 [finding that constitutional avoidance canon rests in part on "a preference for avoiding the unnecessary resolution of constitutional questions"].)

(a) Amicus PRI's Argument

Amicus Pacific Research Institute ("PRI") claims that the California Rule's 'Comparable New Advantage' Test cannot logically be mandatory because it only applies after the court has already found that there was a "substantial impairment" that was "reasonable and necessary." (*See* Amicus PRI, at pp. 16, 53–54.)

The modifier "substantial" in amicus's proposed "substantial impairment" formulation comes from the United States Supreme Court's more general Contract Clause analysis. (*Id.* at pp. 27–28 [over-reading *Fourth La Costa Condominium Owners Ass'n v. Seith* (2008) 159 Cal.App.4th 563, 584, to say that *all* federal contract clause jurisprudence exactly mirrors state contract clause jurisprudence].) Amicus PRI cites no *pension* case applying the California Rule that have required a "substantial" impairment before beginning the California Rule analysis. (Amicus PRI, at pp. 25–28.) Amicus PRI bases this equivalency on its argument that the California Contract Clause analysis is identical to the federal Contract Clause analysis (*id.* at pp. 28–35), and ignores the fact that the California Rule is a special application of this more general test to the pension context, in which this Court has repeatedly set down specific rules.

But even presuming that a "substantial" impairment is necessary in order for the Contract Clause to apply, Amicus PRI misunderstands what a showing of "substantial impairment" requires. It is the first half of what is,

functionally, a burden shifting test. This Court looks first to see if there was such an impairment for an individual employee or pensioner in order to decide whether or not to begin the more complex Contract Clause analysis at all. This first step focuses on whether the Petitioner identified a qualifying impairment. Only *after* such an impairment has been found does the inquiry shift to whether the government's impairment was legal because, *inter alia*, the Legislature provided a comparable new advantage that reduced or eliminated the impact of this impairment.

The "reasonable and necessary" language Amicus PRI refers to (p. 16) also comes from the federal Contract Clause analysis in *U.S. Trust*. Again, Amicus' argument fails because it ignores the fact that the California Rule is an application of this more general test to the pension context, in which this Court has set down specific rules defining changes that are *per se* deemed unreasonable or unnecessary. Therefore, even if a proposed change passes the three hurdles of the California Rule, it can still fail the more general Contract Clause analysis if, in the totality of the circumstances, the Legislature nevertheless failed to persuade this Court that the proposed change was "necessary" (*see supra* Section II). The Court need not reach this question if the proposed action fails on one of the prongs of the California Rule. (*See, e.g., Allen v. Bd. of Admin.* (1983) 34 Cal.3d 114; *Olson v. Cory* (1980) 26 Cal.3d 672.)

(b) Amicus California Business Roundtable's Argument

In a related argument, Amicus California Business Roundtable claims that the 'Comparable New Advantage' Test cannot logically apply because a court must have already determined that the impairment is necessary, and the 'Comparable New Advantage' Test prevents the government entity from reducing its financial obligation to its employees and pensioners. (Amicus California Business Roundtable, at p. 33 ["[The] California Rule makes it virtually impossible . . . to control pension benefits for current employees."].) The 'Comparable New Advantage' Test is a part of a separate *per se* unreasonableness analysis. The fact that a court decides that the employer is in sufficiently dire straits to deem *some* sort of an impairment 'necessary,' does not mean that *the State's proposed* impairment has passed the hurdles to be deemed 'reasonable.' Furthermore, as Amicus concedes, "the necessity defense has been rejected by every California case where it was presented as a justification for the impairment of vested contractual rights." (*Id.* at p. 44, citing Petitioners' Reply Br., at p. 35.)

More fundamentally, Amicus California Business Roundtable errs by treating the 'Comparable New Advantage' Rule as if it was measured in terms of costs to employers when in fact it is measured in terms of benefits to employees. Although often costs and benefits vary in the same direction,

these are not one-to-one relationships. One of the fundamental assumptions underlying our exchange-based society is that the benefit to one party in a transaction need not equal the cost borne by the providing party.

In this instance, the proper measure of whether a new advantage is "comparable" is the benefit to any particular individual beneficiary. (*Abbott v. City of Los Angeles* (1958) 50 Cal.2d. 438, 449, 453; *Eu, supra,* 54 Cal.3d at pp. 528–532.) Cities and individuals have different risk preferences and different opportunities to diversify and aggregate costs. Under the Rule, the 'comparable new benefit' that the government employer provides may still be less financially burdensome to the government than the current system. For example, government employers could: (a) have a comparative advantage in providing that benefit; (b) want to offer delayed payment of a larger sum in order to avoid short-term budget shortfalls; or (c) take advantage of economies of scale or scope to provide services or benefits at less of a cost than pensioners/employees could find on the open market.

(c) Amici's Arguments Prevent Employees from Benefitting from Their Bargain

Lastly, amici attempt to redefine *sub rosa* the concept of 'comparable new advantages' so as to prevent pension recipients from receiving the benefit of any bargain they strike. (*See, e.g.*, Amicus Association of California School Administrators, at p. 13.) Pension

planning and negotiation necessarily involves employers and employees exchanging and bargaining over an optimal allocation of risk and value. (Amicus Orange County Attorneys' Association, at pp. 14–15.) In the ARSC context, pensioners chose to take on the risk that – for example – they will die early and lose the value of their ARSC purchase. Therefore they should not be prevented from receiving the benefit of the bargain if they live a longer-than-expected life.

The State may benefit from the bargains it makes. (Accord. *El Paso v. Simmons* (1965) 379 U.S. 497, 515 ["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."].) Petitioners are not arguing that the State may not enforce a pension term that, based on some contemplated contingency, has turned out to save the State money. All Petitioners are asking is that the same should go for public employees who make a deal, the value of which also turns based on some foreseeable future contingency which may resolve in their favor.

Therefore, to the extent pensioners have foreseeably benefitted from the tradeoffs and risks that the political process allocated between employees and employers (when the Legislature drafted the terms in the pension statutes, and through negotiations), these benefits are vested pension rights protected by the Contract Clause.

2. **Foreseeability**

One of the seminal cases in Contract Clause jurisprudence that addresses this foreseeability concept is *U.S. Trust*, in which the Supreme Court rejected New Jersey's attempt to disavow its similarly foreseeable contractual obligations. In *U.S. Trust*, New Jersey passed a law that would have retroactively repealed a covenant limiting the way that the New York and New Jersey Port Authority could use certain funds. (431 U.S. at p. 14.) A bondholder objected, and the Court decided in the bondholder's favor. (*Id.* at p. 32.)

In reaching that conclusion, the Court rejected New Jersey's argument that events had overtaken the original covenant. (*Id.* at pp. 28–32.) It held that the past New Jersey legislature need not have predicted with 100% clarity how much its commitments would cost in order for the current legislature to be held to them. (*Id.* at p. 31.) The legislature was bound by the contractual terms because it adopted the covenant at issue "with full knowledge" that the Port Authority's substantial operating deficits were likely. (*Id.* at pp. 31–32.) It even held that the 1970s' newly-found public interest in "environmental protection and energy conservation" was foreseeable because these issues "were not unknown," in the early 1960s when the original agreement was struck. (*Id.* at p. 32.) The legislature was not entitled to avoid the cost of its decisions merely because these eventualities came to pass. (*Ibid.*)

In this case, Amicus California Business Roundtable claims that the legislature here was "blindsided by unexpected obligations," and yet point to nothing that was unforeseen. (p. 35.)

Yes, people are living longer. (Amicus League of California Cities, at p. 25.) And the economy has had good years and bad years. (*Ibid.*) And sure, health care costs were rising, but have slowed or stabilized. People have moved into and out of California. Tax policies have changed and changed again.

Actuaries and policy-makers have known about and sought to accommodate these "known unknowns" for decades—every government decision is to some extent based on a probability distribution. And some of these changes are the direct result of policies the Legislature itself has recently adopted. Absent a persuasive showing that one or many of these risks were categorically unforeseen, it would be improper for this Court to aggrandize to itself the power of identifying broad, foreseeable social trends that it believes warrant rescission of a pension contract upon which individual employees and pensioners have come to rely. As Amicus League of California Cities admits, there are any number of changes for which policymakers in 2018 are preparing. (p. 25.) The California Legislature can and should attempt to prepare for these changes. If the Legislature wants to (and thinks it prudent and worth the uncertainty it would create), it is free to make any new vested pension rights conditional

on future economic or social trends without violating any constitutional principles.

Amici make a lot of hay out of the fact that CalPERS's actuarial estimates mispriced ARSC. They claim that the California Rule forced the State to shoulder this 'unforeseen' burden that it cannot rescind. (*See, e.g.*, Amicus City of Pacific Grove, at p. 8; Amicus League of California Cities, at pp. 43, 44 [citing to cases and briefs describing a "bonanza far outstripping the[] expectations" of pensioners and "large unexpected windfalls"].) That is factually not the case here. CalPERS maintained the power to change the price of ARSC as it learned that actuarial predictions were proving erroneous.

The importance of this fact to this appeal cannot be overstated.

Government Code section 21052 gave to CalPERS the ability to set the cost of ARSC. ("The method for calculating the amount of the contribution shall be determined by the chief actuary and approved by the board.") CalPERS could, and did (*see* Joint Appx., at pp. 312–321), increase the cost of ARSC over time as their experience with the program showed them that their initial actuarial estimates were erroneous. This did not, and would not have violated the California Rule, because the Legislature had passed statutory language giving CalPERS the authority and obligation to accurately calculate this cost.

As a final point, this Court should note that amici cite no law supporting a claim that a mistake by a government employee entitles the government to break its contractual obligations protected by the California Rule. Their efforts in this regard appear to be attempts to shoehorn their policy arguments into a 'necessity' argument, but this underlying assumption does not have support in either the law or the facts of this case.

B. ARSC Is a Pension Right that Benefitted Both Individuals and the State

Amici discuss ARSC as if it was a give-away to employees, (Amicus City of Pacific Grove, at p. 11; Amicus Howard Jarvis Taxpayers Association, at pp. 25–26), but that is not the case.

The State benefits from offering ARSC to the extent that long-tenured public employees will opt to take earlier retirement (at no additional cost to the State), which will vacate positions and permit the State to hire less expensive, younger employees. Amicus City of Pacific Grove complains, without providing any evidence, that the early retirements that ARSC created were bugs in the system. (p. 8.) Instead, when properly managed, these early retirements were features – a no cost means of reducing the State's salary obligations. (*Cnty. of Orange v. Ass'n of Orange Cnty. Deputy Sheriffs* (2011) 192 Cal.App.4th 21, 45, 47, citing *American River Fire Protection Dist. v. Brennan* (1997) 58 Cal.App.4th 20, 67 [discussing value to employers of providing incentive to retire].)

Additionally, amici who treat ARSC as a boondoggle (*see, e.g.*, Amicus Howard Jarvis Taxpayers Association, pp. 25–26) fail to acknowledge that both the State and employees benefit substantively from ARSC as a public program. One of the legislative purposes behind ARSC was to permit employees to take time out of state service to raise children or gain education without sacrificing their ability to earn a pension. (Joint Appx., at pp. 256, 260, 266, 271–272.) This did benefit employees who wanted to take advantage of ARSC. But it also benefitted the State by attracting and retaining the kinds of employees who sought to undertake parenting responsibilities and further education.

There is no difference in this respect between ARSC and the pension benefits that remain in place, which permit, for example, members of the military to get credit for time served in public service elsewhere. (*See* Cal. Gov. Code § 21020 *et seq.*) The State has defined particular attributes in potential employees that it wants to attract, and Amicus Association of California School Administrators' attempts to draw such a distinction fails. (p. 9.)

Amici argue that one of the reasons ARSC was not a pension right was because it was not related to the length of time a person was employed. They claim that the five-years of service requirement was intended merely to be "consistent" with the Internal Revenue Code. (*See, e.g.*, Amicus