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California Supreme Court To Decide: What's Next for the 'California Rule' and Public Employee Pensions as Vested Rights

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AGENDA

- What is the “California Rule”
- Key Cases on Vested Rights
- What did the Supreme Court decide in *CalFIRE?*
- Remaining Cases Before California Supreme Court that Challenge Pension Legislation of 2012
- What’s Next?

WHERE IT BEGAN – PUBLIC EMPLOYEE PENSIONS AS VESTED RIGHTS

KERN V. CITY OF LONG BEACH (1947)

THE FACTS:

- The City of Long Beach offered pension benefit to city employees after **20 years of service**.
- The pension was equal to **50% of annual salaries**.
- 32 days before Kern completed 20 years of service, the City amended its charter to **eliminate pensions for all persons who were not yet eligible to retire**.

KERN V. CITY OF LONG BEACH (1947)

HOLDING:

The Supreme Court said that Kern acquired a vested right to a pension which the city could not eliminate without impairing a contractual obligation.

- Pensions are compensation for services performed and part of the employment contract.
- Pensions induce individuals to become and remain public employees.
- Public employees earn pension rights as soon as they perform substantial service for the public employer.
- **But Kern acknowledged that "pension systems must be kept flexible to permit adjustments."**

KERN V. CITY OF LONG BEACH (1947)

"[A]n employee may acquire a vested contractual right to a pension but that … right is not rigidly fixed by the specific terms of the legislation in effect during any particular period in which [he or she] serves… **The employee does not have a right to any fixed or definite benefits, but only to a substantial or reasonable pension**."

ALLEN V. CITY OF LONG BEACH (1955) ("Allen I")

THE FACTS:

- The City of Long Beach's City Charter was amended as to current employee members:
  - Employees' future member contributions increased from 2% to 10% so as to match member contribution rates of employees in state plan.
  - Plan changed from fluctuating, to fixed, plan.
  - New requirement to make up missed employee contributions from leave of absences for military service.

Allen I

Allen I announced: What is called "The California Rule"

To be sustained as **reasonable**, modifications to vested pension rights:

- must bear some **material relation to the theory of a pension system** and its successful operation, and
- changes which result in disadvantage to employees **should** be accompanied by **comparable new advantages**.

Allen I

- **THE HOLDING:**
  - The *Allen I* court concluded the changes to pre-1945 pension rights were **not reasonable** because they were all detrimental and there was no corresponding increase in benefits.
  - The *Allen I* court also stated that the change bore no relation to the functioning and integrity of the pension systems established for the employees.
  - Notably, there was no indication that the city would have any difficulty meeting its pension obligations to the pre-1945 employees under the prior system.

ABBOTT V. CITY OF LOS ANGELES (1958)

THE FACTS:

- The city sought to change from a fluctuating pension benefit to a fixed pension benefit.

THE HOLDING:

- The *Abbott* court found the change unreasonable and underscored: **"it is the advantage or disadvantage to the particular employees whose own contractual pension rights, already earned, are involved which are the criteria by which modifications to pension plans must be measured."**

ABBOTT V. CITY OF LOS ANGELES (1958)

The *Abbott* court rejected as "speculation" the assertion that rising costs might otherwise cause the pension system to cease to exist.

"Rising costs alone will not excuse the city from meeting its contractual obligations, the consideration for which has already been received by [the City]."

BETTS V. BOARD OF ADMINISTRATION (1978)

- **THE FACTS:**
  - PERS plan was changed in 1974 from fluctuating benefit to fixed benefit; change was inapplicable to members who had retired prior to its effective date.
- **THE HOLDING:**
  - The change was unconstitutional and the addition of a COLA in 1963 was not a sufficient new advantage to permit the impairment to the pension that plaintiff, a former State Treasure, had already earned.

BETTS V. BOARD OF ADMINISTRATION (1978)

When positive changes are made to the pension system at any time during employment, such changes become part of the employee's vested pension rights.

"An employee's contractual pension expectations are measured by benefits which are in effect not only when employment commences, but which are thereafter conferred during the employee's subsequent tenure."

ALLEN V. BOARD OF ADMINISTRATION (1983)(“*Allen II*”)

- **THE FACTS:**
  - Constitutional revisions in 1966 turned state legislators from part-time employees making $6,000 per year to full-time public servants making $16,000 per year.
  - State legislators who retired prior to 1967 were entitled to pension benefits based on the salaries of active legislators. The 1966 revisions eliminated that provision. But a new COLA formula was implemented in the meantime that substantially increased pension benefits without the need for salary increases.

Allen II

Before undertaking its analysis, the Allen II court stated: **"With respect to active employees, we have held that any modification of vested pension rights must be reasonable… and when resulting in disadvantages to employees *must* be accompanied by comparable new advantages."**

- **This is the only time the Supreme Court has replaced the word "should" with "must" when describing the California Rule.**

Allen II

- **THE HOLDING:**
  - The change restricting pension benefits for such former part-time members to be based on their former salary but with direct COLA adjustments was constitutionally permissible because the particular change in the nature and scope of legislators' work after the part-time legislators had retired was not among the reasonable pension expectations of such legislators while they were working under the part-time system.

LEGISLATURE V. EU (1991)

- **THE FACTS:**
  - Statewide proposition: no participant in Legislators' Retirement Plan should accrue any further benefit or any further service towards vesting.
- **THE HOLDING**:
  - Supreme Court: Legislators had "**right to earn future pension benefits through continued service, on terms substantially equivalent to those**" existing at the time they began working, or added at any point during their service.

LIMITS ON THE "CALIFORNIA RULE"

MILLER V. STATE OF CALIFORNIA (1977)

THE FACTS:

- Legislature reduced the mandatory retirement age from 70 years to 67 years.
- The difference between prior maximum benefit at age 70 and current benefit at age 67 was a decrease from $2,365/month to $1,863/month.

MILLER V. STATE OF CALIFORNIA (1977)

HOLDING:

- The Legislature retained the authority to change the statutory provisions relating to duration of permitted employment.

ANALYSIS:

- "It is well settled in California that public employment is not held by contract but by statute and . . . no employee has a vested contractual right to continue in employment beyond the time or contrary to the terms and conditions fixed by law."

INTERNATIONAL ASSN. OF FIREFIGHTERS v. CITY OF SAN DIEGO (1983)

THE FACTS:

- Member contributions were established based on age at entry into the retirement system, and were actuarially determined thereafter.
- Retirement System changed member contribution based on actuarial factors.

INTERNATIONAL ASSN. OF FIREFIGHTERS v. CITY OF SAN DIEGO (1983)

Court discusses *Kern, Allen I, Abbott* and *Betts*, then notes:

"What distinguishes each of these cases from the one before us is the nature of the contractual rights which became vested in plaintiff's members upon their acceptance of employment. In the cases relied upon by plaintiff, employees' vested contractual rights were modified by amendment of the **controlling provisions of the retirement system** in question to reduce (or abolish) the net benefit available to the employees."

INTERNATIONAL ASSN. OF FIREFIGHTERS v. CITY OF SAN DIEGO (1983)

> **"In the present case, no modification was made in the retirement system; instead, the revision in the factor representing future compensation of employees and the resulting revision in the rate of contribution were made pursuant to the charter and ordinances which delineate City's retirement system and prescribe the employees' vested rights."**

INTERNATIONAL ASSN. OF FIREFIGHTERS v. CITY OF SAN DIEGO (1983)

> **"Change in contribution is implicit in the operation of City's system and is expressly authorized by that system and no vested right is impaired by effecting such change."**

REAOC V. COUNTY OF ORANGE (2011)

Question posed to the California Supreme Court by the United States Court of Appeals for the Ninth Circuit:

> **"Whether, 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."**

REAOC V. COUNTY OF ORANGE (2011)

- Court answered yes – but the "legislative intent to create private rights of a contractual nature against the governmental body must be '**clearly and unequivocally expressed**.'"
- "Thus, it is presumed that a statutory scheme is not intended to create private contractual or vested rights and a person who asserts the creation of a contract with the state has the burden of overcoming that presumption."

*Cal. Fire Local 2881 v. CalPERS (*2019)

BACKGROUND:

- PEPRA elimination of ability to purchase of up to five years additional retirement service credit ("ARS"), sometimes called "airtime"). (Gov. Code §§ 20909, 7522.46.)
- Plaintiffs' claimed violation of vested pension right.

Cal. Fire Local 2881 v. CalPERS (2019)

ANALYSIS: Supreme Court stated that there were "two issues" for decision:

1. The first issue was "whether the opportunity to purchase ARS was a 'vested right' — that is, a right protected by the constitutional contracts clause."
2. The second issue, which the Court stated "arises only if we concluded that the opportunity to purchase ARS credit is entitled to constitutional protection," is "whether the Legislature's elimination of that benefit in PEPRA constituted an unconstitutional impairment of public employees' vested rights."

Cal. Fire Local 2881 v. CalPERS (2019)

- On the first issue, the Court used the *REAOC* analysis to determine whether the "legislative intent to create private rights of a contractual nature against the governmental body" was "clearly and unequivocally expressed."
- Called **"unmistakability" doctrine**.

Cal. Fire Local 2881 v. CalPERS (2019)

- Supreme Court concluded that broadly stated language of ARS purchase statute **did not** suggest an express intention to create a constitutionally protected benefit.
- **However,** Court then determined that it must assess whether such an intent should **be implied** on the theory that ARS was a form of **deferred compensation** for past work.

Cal. Fire Local 2881 v. CalPERS (2019)

- Court concluded that such an implied intent also should not be inferred because ARS had to be *purchased* by employees at their own option, thus its receipt was not conditioned solely on continued work in exchange for receipt of “core pension benefits”.

*Cal. Fire Local 2881 v. CalPERS (*2019)

- Therefore, the Court deferred answering the second question, stating that its decision "expresses no opinion on the various issues raised by the state and amici curiae relating to the scope of the California Rule."

California Supreme Court Has Accepted Review of Five Other Cases Challenging Pension Legislation of 2012

1. *ACDSA v. AlamedaCERA, et al.* (“*Alameda*”)
2. *Marin Assoc. of Public Employees, et al. v. Marin CERA* (“*Marin*”)
3. *McGlynn, et al. v. State of California* (“*McGlynn*”)
4. *Hipsher v. LACERA* (“*Hipsher*”)
5. *Wilmot v. CCCERA* (“*Wilmot*”)

Commonalities of Five Pending Supreme Court Cases

1. *Alameda* and *Marin* both involve challenges to amendments to compensation earnable statute in CERL that applies to "legacy" ("classic") (i.e., non-PEPRA) members
2. *McGlynn* involves proper tier of judges who were elected to their positions prior to January 1, 2013, but first assumed those positions on or after January 1, 2013.
3. *Hipsher* and *Wilmot* both involve challenges to PEPRA's felony forfeiture law applicable to legacy members.

Alameda

- *Alameda* was designated as the "lead" case and it will be decided next.
- *Alameda* includes challenges brought against Alameda CERA, Contra Costa CERA and Merced CERA.

Alameda

- AB 340/197 (“AB 197”) amended Gov. Code § 31461, defining “compensation earnable” under CERL.
- Retirement systems respond by excluding from “**compensation earnable**”:
  - ☒ standby pay, administrative response pay, call-back pay.
  - ☒ cash payments in lieu of health insurance and due to changes in IRC 125 plan.
  - ☒ leave in excess of that which may be earned and payable in each 12-month period during the final average salary period
- New exclusions apply to payments and final average salary periods occurring after January 1, 2013.

Alameda – Petitioners' Allegations

AB 197 Violated Contract Clause of Constitution:

- Vested right to inclusion of payments in pension calculation.
- Exclusion of pay items will reduce pension benefits.
- No comparable advantage provided.

Briefing to Supreme Court in *Alameda*

The individual and union parties argue that whenever a retirement board policy, or retirement system practice, promises a retirement benefit that is then authorized by law, the legislature and retirement boards have no authority to restrict those policies or practices prospectively unless the disadvantaged members are provided a "comparable new advantage."

Briefing to Supreme Court in *Alameda*

The State, Contra Costa County Sanitary District and Certain Amicus Curiae argue that the Supreme Court should abandon or greatly weaken the "California Rule," such that changes to retirement benefit accrual rights of current members may be made without providing a comparable new advantage to them.

Briefing to Supreme Court in *Alameda*

The retirement boards struck more of a middle ground by asking the Court to authorize some of the steps that they each took in implementing AB 197, but without seeking to undermine the basic tenets of vested rights protection.

Briefing to Supreme Court in *Alameda*

Merced CERA argued two points:

- (i) AB 197 did not materially change law but only clarified that "compensation earnable" – a general definition – did not require that this pay (e.g., standby pay) be included and therefore its prospective mandatory exclusion from future final compensation periods did not violate vested rights.

(Continued on next slide.)

Briefing to Supreme Court in *Alameda*

Merced CERA argued two points (cont.):

- (ii) Merced CERA's post-*Ventura* settlement agreement, which the court of appeal held mandates including certain terminal pay leave payoffs in legacy members' final compensation, should not be applied to new entrants to MCERA who join through reciprocity as legacy members **after** the Board explicitly limited their compensation earnable rights following the court of appeal decision.

Briefing to Supreme Court in *Alameda*

- ACERA and CCCERA challenged the legality of the court of appeal's estoppel ruling, which required the retirement boards to determine compensation earnable in a manner that contravened AB 197, based on those system's prior policies and settlement agreements.

Issues Raised in *Alameda* after *CalFIRE*

- Are the pay types that are excluded by AB 197 constitutionally protected by the Contracts Clause?
  - This was the "first issue" to be decided in *CalFIRE*

What's Next?

- Will the Supreme Court reach the California Rule in *Alameda*?
- If it does, then what factors will be important to the Court?
  - Prospective only, like *CalFIRE*?
  - Economic impact on plan important?
  - Economic impact to individual members important?
  - Should other factors pertinent to "successful operation" of a defined benefit plan be considered (e.g., Governor's "anti-spiking" references in 12 point plan)?
  - Is there an impact of settlement agreements and/or Board policies that defined compensation earnable before AB 197?
  - Will the Court address the "comparable new advantages" analysis?

Timing?

- *Alameda* is fully briefed.
- Oral argument and possibly a decision by end of 2019?

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Stay tuned

Thank you!