"THERE IS NO WINNING! ONLY DEGREES OF LOSING!"

AKA PENSION LAW UPDATE

County Counsel's Association of California

Ojai, California September 13, 2018

Presented by Arthur Hartinger, Jonathan Holtzman
Founding Partners, Renne Public Law Group

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AGENDA

- Background: How did we get here?
- Most Recent Ninth Circuit Opinion — *Harris v. County of Orange*
- Litigation Update: the So-Called "California Rule" and Supreme Court Cases
- Other Notable Cases

HOW DID WE GET HERE?

THE EVOLUTION OF "THE CALIFORNIA RULE"

KERN V. CITY OF LONG BEACH, 29 Cal. 2d 848 (1947)

- Pension eliminated days before retirement
- Held: Kern acquired a vested right to a pension which the city could not eliminate without impairing a contractual obligation
- Acknowledgement that "pension systems must be kept flexible to permit adjustments"
- **"[E]mployee 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, 45 Cal. 2d 128 (1955)("Allen I")

- A 1951 charter amendment altered the pension rights of pre-1945 police and fire employees
- Vested contractual pension rights may be modified, but "[s]uch modifications must be reasonable and it is for the courts to determine upon the facts of each case what constitutes a permissible change."
- **Emergence of the California Rule: Modifications must bear a material relation to the theory of a pension system and its successful operation, and changes which result in a disadvantage to employees should be accompanied by comparable new advantages.**

ABBOTT V. CITY OF LOS ANGELES, 50 Cal. 2d 438 (1958).

- City changed a fluctuating pension benefit to a fixed benefit.
- The Supreme Court rejected the argument that rising costs could doom the pension system.
- "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, 21 Cal. 3d 859 (1978).

- Retirement benefit changes affecting the State Treasurer.
- Change from fluctuating pension to fixed pension.
- Change made after term of office, but before retirement.

"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, 34 Cal. 3d 114 (1983) ("Allen II").

- Constitutional revisions in 1966 turned State legislators from part time employees making $6,000 per year to full time public officials making $16,000
- Unforeseen windfall, and Supreme Court rejected request for enhanced COLAs
- New Language, replacing "should" with "must"

"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."

ALLEN V. BOARD OF ADMINISTRATION, 21 Cal. 3d 859 (1978) ("Allen II").

"Constitutional decisions have never given a law which imposes unforeseen advantages or burdens on a contracting party constitutional immunity against change."

LEGISLATURE V. EU, 54 Cal.3d 492 (1991)

- Statewide proposition: no participant in Legislators' Retirement Plan should accrue any further benefit or any further service towards vesting

- 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.**

KEY POINTS FROM PRIOR CASES

- From day one, pension cases have always emphasized that pension benefits are flexible, and can be adjusted prospectively "in accord with changing conditions" and to "maintain the integrity of the system."
- The touchstone has always been whether the retirement benefit is reasonable.
- The language about substituting a comparable benefit, as expressed by the Supreme Court, has primarily been "may" rather than must – except in *Allen II*.

KEY POINTS FROM PRIOR CASES

- Whether it is “may” or “must”, a comparable benefit is best viewed as one of many criteria courts must consider when determining whether a vested benefit can be changed.
- Other factors in the cases are whether the rationale for the change relates to the theory of vesting, whether it relates to unforeseen advantages and burdens, the extent of the modification, whether the benefit was eliminated entirely, and whether the change is prospective only.

KEY POINTS FROM PRIOR CASES

- The case law is surprisingly unclear on the distinction between changes that affect prior service versus prospective only changes. Only one case, *Eu*, addresses this issue directly, which involved the potential elimination of earned benefits.

REAOC V. COUNTY OF ORANGE

- Nov. 5, 2007: **Case Filed.** (USDC No. 8:07-cv-01301-AG-MLG.)
- June 19, 2009: **Summary Judgment Granted** (USDC No. USDC No. 8:07-cv-01301-AG-MLG , Dkt No. 183.)
- June 29, 2009: **Ninth Circuit Certified Question to Supreme Court** "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?" 610 F. 3d 1099 (9th Cir. 2010).
- November 21, 2011: **Supreme Court Opinion**: 52 Cal.4th 1171 (2011).
- August 13, 2012: **Summary Judgment Granted** 2012 WL 12950389 (C.D. Cal.)
- February 13, 2014 **Ninth Circuit Affirms** 742 F.3d 1137 (9th Cir. 2014).

REAOC V. COUNTY OF ORANGE – SUPREME COURT PERMITS, WITH SIGNIFICANT LIMITATIONS, A VESTED RIGHTS CLAIM PREMISED ON AN IMPLIED CONTRACT

- 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."

HARRIS V. COUNTY OF ORANGE, 9th Circuit Court of Appeal No. 13-56061 (September 5, 2018)

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

GAYLAN HARRIS, on behalf of himself and others similarly situated, *Plaintiff-Appellant*, v. COUNTY OF ORANGE, *Defendant-Appellee.*	No. 13-56061 D.C. No. 8:09-cv-00098-AG-MLG OPINION

Appeal from the United States District Court
for the Central District of California
Andrew J. Guilford, District Judge, Presiding

Argued February 6, 2014
Submitted August 28, 2018
Pasadena, California

Filed September 5, 2018

HARRIS V. COUNTY OF ORANGE

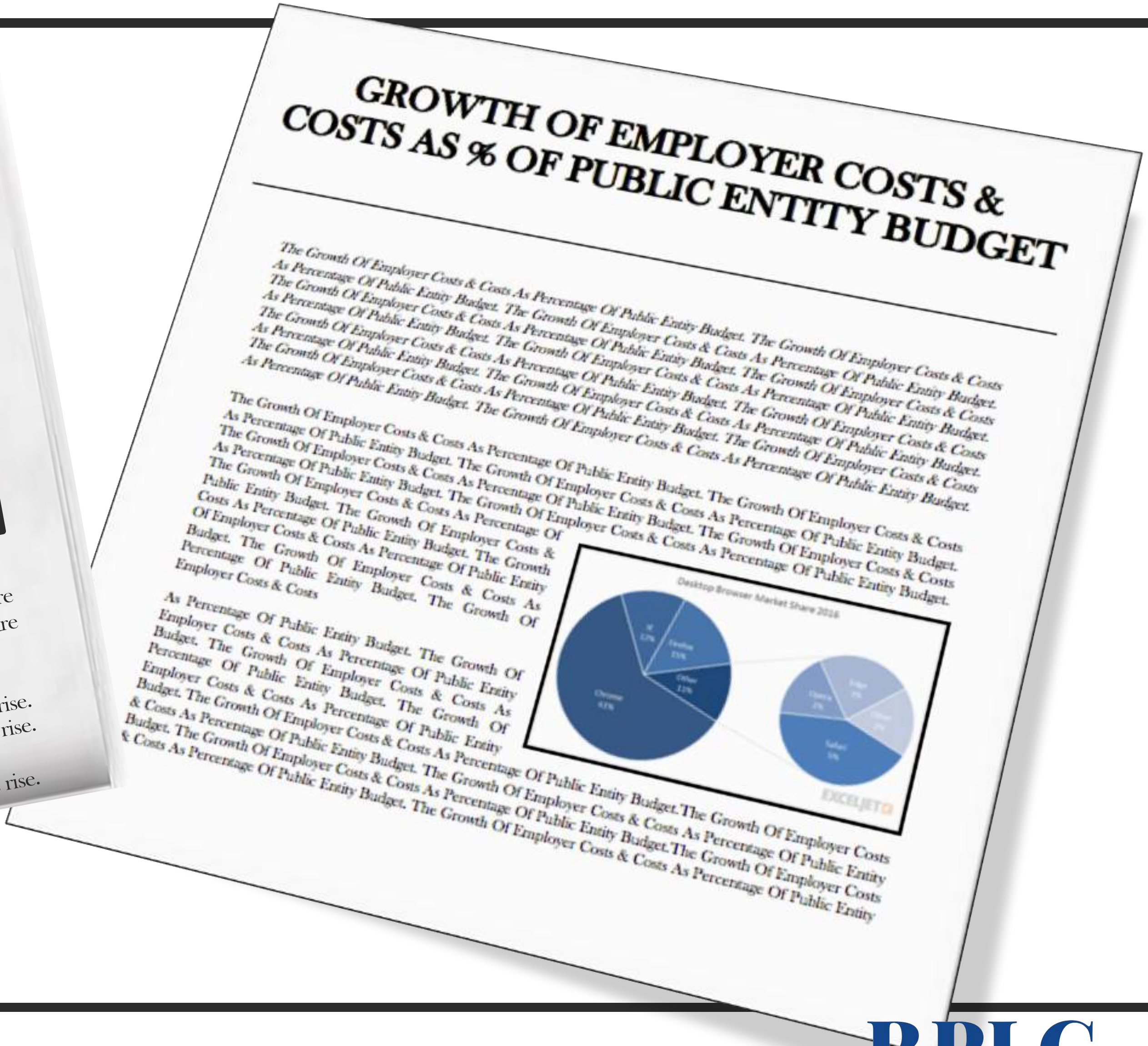
- Class Action Seeking Damages

- Three Issues:
  - Implied subsidy issue in *REAOC*
  - *Grant* Reduction
  - Age Discrimination under the FEHA

HARRIS V. COUNTY OF ORANGE - HOLDING

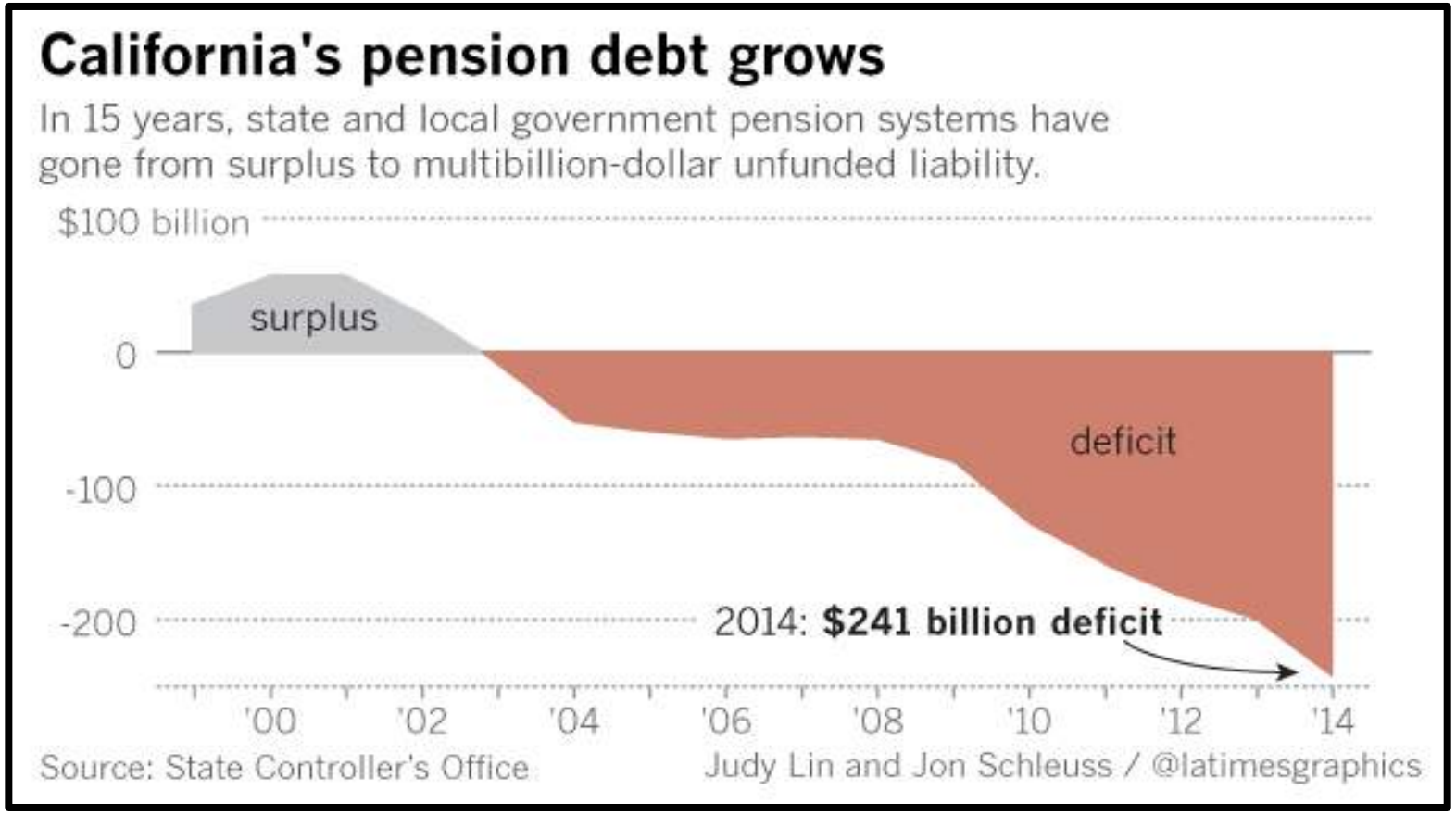
- Affirms dismissal of vested rights challenge to elimination of the implied subsidy
- Affirms dismissal of the age discrimination claim
- Remands back to district court the vested rights challenge to the grant reduction. The allegations were held sufficient to survive a motion to dismiss.

IS THE SKY FALLING?



GROWING UNFUNDED LIABILITIES

Los Angeles Times:

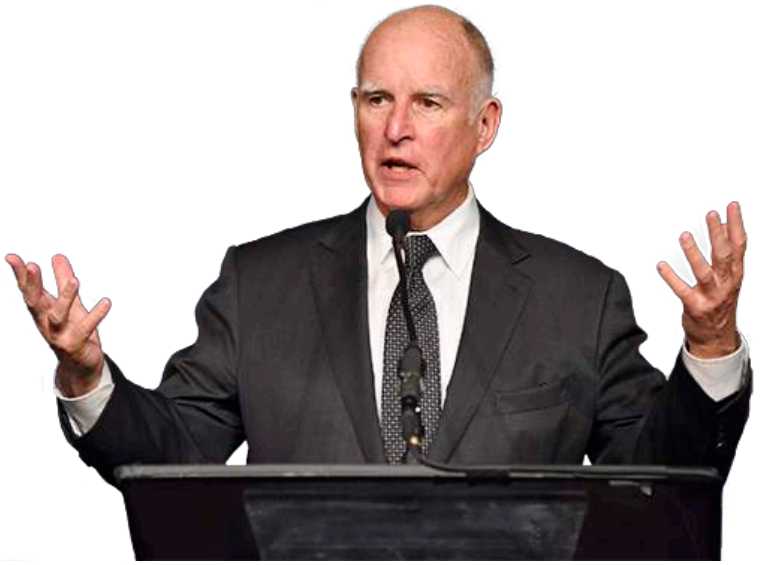


SOURCE: (LIN, JUDY, "THE OVERHAUL," LOS ANGELES TIMES, OCT 28, 2016.)

CHALLENGES TO THE "SO CALLED" CALIFORNIA RULE

GOVERNOR BROWN

"I have a "hunch" the courts will modify the California Rule, so "when the next recession comes around, the governor will have the option of considering pension cutbacks for the first time in a long time."



SOURCE: SACBEE.COM/ARTICLE194434479, JANUARY 12, 2018

PENDING SUPREME COURT CASES INVOLVING THE "CALIFORNIA RULE"

1. **Marin Assn. of Public Employees v. Marin County Employees Retirement Sys., 2 Cal. App.5th 674 (2016) ("*MCERA*")**

2. **Cal. Fire Local 2881 v. CalPERS, 7 Cal. App.5th 115 (2016) ("*CAL FIRE*")**

3. **Alameda Deputy Sheriffs' Assn., et al. v. Alameda County Employees' Retirement Assn, et al. 19 Cal.App.5th 61 (2018) ("*ACERA*")**

4. **McGlynn v. State of California, 21 Cal.App.5th 548 (2018) ("*McGlynn*")**

MCERA - BACKGROUND INFO

- AB 340/197 amended Gov. Code § 31461, which defined "compensation earnable" under CERL, added a new section to curb "spiking"
- MCERA excludes 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
- Applies to payments and final average salary periods occurring after January 1, 2013

MCERA - PETITIONERS' ALLEGATIONS

Violation of Contract Clause:

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

MCERA - ARGUMENTS BY MCERA
NO VIOLATION OF VESTED RIGHT

- PEPRA did not change the law but only clarified that "compensation earnable" – a general definition – did not include this pay.
- PEPRA retained the existing general definition of "compensation earnable" in Gov. Code 31461(a).

MCERA - HOLDING

"[W]hile a public employee does have a 'vested right' to a pension, that right is only to a 'reasonable' pension—not an immutable entitlement to the most optimal formula of calculating the pension. **And the Legislature may, prior to the employee's retirement, alter the formula, thereby reducing the anticipated pension. So long as the Legislature's modifications do not deprive the employee of a 'reasonable' pension, there is no constitutional violation**." (2 Cal.App.5th at p. 680.)

MCERA - HOLDING

- California Supreme Court did not intend "must" to have a literal meaning, citing *Allen v. City of Long Beach* (1955) 45 Cal.2d 128, 131; *Abbott v. City of Los Angeles* (1958) 50 Cal.2d 438, 449; and other cases that say disadvantages "should" be accompanied by comparable new advantages. (2 Cal.App.5th at p. 698.)
- "Should" is the preferred formulation. "And 'should' does not convey imperative obligation, no more compulsion than 'ought.' [citations] In plain effect, 'should' is 'a recommendation, not . . . a mandate.'" (2 Cal.App.5th at p. 699.)

MCERA CASE STATUS

- **Nov. 22, 2016:**
  Grant and Hold

The petition for review is granted. **Further action in this matter is deferred pending the decision of the Court of Appeal, First Appellate District, Division Four, in Alameda County Deputy Sheriff's Association et al. v. Alameda County Employees' Retirement Association et al., A141913 (see Cal. Rules of Court, rule 8.512(d)(2)) or pending further order of the court**. Submission of additional briefing, pursuant to California Rules of Court, rule 8.520, is deferred pending further order of the court. Votes: Cantil-Sakauye, C.J., Werdegar, Chin, Corrigan, Liu, Cuellar and Kruger, JJ.

- **March 28, 2018:**
  Trails ACERA

Further action in this matter is deferred pending consideration and disposition of a related issue in Alameda County Deputy Sheriffs' Assn. v. Alameda County Employees' Retirement Assn., S247095 (see Cal. Rules of Court, rule 8.512(d)(2)), or pending further order of the court. Submission of additional briefing, pursuant to California Rules of Court, rule 8.520, is deferred pending further order of the court.

CAL FIRE LOCAL 2881 V. CALPERS, 7 Cal.App.5th 115 (2016)

- PEPRA elimination of "airtime" (purchase of up to five years service credit). (Gov. Code, §§ 20909, 7522.46).
- Plaintiffs: violation of vested pension right
- Court finds that presumption is against statutory creation of vested rights, citing *Retired Employees Assn. of Orange County, Inc. v. County of Orange* (2011) 52 Cal.4th 1171, 1186, 1189. (7 Cal.App.5th at p. 126).

CAL FIRE

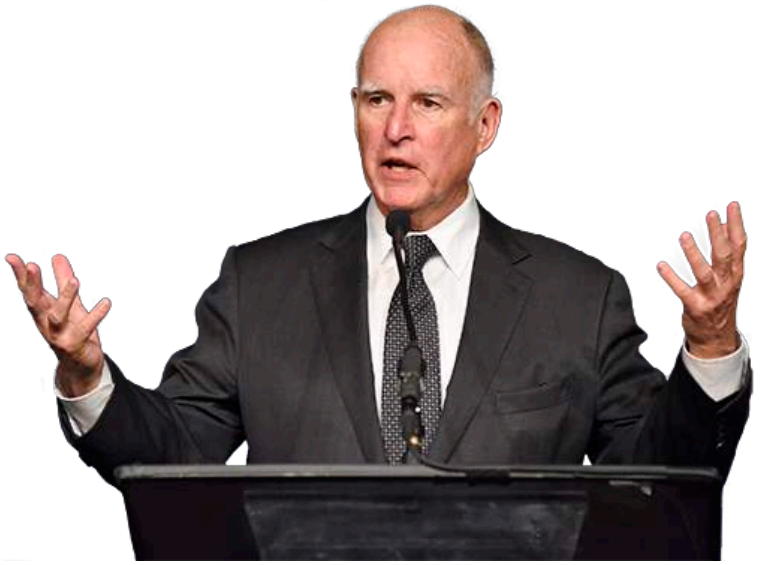
- Court finds air time is not a vested right due to absence of clear statutory language indicating intent to rest
- No failure to provide a comparable advantage. (7 Cal.App.5th at p. 130.) Court agrees with *Marin* that "should" is only a recommendation. (7 Cal.App.5th at pp. 130-131.)
- No showing that plaintiffs lost right to a "reasonable" pension, again citing *Marin*. (7 Cal.App.5th at p. 132.)

SUPREME COURT GRANTS REVIEW

- Review granted April 12, 2017
- *CAL FIRE* likely will be the **first** case heard by Supreme Court—not being held for *Marin* or Alameda cases.
- Fully briefed and waiting for oral argument to be scheduled.

GOVERNOR BROWN INVOLVED IN CAL FIRE

- In California Supreme Court, the Governor files a brief on behalf of the State.
- The Governor's brief argues there was not vested right to airtime, AND
- That employees are entitled to a reasonable and substantial pension – no requirement for a comparable advantage for every disadvantage



ALAMEDA COUNTY DEPUTY SHERIFF'S ASSOCIATION V. ALAMEDA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION, 19 Cal.App.5th 61 (2018)("ACERA")

- Cases involve AB 197 –different sections.
- State: CERL always prevented inclusion of certain final comp period "cashouts" and "terminal" pay; legislature entitled to "clarify" that spiking prohibited.
- Plaintiffs – Disagree, and employees were entitled to rely on retirement board policies that permitted inclusion.

ACERA

- "Compensation earnable" always included vacation or other leave "cashed out" in the final compensation period. PEPRA made no change.
- "Terminal pay" not pensionable but retirement systems equitably estopped based on settlement agreements.
- "On call Pay" was pensionable, but PEPRA changed the rule.
- Rule against "pension enhancements" is also new.

ACERA

"Much of *Marin's* vested rights analysis-including its rejection of the absolute need for comparable new advantages when pension rights are eliminated or reduced is not controversial, and we do not disagree with it. **However, we must respectfully part ways with our colleagues…when it comes to their application of the law to this specific dispute**."

ACERA

"[W]hen no comparative new advantages are given, the **corresponding burden to justify any changes with respect to legacy members will be substantive**."

"[T]otal pension system collapse may be a sufficiently weighty concern to meet this standard…."

ACERA Status

- Case is Fully Briefed
- *MCERA* Trailing *ACERA*
- *ACERA* Trailing *CAL FIRE*

MCGLYNN V. STATE OF CALIFORNIA, 21 Cal.App.5th 548 (2018)

- Judges elected before PEPRA, but took office after PEPRA's effective date
- **Issue**: Do the judges have a vested right to pre-PEPRA benefits?
- **Holding**: The judges are subject to PEPRA
- **Review granted**: June 27, 2018
- Deferred pending **ACERA**

ISSUE RAISED IN PENDING CASES
STANDARD OF PROOF

- *REAOC*: The "legislative intent to create private rights of a contractual nature against the governmental body must be 'clearly and unequivocally expressed.'" (52 Cal 4th 11171, 1186-1187)

- Called **"unmistakability" doctrine**.

How does this doctrine apply to express contract cases?

How does this doctrine apply to pension vs. retiree medical cases?

ISSUE RAISED IN PENDING CASES
COMPARABLE NEW ADVANTAGE

Marin, *Cal Fire* and *Alameda*: Courts concluded that California Supreme Court precedent does not require a comparable new advantage for every disadvantage.

- "Should" not "must" remains the Court's preferred expression. And "should" does not convey imperative obligation, no more compulsion than "ought." (*Marin* at 699.)
- Legislature may make "reasonable" modifications; employee entitled only to a "substantial or reasonable" pension. (*Marin* at 702.)
- But, does comparable benefit even make sense in cases of unforeseen benefits?

ISSUE RAISED IN PENDING CASES
PROSPECTIVE CHANGES

- The decisions in both *Marin* and *Cal Fire* rested, in part, on the **prospective nature of the changes** at issue in those cases.
    - "Earned in this context obviously means in exchange for services already performed." (2 Cal.App.5ht at at 694 [quoting *White v. Davis* (2003) 30 Cal.4th 528, 566].)
- Other jurisdictions: E.g., *Scott v. Williams*, 107 So.3d 379 (Fla. 2013), 388-389 [approving prospective amendment "so long as any benefits tied to service performed prior to the amendment date are not lost or impaired"].)
- Treating prospective changes differently from benefits based on service already rendered makes sense in view of the fact that vested rights rest upon the theory of deferred compensation.

ISSUE RAISED IN PENDING CASES
JUSTIFICATION FOR MODIFICATION

Alameda Court departed from *Marin* Court on standard for assessing change:

- "If the justification for the change is the financial stability of the specific CERL system. . . [would the system] have difficulty meeting its pension obligations."

ISSUES RAISED IN PENDING CASES
REGULATORY EXCEPTION

- Argument made for the first time in the *ACERA* case - that a different standard applies to alterations in vested benefits when the State acts in a regulatory capacity to address abuses.

- Such changes raise only limited concern under the Contract Clause, and are distinguishable from the State's regulation of its own contracts.

- The argument has teeth because *ACERA* arises under the '37 Act, which does not even apply to State employees. Hence, the argument is that PEPRA's provisions amending CERL are purely regulatory in nature.

OTHER NOTABLE CASES

HIPSHER v. LACERA, 24 Cal. App 5th 740 (June 2018), petition for review filed July 27, 2018, currently pending

- Firefighter convicted of running offshore gambling operation shortly after retirement
- LACERA reduced his benefits pursuant to PEPRA based on determination that conduct was committed in the course of his duties
- Hipsher alleges PEPRA impaired vested right to pension

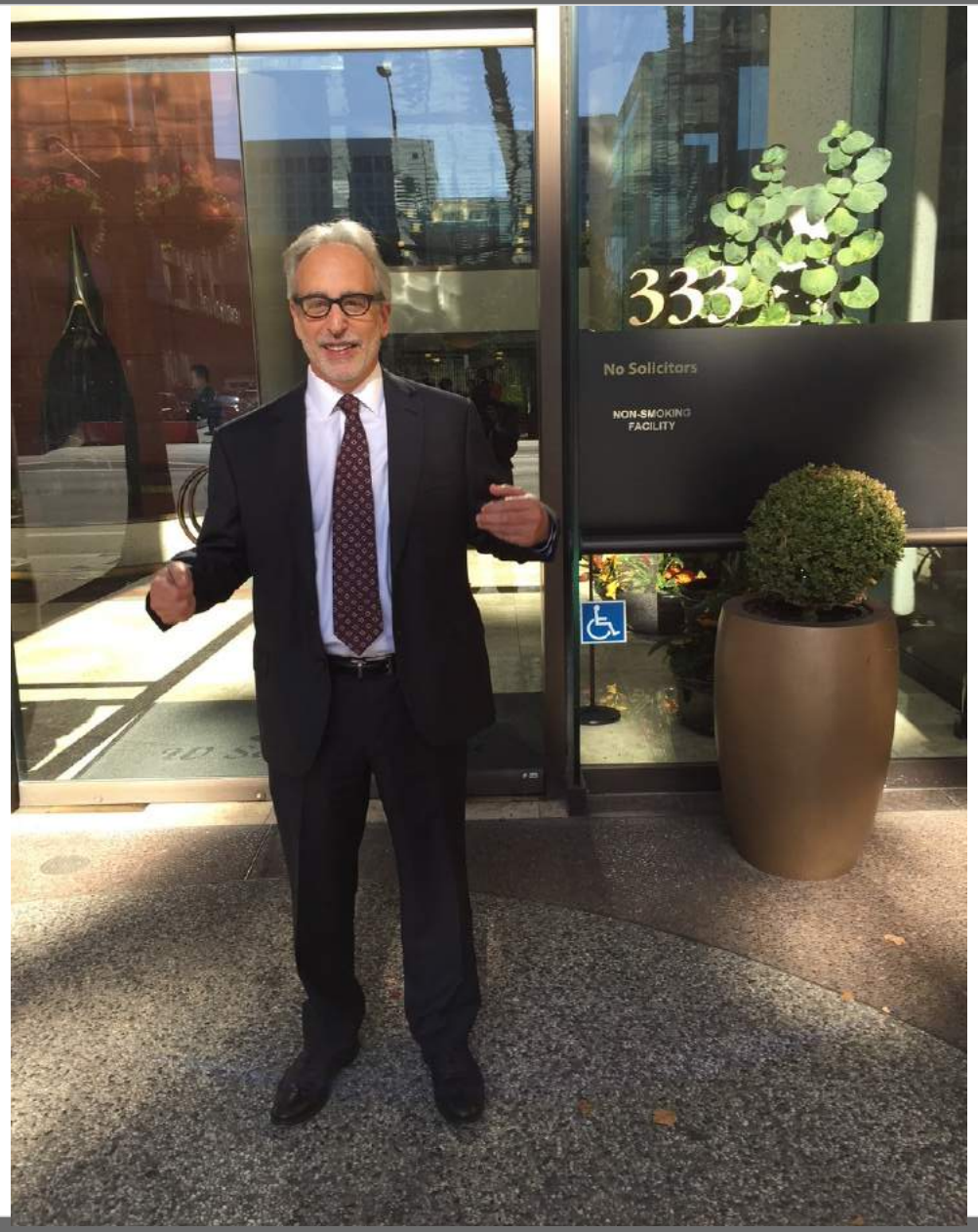
HIPSHER v. LACERA

- Follows *MCERA* in stating changes in benefits need not be accompanied in all cases by a comparable new advantage

- "[I]t would be anomalous to suggest the Legislature must reward an employee for conviction of a job-related felony by providing a comparable new advantage...."

- Distinguishes *Kern* because forfeiture limited to felonious conduct during course of employee's duties.

Vallejo Police Officers Association v. City of Vallejo, 15 Cal.App.5th 601 (2017)



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Vallejo Police Officers Association v. City of Vallejo

- City unilaterally imposed changes to retirement medical plan benefits
- Vested rights challenge
- **HOLDING 1**: MOU did not confer a vested right (noting that the MOU had a term)
- **HOLDING 2:** The subjective understandings of individuals, as well as understanding communicated outside the legislative approval process are not admissible as evidence of the City's intent to vest a benefit.
- **Review Denied**: December 20, 2017

Thank You!