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
Intervenor and Respondent

On Review from the Court of Appeal for the First Appellate District
Division Three, Case No. A142793
After an Appeal from the Superior Court, County of Alameda
Case Not. RG12661622
(Hon. Evilio Grillo)

APPLICATION FOR PERMISSION TO FILE AMICUS BRIEF and AMICUS BRIEF OF THE CITY OF PACIFIC GROVE

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APPLICATION FOR PERMISSION TO FILE AMICUS BRIEF

The City of Pacific Grove, speaking in the interest of the small cities within the State of California (referred to herein as "small cities") hereby applies to file an Amicus Brief in support of Intervenor and Respondent State of California. Small cities, such as Pacific Grove, are public entities that as employers are burdened with the responsibility of funding employee pensions. The historic limitation placed on small cities' ability to modify pension benefits has resulted in budgetary shortfalls that have harmed the small cities and their residents. When an inaccurate actuarial study produces an outcome dangerous to the welfare of small cites – indeed to the entire benefit system – the law must provide for equitable adjustment. If nothing more, it's a simple matter of correcting a mistake in the interest of local governmental survival.

Broadly, this case presents the opportunity to review and test the viability of the so-called "California Rule" under which the legislature, by way of pension statutes, purportedly forms a contract between the state and its employees on the employee's first day of work, thereby diminishing the state's right to modify or limit those pensions as somehow unconstitutional. Cal Fire presents the specific question of whether the enactment of Government Code sections 7522.46 and 20909(g) violates the Contracts Clause of the California Constitution (Cal. Const., art. I, § 9) because it denies a vested right possessed by certain employees.

In 2003, with the enactment of Government Code section 20909, the State Legislature gave public employees (beyond the teaching profession) an *option* to purchase retirement service credit – of up to five years of "airtime" service that did not correspond to actual service – as a way to calculate retirement to increase employee's pension benefits. (Assembly Bill 719) Public employees electing to purchase the option were to bear the full cost of these increased benefits. The Legislature began to recognize that in

practice the government entities – such as the small cities – not the employees, were bearing the actual cost of airtime. Thus, in 2013 the Legislature ended the airtime purchase option when it adopted Government Code section 7522.46, which in turn enacted 20909(g), as part of the Public Employees' Pension Reform Act of 2013 (PEPRA).

Cal-Fire filed a petition for writ of mandate with the Trial Court seeking an order directing CalPERS to allow public employees hired before January 1, 2013, to purchase airtime. (Appeal citation generally JA 156-167.) The petition alleged that the option to purchase airtime in section 20909 was a vested right and that section 7522.46, ending the option to purchase airtime for employees hired before PEPRA's effective date, impaired that right in violation of the contracts clause of the California Constitution. (JA 161-162.) The Trial Court properly denied that petition, and the Court of Appeal, in *Cal Fire Local 2881 v. California Public Employees' Retirement System* (2016) 7 Cal. App. 5th 115 (Opinion) correctly affirmed. Small cities support the State of California in asking that the Opinion be upheld, as it correctly sets aside a deeply flawed pension benefit system that has been economically crippling small cities.

The small cities, as the employers responsible for funding their employee pensions, present a unique perspective to why Cal Fire is incorrect, and the Opinion must be upheld. The small cities will focus, with particularity, on whether the repeal of Government Code section 20909 violates the Contracts Clause of the California Constitution because it denied a vested right possessed by certain employees. Cal Fire argues that, for all employees who were hired or employed while the airtime benefit was in place, that benefit can never be taken away. The rigidity Cal Fire seeks to uphold is a threat to the economic well-being of small cities.

The small cities' brief addresses from a different point of view, the impact of pension miscalculations and the inability to modify those pensions

based on the "California Rule" that the Opinion overturns, and Cal-Fire seeks to perpetuate. (See, Cal Fire Opening Brief on the Merits, p. 22, quoting *Allen v. Board of Administration* (1983) 34 Cal.3d.114, 120.) These small cities believe that the Court would benefit from considering the small cities' perspective. For these reasons, the City of Pacific Grove, on behalf of these small cities, respectfully requests permission to file the attached brief in support of Intervener and Respondent State of California. (Cal. Rules Ct., rule 8.520, subd. (f)(1).)

No party or its counsel authored this brief in whole or in part, or made a monetary contribution to fund its preparation or submission. (Cal. Rules Ct., rule 8.520, subd. (f)(4)(A).) The City of Pacific Grove, on behalf of these small cities, acknowledges that the Retirement Security Initiative, Luis Belmonte and Peter Weber made monetary contributions to fund the brief's preparation and submission. (Cal. Rules Ct., rule 8.520, subd. (f)(4)(B).)

DATED: February 20, 2018

LOUNSBERY FERGUSON ALTONA & PEAK, LLP

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AMICUS BRIEF

I. Introduction

Government Code section 20909 was adopted on the premise that it would add no cost to the retirement system. The CalPERS actuarial study found that, since the employee would pay both the employee and employer portion of the added benefit, that it would be cost neutral. (see, Joint Appendix (JA) 270-271). CalPERS claimed airtime would cost public employers nothing. (JA 271.) History proved the CalPERS actuarial study to be wrong.

As shown in the Joint Appendix filed by the parties to this action, CalPERS conducted a study of the airtime program seven years after the change was signed into law. (Joint Appendix (JA) 312-321.) Over 33,000 employees in the CalPERS system purchased airtime between June 30, 2004 and June 30, 2007. (JA 313.) Due to faulty actuarial assumptions, CalPERS employees "were consistently and substantially underpaying for airtime. (JA 317-321 - showing airtime underpriced, on average, by at least 11-28 percent).)" (State Respondents' Brief, p. 16.) In addition, employees also retired earlier when they purchased airtime. School employees were three times more likely to retire early if they had purchased airtime. (JA 314; State Respondents' Brief, p. 16.)

Each of these factors increased the cost of airtime purchases. Added costs are passed on to member agencies. In other words, the Legislature approved the airtime legislation based on a faulty study of true costs of the added benefit. The burden of the added retirement costs was passed on to the member agencies, including the City of Pacific Grove and the small cities, resulting in significant and unexpected debt. (see, *San Joaquin County Correctional Officers Association v. County of San Joaquin* (2016) 6 Cal.App.5th 1090, 1095.) Unfunded liabilities were estimated in the hundreds of billions of dollars. (*Marin Association of Public Employees v.*

Marin County Employees Retirement Association (2016) 2 Cal.App.5th 674,680-681, review granted Nov. 22, 2016.) A 2011 Little Hoover Commission report advised the Legislature that "California's pension plans are dangerously underfunded, the result of overly generous benefit promises, wishful thinking and an unwillingness to plan prudently.'" (State Brief, p. 17; quoting *County of San Juaquin* at 1095.)

II. Small Cities Have Become the Victims of the California Rule

Small California cities have no means of performing reliable actuarial studies; they are altogether reliant upon CalPERS. The CalPERS Board has "the sole and exclusive power to provide for actuarial services...". (Cal. Const., art. XVI, sec. 17, subd. (e).) CalPERS Board must "keep data necessary for the actuarial valuation of the system," and in accordance with that data, adopt annual and actuarial interest rates. (Gov. Code, §§ 20131 and 20132.) To do that CalPERS employs an actuary who will valuate the assets and liabilities of the system. (Gov. Code, §§ 20015 and 20133.) Cities are bound by the decisions of the CalPERS Board. (Gov. Code, § 20506; *City of Oakland v PERS* (2002) 95 Cal.App. 4th 29, 55.) As participating agencies, Cities may not refuse to pay the contributions determined by CalPERS within prescribed deadlines. (Gov. Code, §§ 20535 and 20536)

Faulty actuarial studies by CalPERS are thus a significant cost burden to CalPERS member cities. In California, several hundred cities routinely rely on CalPERS for their actuarial support. (see, CalPERS' list of "Public Agency Actuarial Valuation Reports", at https://www.calpers.ca.gov/page/employers/actuarial-services/employer-contributions/public-agency-actuarial-valuation-reports.) If the CalPERS actuarial study is wrong, small cities pay the price.

In the case of state legislation, the bill analysis typically includes references to a CalPERS actuarial study to help inform the Legislature of the "true" cost of the new benefit being considered. Much like a Congressional

Budget Office (CBO) score, it informs the legislative body of the fiscal impacts of the legislation based on a number of assumptions, which prove inaccurate over time. (JA 312; 316-17.) Inaccurate actuarial studies add significant costs to CalPERS Cities, because they, as employers are legally obligated to cover shortfalls and make further contributions. (JA 283.) The airtime provisions of Government Code section 20909 is but one example of the use of actuarial studies to determine the cost of a new or enhanced retirement benefit.

CalPERS actuarial studies are almost always used in small jurisdictions to determine the true cost of proposed benefit increases during Meyers-Milias-Brown Act (MMBA) labor negotiations.[1] Both local labor and management rely upon actuarial studies provided by CalPERS to determine the cost of a benefit before it is added to a Memorandum of Understanding (MOU) that culminates labor negotiations.

If an actuarial study is flawed, neither party (management or labor) understand the true costs of the bargain they are striking. Budgetary priorities must be shifted to cover for the budget shortfalls to pay for the new or enhanced benefit if the actuarial study is flawed. Management will be reluctant to consider new or enhanced benefits if the rights in a previous new or enhanced benefit are now "vested" due to an actuarial error. If the benefit or enhancement has significant enough costs, such as 3% at 50 for public safety, the small city may be unable to shift budget priorities to cover the losses as was seen in Stockton or Vallejo. (see, *In re City of Stockton, Cal.*,

[1] The only other options available to CalPERS members are to hire its own outside consultant to determine the cost of the potential benefit or to grant the benefit without a cost analysis, which would be a violation of Government Code section 7507 [requiring cities to secure the services of an actuary to provide a statement of the actuarial impact upon future annual costs before authorizing increases in public retirement plan benefits].

526 B.R. 35 (2015); *In re City of Stockton, Cal.*, 478 B.R. 8 (2012); *In re City of Vallejo, Cal.*, 432 B.R. 262 (2010).)

From the management perspective, an inaccurate actuarial study that does not reflect the true cost of the new or enhanced benefit means unanticipated costs. Unanticipated costs will create less funding for future bargaining. This creates a problem for labor in the future. If a "vested right" is established through an actuarial mistake, it is difficult to correct. The class of persons who benefit from the "mistake" may not reflect the overall make-up of the labor bargaining unit.[2] Other members of the bargaining unit will face more difficult bargaining for benefits that will be of use to them and affect their overall compensation. The added costs will leave member agencies with less money to pay the benefits of the workforce as each member agency must shift resources to pay for unanticipated benefits associated with airtime enhanced pension benefits.

Here, the airtime analysis failed to consider the cost to the system of employees who speed up their retirement with the purchase of airtime. (JA 314.) Additionally, any other faulty assumption in the CalPERS actuarial model is compounded by the early retirements. The CalPERS model has not accurately predicted the extension of the lifespan of its members and the rate of return on its investments. (JA 317-321.) When an employee retires early, these faults are compounded by the removal of healthy individuals from the employee pool before their normal expected time of retirement.

From the labor side, the airtime benefits are used by public employees who can afford to purchase the enhanced benefits, usually older workers.

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[2] In this case, the beneficiaries of the airtime benefit were workers over 40. For non-safety employees in the PERS "Public Agency Miscellaneous plan", 92.3% of the participants were 40 or over. 67.7% of the participants were fifty or older. (JA 318.) Similar results were found in other plans. (JA 318-320.)

The majority of the rank and file will not benefit from the enhancement yet will suffer the budgetary consequences of the mistaken actuarial cost estimates during future bargaining.

Under the California Rule, benefits granted based on faulty actuarial assumptions imperil local government. Faulty actuarial assumptions lead to eventual threats to the integrity of the active benefit system.

III. There is no Violation of the Contracts Clause

This Court cannot imply a statutory contract guaranteeing the continued flow of airtime benefits because such implication would severely limit or effectively extinguish the power of the State. Under California law,

> ...a legislative act which would, if construed to be a contract, limit or extinguish the power of the government completely to control the subject matter of the enactment, will not be so construed unless the legislative intention to create a contract clearly appears, and all doubts must be resolved in favor of the continuance of the power of the government. (*Taylor v. Board of Education (Taylor)* (1939) 31 Cal.App.2d 734, 742.)

A court must not implicate the Legislature's willingness to surrender the control over a subject matter unless the "implication of suspension of legislative control [is] unmistakable." (*Claypool v. Wilson (Claypool)* (1992) 4 Cal.App.4th 646, 670.) *Taylor* and *Claypool* hold that the Legislature is allowed to create an obligation "until the legislature sees fit to change the law" unless the language of the legislation clearly and unmistakably suspends the Legislature's ability to act on the subject matter in the future. (*Id., Taylor,* at 743.) The Legislature saw fit to change the law with the enactment of Government Code sections 7522.46 and 20909(g).

The Legislature's right to reduce pension values, without violating the contracts clause of the United States Constitution was recently upheld by the First Circuit Court of Appeals in *Cranston Firefighters, IAFF Local 1363 v.*

Raimondo (*Raimondo*) (2018) 2018 U.S. App. LEXIS 1472, 880 F.3d. 44. The Court in *Raimondo* applied the "unmistakability doctrine" – recognizing that the function of the legislature is "not to make contracts, but to make laws that establish the policy of the state" – to preclude a finding that statutes create a binding contract "absent a clear and unequivocal expression of intent by the legislature to so bind itself." (*Raimondo*, at 2018 U.S. App. LEXIS 1472, 10.)

In addition, it was always clear that public employees, not employers (i.e., small cities), were to bear the full cost of these airtime benefits. (JA 265.) Therefore, the permanency of funding necessary for the finding of an implied statutory contract is lacking. (see, *California Teachers Association v. Cory (Cory)* (1984) 155 Cal.App.3d. 494, 508; see also, *Claypool,* at 670 [noting that the implication of a contract in CTA was based on "the strength of assurances to be found [in the statute] . . . show[ing] a 'commitment to permanency of funding'"]; see also, *Walsh v. Bd. of Admin. of the Public Emp. Ret. Sys.* (1992) 4 Cal.App.4th 682, 699 [holding that the California constitution mandates that "the creation of an enforceable contract with the state requires compliance with the constitutional debt limitation provisions [citations], or a valid appropriation in support of the contract"].)

Furthermore, even if a contract were implied, under contract law CalPERS' mistake would have entitled the small cities to rescission rather than burdening them with liability. (see, Civ. Code, § 1689, subd. (b)(1).) Cal Fire's attempt to apply the California Rule to enforce these purported contracts creates an unconscionable result for the small cities. (*Donovan v. RRL Corp.* (2001) 26 Cal.4th 261.)

IV. Accountability Is Critical

The California Rule was developed under a much different set of circumstances than are present in this case. Over a series of cases dealing with benefit cuts, this Court developed the California Rule. (*i.e., Allen v.*

City of Long Beach (1955) 45 Cal.2d 128; *Legislature v. Eu* (1991) 54 Cal.3d. 492.)

> 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. [Citations.] As to retired employees, the scope of continuing governmental power may be more restricted, the retiree being entitled to the fulfillment without detrimental modification of the contract which he already has performed. (*Allen v. Board of Administration*, supra, 34 Cal.3d at p. 120 [disadvantageous amendments to pension plan ruled unconstitutional].)[3]see also *Abbott v. City of Los Angeles* (1958) 50 Cal.2d 438 [amendment substituting fixed pension for payments on a fluctuating basis invalid; increase in benefits for a narrow class of pensioners was not commensurate with detriment imposed], *Betts*, supra, 21 Cal.3d 859 [no comparable benefits were provided to offset the detriment to former State Treasurer of less generous, later-enacted method of calculating pension]; *Olson v. Cory* (1980) 27 Cal.3d 532, 541 [statute limiting cost-of-living increases for retired judges failed to provide any offsetting comparable advantages].) Importantly, "it is the advantage or disadvantage to the particular employees ... by which modifications to pension plans must be measured." (*Abbott*, supra, 50 Cal.2d at p. 449.)

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[3] See also *Abbott v. City of Los Angeles* (1958) 50 Cal.2d 438 [amendment substituting fixed pension for payments on a fluctuating basis invalid; increase in benefits for a narrow class of pensioners was not commensurate with detriment imposed], *Betts*, supra, 21 Cal.3d 859 [no comparable benefits were provided to offset the detriment to former State Treasurer of less generous, later-enacted method of calculating pension]; *Olson v. Cory* (1980) 27 Cal.3d 532, 541 [statute limiting cost-of-living increases for retired judges failed to provide any offsetting comparable advantages].)

The unilateral cuts made in pensions were a generalized response to funding issues faced by a pension board that is required to act as a fiduciary. (*O'Neal v. Stanislaus County Employees' Retirement Assn.* (2017) 8 Cal.App.5th 1184.) In many cases, the only "member agency" was the local government that established and governed the pension system. (i.e. *Allen v. City of Long Beach,* supra, 45 Cal.2d 128 [the City of Long Beach made the pension changes for its own employees and retirees].)

The interests of the small cities are not as a fiduciary that makes unilateral changes to a pension plan. They are member agencies that bargained to grant the airtime benefit to their employee groups based on the actuarial assumptions made by PERS. (*see*, Gov. Code, §§ 20460, 20506.) Yet small cities are strictly liable under the California Rule, as advocated by Petitioner, for reliance on a study by CalPERS. (Gov. Code, § 20831.) In the local instance, both management and labor relied upon the accuracy of the CalPERS study presented to the Legislature.

CalPERS is not a controlled entity akin to many of the pension systems of the time when the California Rule was formulated. Member agencies have no say in the governance of CalPERS yet are liable under the California Rule for their mistakes. Whether the actuarial information is conveyed to the Legislature considering new benefits or directly to a city when it is assessing a benefit request during labor negotiations under the MMBA labor negotiations, the ability to make changes to address a faulty PERS-generated actuarial study must be recognized as a reasonable option to preserve a healthy and sustainable city pension program.

The small cities do not ascribe any motive to the flawed actuarial studies, although it is tempting to cite a cause. The CalPERS Board[4], responsible for approving such studies, is dominated by retirees, representatives of employee organizations and elected officials as ex officio members who, quite naturally are inclined to favor benefit packages. (see, California Public Sector Employment Law, Ch. no. 1, Title, § 9.05 "1-9 California Public Sector Employment Law" (LexisNexis Matthew Bender) ["The Board of Administration of CalPERS is distant, remote, buffered by huge, thick layers of bureaucracy and is relatively unresponsive."].

Yet, the small cites are not urging that the cause of erroneous actuarial studies be addressed. We only argue that when any such study is demonstrably wrong – and harmful to the very existence of a public agency – that a means of taking corrective action be made legally possible.

The airtime benefit conferred by Government Code section 20909 is a graphic example of the need to correct course. The point is this: when an inaccurate actuarial study produces an outcome dangerous to the welfare of small cites – indeed to the entire benefit system – the law must provide for equitable adjustment. If nothing more, it's a simple matter of correcting a mistake in the interest of local governmental survival.

V. The Time for Change is Now

Past cases from which the California Rule evolved are no longer reliable criteria. (see, *Olson v. Cory* (1980) 27 Cal.3d 532; *Legislature v. Eu*, supra, 54 Cal.3d 492; *Allen v. Board of Administration*, supra, 34 Cal.3d.114;

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[4] The Legislature established CalPERS in 1931; it became operational in 1932, providing retirement benefits only to state employees. Over the years, the Act was amended to allow cities, counties and districts (water, fire, sanitary, transit, community service, etc.—there are hundreds and hundreds of special districts in the State, exclusive of school districts) to join CalPERS under Government Code section 20460 et seq.

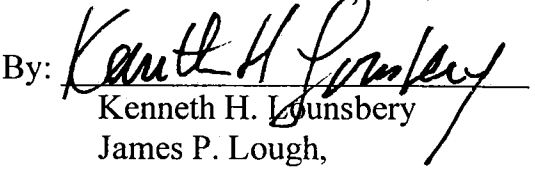
In re Retirement Cases (2003) 110 Cal.App.4th 426, 447.) The harsh standard of inflexibility is the product of a time when pension systems were run by the employer and certain benefit roll-backs were unsupported by a showing of economic necessity. Now, the CalPERS Board (as described above) sets the standards for actuarial review. Local governments no longer know what they're getting into; they have no control over the study which is the basis for a recommended benefit. It is no solution to say that any benefit, once conferred, is inviolable when the basis for its original approval is demonstrably wrong – and, not just wrong – but potentially fatal to the capability of a small city to deliver vital governmental services.

VI. Conclusion

The Opinion correctly sets aside a deeply flawed pension benefit system that has been economically crippling small cities. The Legislature properly enacted Government Code sections 7522.46 and 20909(g). The California Rule cannot, and should not, be applied to cripple the State Legislature, and bankrupt small cities, to perpetuate supposed "vested rights" established through actuarial mistakes.

DATED: February 20, 2018

LOUNSBERY FERGUSON ALTONA & PEAK, LLP

By: 

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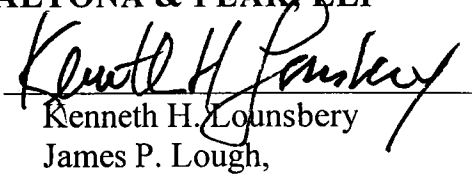
CERTIFICATE OF WORD COUNT

Pursuant to California Rules of Court, Rule 8.520(c), I certify that this Application to File Amicus Brief, and Amicus Brief of the City of Pacific Grove is proportionally spaced, has a typeface of 13 points or more, and contains 3,752 words, excluding the cover, the tables, the signature block and this certificate, which is less than permitted by the Rules of Court. Counsel relied on the word count feature of the word processing program used to prepare this brief.

DATED: February 20, 2018

LOUNSBERY FERGUSON ALTONA & PEAK, LLP

By: 

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PROOF OF SERVICE
CAL FIRE Local 2881 (formerly known as CDF Firefighters), et al.
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California Public Employment Retirement System (CalPERS)
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First District Court of Appeal Case No. A142793
Alameda County Superior Court Case No. RG12661622

I, Kathleen Day, declare that I am over 18 years old and not a party to the action. My business address is 960 Canterbury Place, Ste. 300, Escondido, California, 92025.

On, February 21, 2018 served the following documents:

APPLICATION FOR PERMISSION TO FILE AMICUS BRIEF and AMICUS BRIEF OF THE CITY OF PACIFIC GROVE

on the parties listed below/on the attached service list, in the following manner:

[X] **(BY MAIL)** I placed each such sealed envelope, with postage thereon fully prepaid for first-class mail for collection and mailing at Lounsbery Ferguson Altona & Peak LLP, Escondido, California, following ordinary business practices. I am familiar with the practice of Lounsbery Ferguson Altona & Peak LLP for collection and processing of correspondence, said practice being that in the ordinary course of business, correspondence is deposited in the United States Postal Service the same day as it is placed for collection.

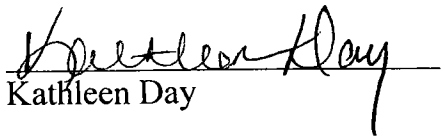
[ ] **(BY FEDERAL EXPRESS OVERNIGHT DELIVERY)** I am readily familiar with the firm's practice of collection and processing of correspondence for Federal Express delivery. Under that practice it would be deposited in a box or other facility regularly maintained by Federal Express, in an envelope or package designated by Federal Express with delivery fees prepaid.

[ ] **(BY ELECTRONIC MAIL)** I sent the documents via email addressed to the e-mail address listed above and in accordance with the Code of Civil Procedure and the California Rules of Court. I am readily familiar with the firm's practice of preparing and serving documents by e-mail, which practice is that when documents are to be served by e-mail, they are scanned in a pdf format and sent to the addresses on that same day and in the ordinary course of business.

[ ] **(BY TRUEFILING)** I hereby certify that on the below date, I electronically filed the foregoing with the Clerk of the Court using the Truefiling electronic filing system pursuant to Local Rule ___, which will send notification of such filing to the e-mail addresses denoted on the Electronic Mail notice list, and I hereby certify that I have sent the foregoing document or paper via the method indicated in this Proof of Service on the date set forth herein.

I declare under penalty of perjury under the laws of the State of California that the above is true and correct

Executed on **February 21, 2018** at Escondido, California.



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