No. S239958

**IN THE SUPREME COURT OF THE STATE OF CALIFORNIA**

---

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

*Petitioners and Appellants,*

v.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CalPERS)

*Defendant and Respondent,*

and

THE STATE OF CALIFORNIA,

*Intervener and Respondent.*

SUPREME COURT
FILED
JAN 22 2018
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On Review From The Court Of Appeal For the First Appellate District, Division Three, Civil No. A142793

After An Appeal From the Superior Court For The State of California, County of Alameda, Case Number RG12661622, Hon. Evelio Grillo, Presiding Judge

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# REPLY BRIEF ON THE MERITS

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# I.
# INTRODUCTION

Respondent State of California tries to justify the elimination of a vested pension benefit, swimming against a 65-year tide of cases which protect vested pension rights from impairment unless employees receive offsetting comparable advantages. Respondent cannot prevail under that longstanding rule, so instead it argues unconvincingly that a statute in a pension law which provides employees with up to one-sixth of the value of their retirement allowance is not a pension benefit at all.

Respondent also claims, on one hand, that the statute at issue, Government Code section 20909 ("section 20909"), should not be read to create contract rights, but, on the other, concedes it does just that. Respondent also argues—in the face of contrary contract law principles and pension cases—that optional pension benefits may be withdrawn unilaterally even where the offer has induced service by employees.

Respondent ultimately, and without acknowledging it, seeks reinterpretation by this Court of its comparable advantages rule. Yet if fails to justify why this Court should revise a body of law that has induced extensive reliance by employers, employees and retirement systems.

Finally, Respondent asks this Court to apply the necessity doctrine for the first time to justify the impairment of a vested pension benefit. But none of the conditions this Court has enunciated for application of that

doctrine—an "emergency" and a "temporary" impairment of vested rights—exist here.

## II.
## SECTION 20909 CREATED A VESTED CONTRACT RIGHT FOR EMPLOYEES WHO PERFORMED SERVICES FOR THE STATE PRIOR TO ITS REPEAL

Respondent claims section 20909 did not create contract rights for current employees to purchase Additional Retirement Service Credit ("ARSC"). Respondent spends much time arguing that statutory schemes generally should not be read to create contract rights. But that principle does not apply because Respondent concedes that section 20909 creates contract rights.

### A. As Respondent Concedes, The Language Of Section 20909 Clearly And Unequivocally Sets Forth An Intent To Contract

Notwithstanding Respondent's assertion (Ans. Br. at pp. 11, 22, 24, 25, 29, and 30)[1], Petitioners do not claim that section 20909 created *implied* contract rights. As the court of appeal recognized, Petitioners contend the statute created *express* contract rights. (*Cal Fire Local 2881 v. California Public Employees' Retirement System* (2016) 7 Cal.App.5th 115, 126

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[1] Respondent claims Petitioners "all but concede[] that neither the statute itself nor the legislative history provides evidence of an express legislative intent to contract" (Ans. Br. at p. 25) without identifying where this phantom concession occurred.

["plaintiffs theorize that the prior version of section 20909 created … an 'express vested right'"].)

### 1. Section 20909 Expressly Lays Out Contract Terms

"The terms of an express contract are stated in words" whereas "[t]he existence and terms of an implied contract are manifested by conduct." (*Retired Employees Ass'n of Orange County, Inc. v. County of Orange* (2011) 52 Cal.4th 1171, 1178, citing Civ. Code §§ 1620, 1621.) The main difference between express and implied contracts "is the evidentiary method by which proof of their existence and terms is established." (*Youngman v. Nevada Irr. Dist.* (1969) 70 Cal.2d 240, 246.)

Petitioners highlighted a broad array of statutes and ordinances which California courts found created vested pension rights. (Appellants' Opening Brief ("AOB") at pp. 31–36.) Likewise, the "statutory language" of sections 20909(a) and (b) "clearly evince a legislative intent to create private rights of a contractual nature" (*Retired Employees*, 52 Cal.4th at p. 1187)[2]:

---

[2] Respondent reads *Retired Employees* as a break from this Court's vested rights precedent. But the test articulated in *Retired Employees*—that "legislation in California may be said to create contractual rights when the statutory language or circumstances accompanying its passage 'clearly …evince a legislative intent to create private rights of a contractual nature enforceable against the [government body]'"—is consistent with, and drew heavily from, prior vested rights cases. (52 Cal.4th at p. 1187, (internal quotes omitted) citing, *inter alia, Valdes v. Cory* (1983) 139 Cal.App.3d 773, 786; *Bd. of Admin. v. Wilson* (1997) 52 Cal.App.4th 1109, 1135; and *California Teachers Assn. v. Cory* (1984) 155 Cal.App.3d 494, 506.)

> (a) *A member who has at least five years of credited state service, may elect*, by written notice filed with the board, *to make contributions* pursuant to this section *and receive* not less than one year, nor more than five years, in one-year increments, of *additional retirement service credit* in the retirement system.
>
> (b) *A member may elect to receive this additional retirement service credit at any time prior to retirement by making the contributions as specified in Sections 21050 and 21052.* A member may not elect additional retirement service credit under this section more than once.

(§ 20909(a), (b) [emphasis added].)

The offer presented in the statute allows employees to purchase up to five years of service credit "at any time prior to retirement." (§§ 20909(a) and (b); *Valdes v. Cory*, 139 Cal.App.3d at p. 787 ["explicit language in the retirement law constitutes a contractual obligation on the part of the state as employer"].) Acceptance and consideration is provided through "at least five years of credited state service," (§ 20909(a)), and "contributions as specified in Sections 21050 and 21052," (§ 20909(b)). Section 20909 sets forth a "palpable element of exchange" which results in a contractual 'promise,' an intent to confer private rights." (*California Teachers Assn.*, 155 Cal.App.3d 494, 506, citing Rest. (2nd) Contracts, § 2.) Nothing need be "implied" from section to find offer, acceptance, and bargained for consideration. (*Lundgren v. Deukmejian* (1988) 45 Cal.3d 727, 735 [no

need for resort to legislative intent if statutory language clear and unambiguous].)

Further, the Legislature is clear when it does not intend to create vested rights in pension statutes. (§ 31581.2(b) ["enactment of a resolution pursuant to this section shall not create vested rights in any member"].) Section 20909 did not contain any such limitation.

#### 2. Respondent Admits that the Statute Created at Least One Contract, But Misreads its Express Terms

Respondent admits that a "plain reading of the [section 20909] makes clear that the unambiguous exchange of consideration contemplated by the Legislature was *airtime in exchange for payment*." (Ans. Br. at p 25 [emphasis in original].) This concedes that section 20909 creates *some* contract rights. But it overlooks the fact that employees first needed "five years of credited state service" to purchase ARSC. (§ 20909(a).) The consideration which formed the contract was payment *plus* service in exchange for service credit.

### B. The Contract Clause Protects Pension And Other Employee Benefits Beyond Just Deferred Compensation

Respondent argues that the Contract Clause protects *only* "deferred compensation." (Ans. Br. at pp. 29–30.) This reads phrases about "pensions" being "deferred compensation" too broadly, in isolation from larger principles espoused in the case law. All pension benefits are

ultimately some form of "deferred compensation," but arguments about whether section 20909 provides a "pension benefit" or a "pension right" are academic because both enjoy Contract Clause protections.

California courts have repeatedly rejected derivatives of Respondent's argument and applied Contract Clause protections to not only the basic pension benefit but, *inter alia*, to disability benefits, sabbaticals, longevity pay, and supplemental pension benefits like retiree healthcare benefits. (AOB at pp. 25–26.) What controls is whether the benefit is "part of the contemplated compensation for those services and so in a sense a part of the contract of employment itself." (*Int'l Ass'n of Firefighters v. City of San Diego* (1983) 34 Cal.3d 292, 302 [public pension plan part of employment "contract"].) The right to purchase ARSC after the provision of sufficient state service was part of Petitioners' employment contract.

In circumstances similar to here, in *Santin v. Cranston* (1967) 250 Cal.App.2d 438, 442, the court of appeals concluded that two California National Guard officers had a vested right under *Allen v. City of Long Beach* (1955) 45 Cal.2d 128 to receive additional retirement service credit for past inactive United States Military service. The Legislature amended the applicable Military and Veterans Code provisions to exclude inactive service before the plaintiffs retired. The court held that the plaintiffs were entitled to the pre-amendment benefit, specifically rejecting the argument that the benefit was not vested: "The 'California rule' is based upon the

theory of the existence of a contract. Some contracts contain terms more advantageous than others. Some contracts of employment contain both better compensation and so-called 'fringe' benefits than others. They are contracts nonetheless." (*Santin,* 250 Cal.App.2d at pp. 443-444.)

*Bd. of Admin. v. Wilson* (1997) 52 Cal.App.4th 1109 rejected a governor's claim that only pension "benefits" were protected by the Contract Clause. "Although certain cases happened to involve modification of benefits, the controlling principle applies to modification of any 'vested contractual pension right.' … *Valdes* itself did not involve a modification of benefits but rather a modification in the payment of employer contributions to the fund." (52 Cal.App.4th at p. 1145, quoting and discussing *Valdes,* 139 Cal. App. 3d at 784.) *Wilson*, like *Valdes*, involved not the pension benefit itself but ancillary rights to an actuarially sound retirement system. (*Wilson*, 52 Cal.App.4th at pp. 1153–1154.)

Two other types of pension cases further undermine Respondent's argument. Cost of living adjustments are another ancillary pension right which courts have nonetheless afforded identical Contract Clause protection. (*Olson v. Cory* (1980) 27 Cal.3d 532, 534–535; *Pasadena Police Officers Ass'n v. City of Pasadena* (1983) 147 Cal.App.3d 695, 706–707.) Consider *Protect Our Benefits v. City and County of San Francisco* (2015) 235 Cal.App.4th 619, 622, which ruled that employees enjoyed

vested contractual rights to a cost of living enhancement tied not to service but to investment returns.

Similarly, disability retirement rights exist apart from service retirement rights. In *Frank v. Board of Administration* (1976) 56 Cal.App.3d 236, the plaintiff was statutorily-entitled to law enforcement industrial disability rights when he began work. Subsequently, however, the Legislature removed his classification from the list of those entitled to law enforcement industrial disability rights. Subsequently, when the plaintiff suffered a job-related injury and qualified for disability retirement he received lesser benefits than initially promised. Applying *Allen v. City of Long Beach*, the court of appeal held that plaintiff's vested pension rights were violated by his exclusion from the law enforcement benefit. (56 Cal.App.3d at pp. 245–246.) Like section 20909, disability retirement benefits are an *optional* benefit with a precondition (*i.e.*, job-related disability). It did not matter in *Frank* that *at the time the statute was amended* the employee had yet to qualify for, or exercise his right to apply for, disability retirement. Nor should it matter here that current employees had not yet qualified to purchase, or elected to exercise their right to purchase, ARSC when section 20909 was amended.

Section 20909 is closer to a core pension benefit than actuarial soundness, cost of living adjustments or disability retirement because purchasing service credit directly affects employees' *initial* retirement

allowances. Those disadvantaged by the amendment now have to work five years longer or retire with a lesser benefit.

## C. Even Optional Pension Benefits Cannot Be Revoked After Employees Begin Employment

### 1. Employees Reasonably Expected to be Able to Purchase ARSC "At Any Time Prior to Retirement"

Respondent's arguments completely ignore employees' reasonable expectations. (AOB at p. 33; *Bellus v. City of Eureka* (1968) 69 Cal.2d 336, 341, 350 [protecting employees' reasonable expectation that city would fund retirement system].) In *Betts v. Board of Administration* (1978) 21 Cal.3d 859, this Court concluded that, having performed services for four years under a particular statute, the original version, not an amended version, "form[ed] the basis by which petitioner's reasonable pension expectations must be measured." (*Id.* at pp. 867–868; *Frank,* 56 Cal.App.3d at p. 245 [employees' "reasonable expectations" to disability retirement rights "thwarted" by amendment].)

Section 20909 was in effect for ten years. Employees reasonably expected to be able to purchase ARSC up to their retirement *because the statute said so.* (§ 20909(b); *California Teachers Assn.,* 155 Cal.App.3d at p. 507, citing Rest. (2nd) Contracts, § 50 ["a bargain may be sealed by performance with knowledge of the offer."].)

The record is replete with employees who intended to exercise their contractual rights under the statute but, for varying reasons, did not. (JA at pp. 157–166.) In a fact reminiscent of *Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 850 [pension benefit eliminated when employee was 32 days shy of service requirement to vest], one petitioner who intended to purchase ARSC was only 16 days short of service eligibility when the benefit was eliminated. (JA at pp. 158, 164.)

### 2. The Right to Purchase ARSC "At Any Time Prior to Retirement" Could Not Be Eliminated For Those Employed Before the Public Employees' Pension Reform Act of 2013 ("PEPRA")

Respondent argues that the right to purchase ARSC could be revoked for anyone who had not already purchased it by January 1, 2013. (Ans. Br. at p. 25.) However, an employee's right to promised pension benefits vests with the commencement of service. (*Betts*, 21 Cal.3d at p. 863.) The right to purchase ARSC in the future, or to accrue additional service credit to become eligible to purchase, therefore vested in the sense that it could not be destroyed by statutory amendment. (*Kern*, 29 Cal.2d at pp. 855–856; *Legislature v. Eu* (1991) 54 Cal.3d 492, 531–532.)

Respondent ignores these deep-rooted principles by characterizing the five-year service requirement in section 20909 as an "eligibility" requirement. (Ans. Br. at pp. 27–28.) But sufficient service is both

consideration and an eligibility requirement. All pension systems have durational eligibility requirements[3]—yet the employer cannot revoke a promised benefit before the employer reaches eligibility. (*Kern,* 29 Cal.2d at p. 856.)

### 3. Optional Benefits are Protected by the Contract Clause

Respondent characterizes section 20909 as an "option" freely revocable before employees exercised it. (Ans. Br. at pp. 25–26.) But options, like defined benefits, attract and retain employees because employees value them. Respondent cites no case providing lesser protection to optional benefits. (*Frank,* 56 Cal.App.3d at pp. 242–244 [optional disability benefits protected by Contract Clause].) Moreover, the offer in the statute contained an explicit timeframe—"at any time prior to retirement" (§ 20909(b))—which precluded the offer being withdrawn prematurely.

Even if the statute provided no time limit, it would be treated as an offer of a unilateral contract term for which performance is tendered by beginning and continuing employment. (Rest. (2nd) of Contracts § 45; *see also State v. Agostini* (1956) 139 Cal.App.2d 909, 914 ["[I]f an offer for a unilateral contract is made, and *part of* the consideration requested in the

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[3] *See, e.g.*, Gov. Code § 21060 (a) [PERL five-year vesting rule]; Gov. Code § 31672 [County Employee Retirement Law ("CERL") ten-year vesting rule].

offer is given or tendered by the offeree in response thereto, the offeror is bound by a contract, the duty of immediate performance of which is conditional on the full consideration being offered or tendered."])

In *Newberger v. Rifkind* (1972) 28 Cal.App.3d 1070, 1076–1077, the court held that employees could enforce an options contract, and purchase stock in the company at the promised price and quantity by tendering the money *at the appropriate time.* Despite employees exchanging neither money nor property for the option, the court found that by beginning and continuing performance and remaining employed, they provided ongoing consideration for the option and accepted the terms of the offered option. (*Id.* at p. 1076.) The same contract rules apply here. (*Retired Employees*, 52 Cal.4th at p. 1179 ["All contracts, whether public or private, are to be interpreted by the same rules …"].)

### D. None Of The Cases Respondent Cites Involve Modification Of Vested Pension Benefits

Respondent argues that amendment of section 20909 had only an "indirect effect[] on pension entitlement." (Ans. Br. at p. 32.) But, as discussed below, the cases Respondent cites do not support that proposition.

*Creighton v. Regents of the University of California* (1997) 58 Cal.App.4th 237, involved a one-time, elective, early retirement incentive which was specifically designated "not vested." (*Id.* at p. 244.) The court

of appeal " h[e]ld only that a one-time limited offer of special incentives for early retirement, accompanied by such an express disclaimer" was not a vested right. (*Id.* at p. 245.)

The facts in *Miller v. State of California* (1977) 18 Cal.3d 808 are fundamentally different from this case because they addressed a civil service statute imposing a mandatory retirement age, not the modification of a pension benefit. Consequently, this Court did not determine whether the modification was permissible under *Allen* and its progeny. (*Id.* at p. 817.)

*Piombo v. Board of Retirement* (1989) 214 Cal.App.3d 329 involved a plaintiff who elected to withdraw his pension contributions from a county retirement plan upon separation. *After* his separation, a 1965 law permitted employees to redeposit pension contributions into the plan if they started employment with a public agency in a reciprocal plan. But in 1971, *before* the plaintiff rejoined a public agency with a reciprocal plan, the Legislature amended the 1965 law to preclude employees in the plaintiff's situation from redepositing contributions. The court of appeal rejected plaintiff's claim to a vested right in the 1965 law because his employment contract with the county ended before it was enacted. (*Id.* at pp. 338–339.) This case is inapposite because section 20909 existed during Petitioners' employment.

*Vielehr v. State of California* (1980) 104 Cal.App.3d 392 is a state employee discipline case. Like, *Miller* it recognized that indirect effects on pension entitlements, such as salary, do not convert non-vested benefits into constitutionally-protected ones. Likewise, *San Diego Police Officers' Ass'n v. San Diego City Employees' Retirement System* (9th Cir. 2009) 568 F.3d 725, 738–739, involved a negotiated salary provision where the employer agreed to temporarily pay employees' retirement contributions. It did not involve a statutory retirement benefit.

Respondent also argues that since section 20909 was based on the federal tax code the Legislature could not have promised a future right to purchase since the tax code *might* change. But that is like arguing that employees could not be promised a right to future service because their jobs *might* be eliminated. (*Eu,* 54 Cal.3d at p. 52 ["right to earn future pension benefits through continued service, on terms substantially equivalent to those" existing at the time they began working, or added during service]; see also AOB at pp. 20–21.)[4]

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[4] Nor does *State, ex rel. Hughes v. Public Employees Retirement System* (Ohio 1988) 520 N.E.2d 577, 579–580 support Respondent. The Ohio Constitution permits retroactive pension right modifications that are "done reasonably and not arbitrarily." (*State, ex rel. Horvath v. State Teachers Retirement Board* (1998) 83 Ohio St. 3d 67, 76–77.) So if, as occurred in *Hughes*, the employer impairs its contractual obligations, it has no obligation under Ohio law to provide a comparable advantage.

## III.

## RESPONDENT MISSTATES AND MISCOMPREHENDS THIS COURT'S PRECEDENTS GOVERNING MODIFICATIONS TO VESTED PENSION RIGHTS

Respondent incorrectly claims the comparable advantages rule applies only to the "risk of drastic reduction or elimination" of vested pension rights. (Ans. Br. at p. 37.) Equally improperly, it argues the rule is just "one of multiple factors to be considered in determining whether modifications are reasonable and justified." (*Id.* at pp. 37–38, citing *Cal Fire Local 2881,* 7 Cal.App.5th at p. 131; *Marin Association of Public Employees, et al. v. Marin County Employees' Retirement Association, et al.* (2016) 2 Cal.App.5th 674,700–703.) Respondent reduces the rule to a mere recommendation, co-opting the novel "must" versus "should" rationale of *Marin Association of Public Employees*. (Ans. Br. at pp. 38–39, citing *Marin Association of Public Employees* 2 Cal.App.5th at pp. 698–699; see also *Cal Fire Local 2881,* 7 Cal.App.5th at pp. 130–131.) And parroting those cases, Respondent argues that so long as the employee maintains a "substantial or reasonable pension" few limitations restrict government's authority to eliminate benefits. (Ans. Br. at p. 39.)

But this Court has never authorized so rudderless a standard. Where this Court references "substantial" and "reasonable" since *Allen v. City of*

*Long Beach*, it did so as part of a broader analysis into whether an impairment occurred and whether the impairment was permissible.

Respondent also invokes the "necessity defense," arguing that the elimination of section 20909 was "reasonable and necessary" to serve an important public purpose. (Ans. Br. at p. 39.) While the "necessity defense" *may* justify *temporary* impairment of vested contract rights in emergency situations, it has been *repeatedly* rejected when advanced by past governors and legislatures to justify impairments of vested contract rights. Its prerequisites do not exist here.

### A. The Comparable Advantages Rule Is A Mandatory, Singular Rule, Not Part Of A Balancing Test

Respondent never sets forth the comparable advantages rule, presumably because its argument that the "absence of comparable advantages must be balanced with other factors" (Ans. Br. at p. 39) so directly conflicts with it:

> 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. Bd. of Admin.* (1983) 34 Cal.3d 114, 120 [emphasis added].)

Nowhere amongst the "any" and the "musts" of *Allen* and its lineage does this Court indicate that a balancing test with other factors is