Case No. S239958

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

CAL FIRE LOCAL 2881, 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 No. RG12661622
(Hon. Evelio Grillo)

APPLICATION FOR PERMISSION TO FILE AMICUS BRIEF AND AMICUS BRIEF OF THE CALIFORNIA BUSINESS ROUNDTABLE IN SUPPORT OF RESPONDENTS

Beth Heifetz,
pro hac vice forthcoming
G. Ryan Snyder,
pro hac vice forthcoming
JONES DAY
51 Louisiana Avenue, NW
Washington, DC 20001-2113
Telephone: 202-879-3939
Facsimile: 202-626-1700

*Karen P. Hewitt, SBN 145309
JONES DAY
4655 Executive Drive, Suite 1500
San Diego, CA 92121-3134
Telephone: 858-314-1200
Facsimile: 844-345-3178
kphewitt@jonesday.com

Counsel for Amicus Curiae California Business Roundtable

TABLE OF CONTENTS

TABLE OF CONTENTS
(continued)

Page

TABLE OF AUTHORITIES

Page(s)

CASES

CONSTITUTIONAL PROVISIONS

STATUTES

OTHER AUTHORITIES

APPLICATION FOR PERMISSION TO FILE AMICUS BRIEF

The California Business Roundtable is a nonpartisan organization comprised of the senior executive leadership of the major employers throughout the State, with a combined workforce of over 750,000 employees. For more than 40 years, the Roundtable has identified the issues critical to a healthy business climate and provided the leadership needed to strengthen California's economy and create jobs.

The Roundtable believes that California cannot foster a healthy business climate and stronger economy without pension reform. The State's pension plans are dangerously underfunded. Unless California makes serious changes, pensions will consume an ever-larger share of the budget, forcing State and local governments to increase taxes and cut essential services, such as building infrastructure and maintenance, that are the backbone of the economy. It is therefore in everyone's interest—businesses, public employers and employees, and California citizens—for the State to take steps necessary to ensure that its pension plans remain solvent.

The Public Employees' Pension Reform Act, Gov. Code § 7522 et seq., was a good first step toward achieving that goal. But the Act is

threatened by the judicially created California Rule, which restricts the Legislature's power to adopt sensible, forward-looking pension reform. Under the California Rule, once a public employee has started working, the State can never reduce the rate at which that employee earns pension benefits for future services. In other words, the California Rule creates a one-way ratchet: the rate at which employees earn pension benefits for future services can go up, but can never go down.

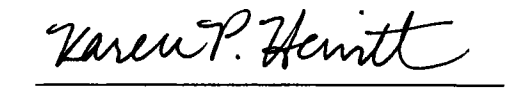
The Roundtable agrees with the State of California that the Act's elimination of the statutory offer to sell airtime does not violate the California Rule. There is no evidence that the Legislature intended to make this offer irrevocable, and the option to purchase airtime does not qualify as a "pension right" because it is not deferred compensation for an employee's services. *See* Intervener and Resp't State of California's Answer Br. on the Merits at 11–12. If the Court finds that the Act runs afoul of the California Rule, however, the Court should hold that the Rule unconstitutionally restricts the Legislature's power over pensions. Because the respondents do not make this argument, the Roundtable's brief fills that gap by explaining why the Court should reject the California Rule and overrule the cases that adopted it. *See Fisher v. City*

of Berkeley, 37 Cal. 3d 644, 654 & n.3 (1984) (deciding an "extremely significant issue[] of public policy" that was first raised by an amicus).

For these reasons, the Roundtable respectfully requests permission to file the attached brief in support of the respondents. *See* Cal. R. Ct. 8.520(f). The Roundtable confirms that no party or party's counsel authored this brief in whole or in part, or made a monetary contribution to fund its preparation or submission. *See* Cal. R. Ct. 8.520(f)(4)(A). The Roundtable acknowledges that the Laura and John Arnold Foundation has made a monetary contribution to fund the brief's preparation and submission. *See* Cal. R. Ct. 8.520(f)(4)(B).

Dated: February 14, 2018

Respectfully submitted,



Karen P. Hewitt, SBN 145309
JONES DAY
4655 Executive Drive, Suite 1500
San Diego, CA 92121-3134
Telephone: 858-314-1200
Facsimile: 844-345-3178
kphewitt@jonesday.com

Beth Heifetz,
pro hac vice forthcoming
G. Ryan Snyder,
pro hac vice forthcoming
JONES DAY
51 Louisiana Avenue, NW
Washington, DC 20001
Telephone: 202-879-3939
Facsimile: 202-626-1700

Counsel for Amicus Curiae California Business Roundtable

QUESTIONS PRESENTED

Under the California and Federal Contract Clauses, statutes create contractual rights only when the Legislature clearly intended to do so. This case presents two questions about that bedrock principle.

1. Under the judicially created California Rule, pension statutes—and only pension statutes—create a highly restrictive set of contractual rights regardless of whether the Legislature intended to create them. Should the Court reject this anomalous pension rule and overrule the cases that adopted it?

2. In 2004, the Legislature offered public employees the option to purchase airtime, but did not say that the offer was irrevocable. In 2012, the Legislature revoked that offer. Did the Legislature unconstitutionally impair a contractual right?

INTRODUCTION

In 2011, the Little Hoover Commission warned that "California's pension plans [were] dangerously underfunded." Little Hoover Comm'n, *Public Pensions for Retirement Security* (2011) (cover letter of Chairman Daniel W. Hancock) (hereinafter, "Little Hoover Comm'n"). The Commission explained that "[p]ension costs to state and local governments [were] rising at a pace that ha[d] grown

unmanageable for public agencies," and that the "money coming in [was] nowhere near enough to keep up with the money that will need to go out." *Id.* at 25, 38. The Commission predicted that, unless the State immediately implemented "aggressive reforms," "the problem will get far worse, forcing counties and cities to severely reduce services and layoff employees to meet pension obligations." *Id.* (cover letter). Indeed, the Commission predicted that governments across the State would "be forced to sacrifice schools, public safety, libraries, parks, roads and social services—core functions of government—and the public jobs that go with them, to pay the benefits that have been overpromised to current workers and retirees." *Id.* at 43.

Since the Commission issued these warnings, the situation has only worsened. A recent study examined 14 California jurisdictions and found that, from 2002-03 to 2017-18, these jurisdictions were forced to increase pension contributions by more than *400%* on average. Joe Nation, *Pension Math: Public Pension Spending and Service Crowd Out in California, 2003–2030*, at x (2018) (hereinafter, "Nation Report"), available at https://goo.gl/9sgcLj. And to pay for the skyrocketing costs, these jurisdictions were forced to cut important programs, such as "social, welfare and educational services, as well

as ... libraries, recreation, and community services." *Id.* at xi. In some cases, these jurisdictions even had to jeopardize public safety—for example, in large part because of rising pension costs, the City of Vallejo was forced to slash employment in its police department from 221 to 143, and in its fire department from 122 to 94. *Id.* at 60.

Yet even these drastic measures were not enough to keep pension debt under control. Between 2008 and 2015, debt for these pension systems soared from $11.8 billion to nearly $120 billion—an increase of more than *900%. Id.* at 84.

Several local governments cracked under the strain. In 2013, the City of Loyalton stopped funding its pension plan altogether, which led the California Public Employees' Retirement System (CalPERS) to slash pension payments to the City's retirees by 60%. Phil Willon, *This Tiny Sierra Valley Town Voted To Pull Out Of CalPERS. Now City Retirees Are Seeing Their Pensions Slashed*, L.A. Times, Aug. 6, 2017, available at https://goo.gl/8dyAyC. In 2014, the East San Gabriel Valley Human Services Consortium also stopped funding its pension plan, which led CalPERS to slash pension payments to the Consortium's retirees by 63%. Stephanie K. Baer, *Their Pensions Were Cut By CalPERS. Now These San Gabriel Valley Retirees Worry About*

Losing Their Homes, San Gabriel Valley Tribune, Mar. 20, 2017, available at https://goo.gl/Gakhap. And several other cities—including San Bernardino, Stockton, and Vallejo—went bankrupt in large part due to out-of-control pensions. *See In re City of San Bernardino*, 566 B.R. 46, 48 (Bankr. C.D. Cal. 2017); *In re City of Stockton*, 542 B.R. 261, 266 (B.A.P. 9th Cir. 2015); *In re City of Vallejo*, 408 B.R. 280, 288 (B.A.P. 9th Cir. 2009).

Ominously, the situation is still deteriorating. Between now and 2029–30, pension contributions will likely rise between 73% and 113% on average. Nation Report at x. At that point, State and local governments could be spending more than *one-sixth* of their total budgets on pensions alone. *Id.*

In 2012, the Legislature passed the Public Employees' Pension Reform Act, Gov. Code § 7522 et seq., to help fix these problems. But this Act—and other reforms like it—are threatened by the judicially created California Rule. Under this Rule, all pension statutes give public employees an unalterable contractual right "to earn, through continued service, additional pension benefits in an amount reasonably comparable to those available when [they began working]." *Legislature v. Eu*, 54 Cal. 3d 492, 530 (1991). In other words, once employees have

started working, the State can never reduce the rate at which they earn pension benefits for future services. For the rest of these employees' working lives, they will continue earning pension benefits at least at the same rate as they did on their very first day—no matter how dire the State's fiscal circumstances.

As explained above, the Roundtable agrees with the State of California that the Act's elimination of the statutory offer to sell airtime does not violate the California Rule. *See* Intervener and Resp't State of California's Answer Br. on the Merits at 11–12. But even if eliminating the airtime offer did violate the Rule, the Court should affirm the decision below because the Rule is fatally and unconstitutionally flawed. The Rule violates the bedrock principle that statutes create contractual rights only when the Legislature clearly intended to do so. The Rule also violates black-letter contract law by creating contractual rights that violate the reasonable expectations of the parties. And the Rule violates longstanding constitutional law by assuming that every contractual impairment automatically violates the California and Federal Contract Clauses. Together, these legal flaws infringe on the Legislature's sovereign right and duty to protect public employers, public employees, and California citizens.

In addition to these legal flaws, the California Rule lacks persuasive or precedential value. The Rule was initially adopted without anything resembling full consideration. Moreover, the Rule has been almost uniformly rejected by federal and state courts—including by several courts that previously accepted it. And the Rule has had—and will continue to have—devastating economic consequences. Thus, this Court should reject the California Rule and overrule any cases adopting it.

In place of the California Rule, this Court should give pension benefits the same constitutional protection as salary—no more, no less. Adopting this approach would give employees a contractual right to any benefits that they have earned through past services, while giving employers the freedom to prospectively modify the rate at which employees earn benefits for future services.

To be sure, treating pension benefits like salary would give State and local governments the ability to reduce the rate at which employees earn benefits for future services. For example, a local government could increase future employee contributions, reduce the rate at which employees accrue benefits for future services, or in the most dire circumstances, potentially stop offering benefits for future services. Yet

governments desperately need this flexibility. As the Little Hoover Commission explained, the problems with public pensions "cannot be solved without addressing the pension liabilities of current employees," and governments cannot address those liabilities without "the authority to restructure future, unearned retirement benefits." Little Hoover Comm'n at v. The Court should use this case to restore that authority.

BACKGROUND

A. The Contract Clauses

When public employees provide services to their employer, any applicable pension statutes "become a part of the contemplated compensation for those services, and so in a sense a part of the contract of employment itself." *O'Dea v. Cook*, 176 Cal. 659, 661–62 (1917). As a result, changes to a pension statute must comply with the California and Federal Contract Clauses. *See Allen v. Bd. of Admin.*, 34 Cal. 3d 114, 119 (1983) ("*Allen II*").

The California Contract Clause provides that a "law impairing the obligation of contracts may not be passed." Cal. Const. art. I, § 9. Likewise, the Federal Contract Clause provides that "[n]o State shall ... pass any ... Law impairing the Obligation of Contracts." U.S. Const. art. I, § 10. Because these clauses contain "parallel proscription[s],"

Allen II, 34 Cal. 3d at 119, courts "apply the same analysis to claims brought under [each clause]," *Retired Emp. Ass'n of Orange Cty., Inc. v. Cty. of Orange*, 610 F.3d 1099, 1102 (9th Cir. 2010). *See also, e.g.*, *Calfarm Ins. Co. v. Deukmejian*, 48 Cal. 3d 805, 826–31 (1989) (in bank); *City of Torrance v. Workers' Comp. Appeals Bd.*, 32 Cal. 3d 371, 376–77 (1982) (in bank).

To determine whether a statute violates the Contract Clauses, courts ask two basic questions. First, they ask whether the State has impaired "an existing contractual relationship." *Torrance*, 32 Cal. 3d at 377. That requires examining whether a contract exists; if so, what rights it has created; and whether the State has altered any of those rights. *See id.*; *accord Nat'l R.R. Passenger Corp. v. Atchison Topeka & Santa Fe Ry. Co.*, 470 U.S. 451, 472–73 (1985).

Second, if an impairment exists, courts ask whether it "exceeds constitutional bounds." *Torrance*, 32 Cal. 3d at 377; *accord Nat'l R.R.*, 470 U.S. at 472. That requires examining whether the impairment is "substantial," whether it is justified by a "legitimate public purpose," and whether it is reasonable and necessary. *Energy Reserves Grp., Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411–12 (1983); *accord Calfarm*, 48 Cal. 3d at 830–31.

When performing this analysis, courts rarely find that a statute has created contractual rights. As this Court has explained, statutes create contractual rights only "when the statutory language or circumstances accompanying its passage *clearly* evince a legislative intent to create [them]." *Retired Emp. Ass'n of Orange Cty., Inc. v. Cty. of Orange*, 52 Cal. 4th 1171, 1187 (2011) (ellipsis and quotation marks omitted; emphasis added). Likewise, the U.S. Supreme Court has explained that, "absent some *clear* indication that the legislature intends to bind itself contractually, the presumption is that a law is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise." *Nat'l R.R.*, 470 U.S. at 465–66 (emphasis added).

This clear-statement rule applies to questions about a contract's existence and its scope. Thus, "[a] court charged with deciding whether private contractual rights should be implied from legislation ... should proceed cautiously both in identifying a contract within the language of a statute and in defining the contours of any contractual obligation." *Retired Emp. Ass'n*, 52 Cal. 4th at 1188–89.

B. The California Rule

Because public employees have a contractual right to all pension benefits they have earned, any modification to those benefits should be analyzed under the ordinary Contract Clause rules described above. Instead of applying the usual rules, however, this Court has created a separate rule for analyzing pension modifications—the California Rule.

The California Rule deviates from ordinary Contract Clause analysis in three fundamental ways. First, the Rule eliminates the long-standing principle that statutes create contractual rights only "when the statutory language or circumstances accompanying its passage *clearly* evince a legislative intent to create [them]." *Retired Emp. Ass'n*, 52 Cal. 4th at 1187 (emphasis added). To the contrary, the Rule requires courts to hold that pension statutes create contractual rights without *any* evidence of legislative intent. *See, e.g.*, *Allen v. City of Long Beach*, 45 Cal. 2d 128, 131–33 (1955) (in bank) ("*Allen I*").

Second, rather than examining the text of a particular pension statute, the California Rule automatically reads several terms into the contractual relationship between public employers and their employees, terms which have not been enacted into law by the Legislature nor incorporated into any collective-bargaining agreement. To begin, the

Rule creates for employees a contractual right to pension benefits "upon acceptance of employment." *Dryden v. Bd. of Pension Comm'rs*, 51 P.2d 177, 178 (Cal. Ct. App. 1935), *opinion adopted*, 6 Cal. 2d 575 (1936). The Rule also creates for employees the "right to earn future pension benefits through continued service." *Eu*, 54 Cal. 3d at 528 (emphasis omitted). And finally, the Rule requires that any modifications to the employee's pension benefits—including modifications to benefits that have not yet been earned—must "bear some material relation to the theory of a pension system and its successful operation" and that any "disadvantage to employees" be offset by "comparable new advantages." *Allen I*, 45 Cal. 2d at 131.

Third, the California Rule differs from ordinary Contract Clause analysis by failing to require an analysis of whether an impairment "exceeds constitutional bounds." *Torrance*, 32 Cal. 3d at 377. Courts applying the Rule rarely ask whether a contractual impairment is "substantial," whether it is justified by a "legitimate public purpose," or whether it is reasonable and necessary. *Energy Reserves*, 459 U.S. at 411–12. Instead, courts simply conclude that any impairment necessarily violates the Contract Clauses. *See, e.g.*, *Eu*, 54 Cal. 3d at 528–34.