*In the Supreme Court of the State of California*

**Alameda County Deputy Sheriffs' Association et al.,**

**Plaintiffs and Appellants,**

v.

**Alameda County Employees' Retirement Assn. and Bd. of the Alameda County Employees' Retirement Assn. et al.,**

**Defendants and Respondents,**

**and**

**The State of California,**

**Intervenor and Respondent.**

Case No. S247095

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First Appellate District, Division Four, Case No. A141913
Contra Costa County Superior Court, Case No. MSN12-1870
Hon. David B. Flynn (Ret.), Judge

# INTERVENOR AND RESPONDENT STATE OF CALIFORNIA'S ANSWER BRIEF ON THE MERITS TO THE OPENING BRIEF OF PETITIONERS ALAMEDA COUNTY DEPUTY SHERIFFS' ASSOCIATION, ET AL.

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## INTRODUCTION

Beginning in the late 1990s, under the pretext of this Court's decision in *Ventura County Deputy Sheriffs' Assn. v. Board of Retirement* (1997) 16 Cal.4th 483, the Alameda County Employees' Retirement Association (ACERA) began to ignore a longstanding limit set forth in the County Employees' Retirement Law (CERL). That statutory limit prevents employees from "spiking" their pension calculations with compensation that was not both earned and payable during the final compensation period. In violation of this limit, ACERA began to inflate employee pensions with compensation that was only payable well outside the final compensation period.

This change did not seem radical at first. ACERA had a cushion of approximately $259 million in deferred gains on its investments, employee unions advocated for the modification, and a few other CERL counties were beginning to allow the practice. Over time, however, problems emerged. Courts ruled that relying on compensation payable only outside the final compensation period was plainly contrary to CERL, and nearly every other CERL county abandoned the practice. ACERA's funding surpluses ultimately devolved into $1.7 billion of unfunded pension liability. Meanwhile, watchdog groups and the public became incensed as they learned more about not only spiking pensions with "terminal pay," but other pension-spiking practices, such as "straddling" and basing pensions on pay merely for remaining on "stand by" outside normal working hours, fomenting cynicism and distrust toward government.

As other pretexts for pension spiking fell away, employee unions insisted that one rationale at least remained solid: the 1999 post-*Ventura* settlement agreement that they had entered into with ACERA. Even if the law did not permit ACERA's various spiking practices, unions maintained that the settlement agreement (to which the State was not a party) not only

allowed those practices, but had effectively removed them from the reach of the State. The theory was that legacy employees—in this case, active employees who were hired before January 1, 2013—had acquired an irrevocable "vested right" to pension spiking, guaranteed by the state and federal Constitutions in perpetuity. Thus, even after the Governor and the Legislature enacted AB 197 to end pension spiking for good, unions—such as the Alameda County Deputy Sheriffs' Association (ACDSA) here—refused to submit. They and other unions challenged the constitutionality of the State's attempt to end abusive pension-spiking practices, on the ground that AB 197 impaired "specific promises" allegedly made within the settlement agreement.

As both the trial court and the Court of Appeal concluded, however, this claim lacks merit. While AB 197 forced ACERA to end various unlawful practices, ACERA never in fact promised employees what ACDSA claims. Indeed, the settlement agreement incorporated the language of CERL itself—including statutory language that has long been understood to unequivocally prohibit ACERA's pension-spiking practices—and specifically mandated that any promise in the agreement be interpreted "consistently with CERL." Furthermore, to the extent that the settlement agreement had promised benefits beyond what CERL permitted, such promises would clearly have been invalid under the law. It was on that basis that the court below determined that AB 197 could not have impaired any vested rights with respect to leave cashouts payable only upon retirement—a determination that no party appealed.

To push this Court to invalidate AB 197, ACDSA does not stop at invoking phantom promises within the settlement agreement. It also invokes "rules" within this Court's jurisprudence that find no actual support in the case law. From ACDSA's perspective, the State may never pass a law that has the effect of reducing a local public employee's future pension

benefits, even if the State is not in a contractual relationship with the employee and even if the reduction only applies to future, not-yet-earned compensation. Thus, according to ACDSA, from the day that an employee is hired, the State may reduce an employee's future salary, but is absolutely prohibited from doing anything over the course of the employee's career that will have the effect of even modestly reducing the rate at which the employee will accrue pension benefits *in the future*. Everything related to that employee's pension benefits—including the pensionability of an "Employee of the Month" bonus to be earned three decades in the future—is frozen permanently.

This interpretation of the contract clauses of the state and federal Constitutions is fundamentally flawed. The contract clause is not a straitjacket, divesting lawmakers of the power to protect the integrity and solvency of public pension systems; safeguard critical investments in education, infrastructure, access to justice, and affordable housing; and ensure competitive compensation for future generations of public employees. ACDSA's theory is also not consistent with the precedent of this Court, the federal courts, or even other state courts. If adopted by the Court, the unions' proposed "California Rule" would erode, and ultimately destroy, the State's power to protect and promote the welfare of its citizens.

The State respectfully requests that this Court vacate the lower court's decision and confirm that AB 197's application to legacy employees is consistent with contract clause and equity principles, without exception.

## BACKGROUND

### I. PENSIONABLE COMPENSATION UNDER CERL

In CERL systems, a member's pension benefit is calculated by the retirement board through a process set forth in statute. The board must first calculate the pensionable compensation that the employee earned during the

employee's final compensation period. That requires the board to take an employee's "compensation"—that is, "remuneration paid in cash" (Gov. Code, § 31460[1])—and determine "compensation earnable" by filtering out compensation for overtime work and other periods not based on "the average number of days ordinarily worked" by similarly situated employees. (§ 31461.) The board must then identify the "compensation earnable" received during the single, contiguous 365-day period chosen by the employee as their "final compensation" period (usually the last year of employment when salary and benefits reach their zenith). (§ 31462.1.)[2] Compensation that is payable only outside the final compensation period (for example, a payment made only upon retirement) is excluded from pensionable compensation. (See *Salus v. San Diego County Employees Retirement Ass'n* (2004) 117 Cal.App.4th 734, 739-740.)

This Court confirmed many of these principles in *Ventura*. While this Court determined that a number of items paid in cash were properly treated as pensionable (see *supra*, 16 Cal.4th at pp. 495-506), nothing in *Ventura* suggested any alteration to CERL's longstanding rules limiting pensionable compensation to compensation that is both earned and payable during the final compensation period.

## II. PENSION SPIKING IN ALAMEDA COUNTY

In April 1998, ACERA adopted a policy to implement *Ventura*. While the policy expressly promised fidelity to CERL (23 CT 6774), it was used as pretext to support a number of practices under which employees inflated their pensions beyond CERL's strict parameters. ACERA began allowing employees to include in their pensionable compensation not only

[1] All further undesignated references are to the Government Code.

[2] Some employees may be subject to a three-year final compensation period under section 31462, in which case their "final compensation" is the average of each of those final three years.

annual cashouts of unused leave, but also an additional cashout for other unused leave hours—often called "terminal pay—that was payable *only* at retirement. (23 CT 6770, 6774.) While under CERL only the first cashout was pensionable (since it reflected what was both earned and payable during the final compensation period), ACERA included *both* cashouts in pensionable compensation so long as the number of hours cashed out did not exceed the number of hours that could be accrued during the final compensation period. (23 CT 6770.) Thus, if an employee accrued 240 hours during the final compensation period and could cash out 80 hours annually, the employee could include the 80-hour cashout *as well as* a cashout at retirement for up to 160 more leave hours (equaling a total of 240 hours, since that was the number of accruable hours annually). In this way, ACERA enabled employees to inflate their final compensation with cashouts of leave often three times greater than what CERL actually permitted.

In addition, the employee could spike their final compensation by "straddling" their final compensation period over two fiscal years—for example, from July 1 of one year to June 30 of the next. Because the employee could cash out 80 hours of unused leave in *each* of the two fiscal years, straddling permitted an *additional* 80-hour cashout of unused leave from the *second* fiscal year to be included in final compensation. With both the inclusion of terminal pay and straddling, the employee could easily inflate their final compensation with cashouts of hundreds of hours of unused leave—many times more than the 80 hours which CERL actually allowed.

After ACERA's policy was adopted, questions arose about whether the policy should retroactively benefit those who had already retired, and if so, who should bear the costs. (23 CT 6771.) ACERA filed litigation seeking a declaration regarding these issues and in 1999 entered into a

settlement agreement. (23 CT 6771, 6774.) While resolving issues related to employees who had already retired, the 1999 settlement agreement merely reaffirmed the 1998 policy as to the pensionable compensation of members retiring after *Ventura*. (23 CT 6774.) The agreement also expressly called for using deferred gains on ACERA's investments to pay for the increased pension benefits. (23 CT 6776.) Employees' contributions did not change. (23 CT 6798.)

Court decisions soon confirmed that ACERA's practices were unlawful. The San Francisco County Superior Court concluded that CERL did *not* in fact allow terminal pay to be included as pensionable compensation, because such pay was not receivable during the final compensation period, but only upon retirement. (*In re Retirement Cases* (2003) 110 Cal.App.4th 426, 474 [summarizing trial court's analysis].) In 2003, the First District Court of Appeal affirmed, concluding that CERL's "language is not ambiguous." (*Id.* at p. 475.) In 2004, another court of appeal ruled that "postretirement payments for unused leave . . . are not part of an employee's final compensation within the meaning of CERL." (*Salus*, *supra*, 117 Cal.App.4th at p. 740.) That court worried that such payments would create "the risk of substantial distortion" in what pension benefits are paid to employees across CERL counties. (*Id.* at p. 741.) Other CERL counties ensured that their policies were consistent with these rulings. ACERA, in contrast, stuck with its practices.

In 2009, ACERA's current outside legal counsel advised the neighboring Contra Costa County Employees' Retirement Association (CCCERA) that *"[t]o be included in final compensation an amount must be <u>both</u> (a) earned by the member and (b) paid (or payable) to the member during the member's final compensation year."* (17 CT 4953.) Shortly afterward, CCCERA—one of the only other county systems allowing terminal pay in final compensation—formally recognized that doing so was

contrary to CERL and not compelled by *Ventura*. It ended the practice as to new employees. (17 CT 5067.) ACERA *still* refused to change its practices.

## III. AB 340 AND AB 197

In 2011, the Little Hoover Commission advised the Governor and Legislature that pension-spiking practices had become "widespread throughout local government," generating "public outrage that cannot continue to be ignored." (*Marin Association of Public Employees v. Marin County Employees' Retirement Association* (2016) 2 Cal.App.5th 674, 682, review granted Nov. 22, 2016 (S237460), quoting Little Hoover Com., Public Pensions for Retirement Security (Feb. 2011), at pp. 36, vi.)

In the face of concern over the integrity and solvency of CERL systems, the Governor and Legislature enacted AB 340 and AB 197. According to AB 340's author, California's public pension systems had been "tainted" by employees who had "taken advantage of the system," in part due to CERL's "very broad and general definition of 'compensation earnable.'" (*Marin*, *supra*, 2 Cal.App.5th at p. 682, fn. 2, quoting legislative history.) AB 340 was intended to "address these abusive practices" by "eliminat[ing]" the "ability for employees to manipulate their final compensation calculations." (*Ibid.*) AB 197, in turn, was passed soon after AB 340's enactment to further "rein in pension spiking by current members of the system to the extent allowable by court cases that have governed compensation earnable in that system since 2003." (Supplemental Clerk's Transcript 114-116.)

The two bills (together, "AB 197") preserved the prior language in the definition of "compensation earnable" as subdivision (a) of section 31461, but added new subdivisions (b) and (c). Subdivision (b) clarifies that "compensation earnable" "does not include, in any case, the following:"

- Payments determined by a retirement board "to have been paid to enhance a member's retirement benefit." (§ 31461, subd. (b)(1).)
- Payments for unused leave amounts exceeding the amount "which may be earned and payable in each 12-month period during the final average salary period, regardless of when reported or paid." (§ 31461, subd. (b)(2).)
- "Payments for additional services rendered outside of normal working hours." (§ 31461, subd. (b)(3).)
- "Payments made at the termination of employment, except those payments that do not exceed what is earned and payable in each 12-month period during the final average salary period, regardless of when reported or paid." (§ 31461, subd. (b)(4).)

Subdivision (c), in turn, clarifies that subdivision (b) is intended to codify the statutory construction of the prior version of section 31461 by the courts in *Salus* and *In re Retirement Cases*. (§ 31461, subd. (c).)

## IV. ACERA'S IMPLEMENTATION OF AB 197

ACERA's new policies to implement AB 197, effective January 1, 2013, continued to permit retiring employees to receive annual leave cashouts and terminal pay, and to incorporate those payments into their final compensation. However, the amount to be included in final compensation was capped by what was both earned and payable during the final compensation period. In practice, this meant that employees typically could include in their final compensation a cashout up to the amount of leave that under their MOU they were able to both accrue and cash out annually.

In light of AB 197's exclusion of pay for services rendered outside normal working hours, the new policy also prospectively precluded employees from including pay for standby or on-call shifts in their final

compensation. (42 CT 12336.) ACERA additionally excluded a number of pay categories from pensionable compensation under section 31461, subdivision (b)(1). (24 CT 7174; 37 CT 11017–38 CT 11054.)

In 2016, the Contra Costa County Superior Court determined that AB 197 barred straddling. ACERA has refused to change its straddling practices.

## V. THE TRIAL COURT'S DECISION

ACDSA filed a writ of mandate challenging ACERA's actions under the contract clauses of the state and federal Constitutions. ACDSA argued that ACERA's implementation of AB 197 impaired legacy employees' vested rights to include in their future pensionable compensation: (1) payments made specifically to enhance a member's pension; (2) payments for services rendered outside normal working hours; and (3) cashouts of unused vacation and sick leave, payable only upon retirement and exceeding what is both earned and payable during the final compensation period.

After ACERA declined to defend the constitutionality of AB 197, the State intervened. The action was consolidated with two similar actions in Contra Costa County and Merced County in the Contra Costa County Superior Court. In 2014, the trial court issued a final statement of decision, largely denying the petitions, but with two narrow exceptions.

With respect to leave cashouts and terminal pay, the court struggled to find any promise in the ACERA settlement agreement that had been impaired by AB 197. Ultimately, it found that AB 197 simply clarified exclusions that already existed in the law and thus did not violate any vested rights. Nonetheless, the court determined that the retirement boards in Contra Costa and Merced counties should be estopped from applying AB 197 to a small number of legacy employees. The court concluded estoppel

was not appropriate in Alameda County, however, because ACERA had never promised anything contrary to AB 197's limitations.

The court found the analysis of AB 197's other two exclusions to be less straightforward. While determining that payments for on-call shifts assumed *voluntarily* by an employee had never been pensionable, the court concluded that payments for *required* shifts might have been pensionable under certain circumstances. In the case of the latter, AB 197 potentially infringed some legacy employees' vested rights. Finally, with respect to AB 197's exclusion of pension-spiking enhancements, the court denied the petitions without prejudice, reasoning it was too early to tell if anyone's vested rights had been violated.

## VI. THE COURT OF APPEAL'S DECISION

The Court of Appeal affirmed the trial court's decision in part, reversed in part, and remanded for further proceedings. The Court of Appeal agreed with the trial court that CERL had never authorized the inclusion of leave cashouts or terminal pay in pensionable compensation beyond what AB 197 allowed. Accordingly, no vested rights as to those items were violated. (See *Alameda County Deputy Sheriffs' Association v. Alameda County Employees' Retirement Assn.* (2018) 19 Cal.App.5th 61, 100-104.) Nonetheless, the court estopped the retirement boards from applying AB 197's limitations on terminal pay to legacy employees, to the extent that those limitations conflicted with settlement agreements into which the retirement boards had entered. (See *id.* at pp. 126-129.)

With respect to the inclusion of payments for services rendered outside of normal working hours and payments made to enhance a member's retirement benefit, the court determined that legacy members had vested rights that AB 197 appeared to modify. (See *supra*, 19 Cal.App.5th at pp. 110-113.) The court then set forth legal standards to evaluate the reasonableness of detrimental changes to vested pension rights, and

remanded for further determinations in accordance with those standards. (*Id.* at pp. 123.)

On March 28, 2018, this Court granted the petitions for review filed by the State, the Central Contra Costa Sanitary District, and ACDSA.

## STANDARD OF REVIEW

"The ultimate questions of whether vested contractual rights exist and whether impairments are unconstitutional present questions of law subject to independent review. The question whether there is an impairment is a mixed question of fact and law." (*Bd. of Administration v. Wilson* (1997) 52 Cal.App.4th 1109, 1129.) The substantial evidence standard of review applies to a trial court's factual findings in granting or denying a writ of mandate. (*City of San Diego v. San Diego City Employees' Ret. System* (2010) 186 Cal.App.4th 69, 78.)

"The party asserting a contract clause claim has the burden of making out a clear case, free from all reasonable ambiguity, [that] a constitutional violation occurred." (*Deputy Sheriffs' Association of San Diego County v. County of San Diego* (2015) 233 Cal.App.4th 573, 578.) The party must also overcome the presumption in favor of a law's constitutionality, which resolves "any doubt as to the Legislature's power to act . . . in favor of the Legislature's action." (*Cal. Redevelopment Assn. v. Matosantos* (2011) 53 Cal.4th 231, 253.)

## ARGUMENT

This Court adjudicates claims under the federal and state contract clauses using the same standard. (See, e.g., *Allen v. Board of Administration* (1983) 34 Cal.3d 114, 119-125 (*Allen II*).)

Analysis of a contract clause claim involves a two-part inquiry. The first part explores "the nature and extent of any contractual obligation." (*Deputy Sheriffs' Assn.*, *supra*, 233 Cal.App.4th at p. 578, quotation marks

omitted.) Here, the threshold question is whether, before AB 197 excluded from pensionable compensation irregular ad hoc payments, payments for services rendered outside normal working hours, and excess terminal pay, legacy employees ever acquired vested rights to the future inclusion of those pay items. If legacy employees never acquired vested rights to the future inclusion of these items, then even ACDSA does not dispute that its contract clause claims fail. If, however, legacy employees acquired vested rights to items excluded from pensionable compensation by AB 197, then this Court must undertake a second inquiry into "the scope of the Legislature's power to modify" the vested rights at issue. (*Teachers' Retirement Bd. v. Genest* (2007) 154 Cal.App.4th 1012, 1027.)

ACDSA's claims fail at both stages of this analysis. While claiming that AB 197 impaired vested rights created by the settlement agreement (see ACDSA Opening Br. 31-33), the promises that ACDSA claims to exist cannot be found in either the settlement agreement or the ACERA Member Handbook (the other alleged source).

In addition, even assuming arguendo that the alleged promises could be found in the agreement or the handbook, ACDSA fundamentally misunderstands their significance. Because the alleged promises were contrary to the governing statute, they were never valid and could not have given rise to vested pension rights. And even if the prior law were unclear in some respects, the Legislature never relinquished its power to clarify the law as to the pensionability of pay items that had not yet been earned. Thus, even in the case that legacy employees were not previously barred from certain spiking practices, the lower court erred by assuming that employees had "vested rights" to spiking going forward. Neither the federal nor the state contract clause precludes altering the pensionability of pay that is yet to be earned.

Finally, even in the event that AB 197 impacted legacy employees' vested pension rights, the contract clauses still would not block the Legislature's actions here. AB 197's exclusions did not change "the basic conditions" under which legacy employees earn their pension. And the exclusions were reasonable and necessary to end abusive pension-spiking practices rampant within CERL systems. Especially because the State has not impaired any of its own financial obligations in exercising its sovereign police power, deference to the Legislature's judgment is appropriate.

# I. ACDSA FAILS TO ESTABLISH A VESTED RIGHT TO ANY OF THE PAY ITEMS AT ISSUE

## A. As a Threshold Matter, the ACERA Settlement Agreement Does Not Contain the Alleged Promises

### 1. Payments to enhance a member's benefit

ACDSA claims that the settlement agreement promises to make payments made to enhance a member's pension benefit pensionable, and that by excluding such payments from pensionable compensation under subdivision (b)(1) of section 31461, AB 197 impaired employee's vested rights. However, as a threshold matter, neither the settlement agreement nor the handbook even *address* payments made to enhance a member's pension benefit, let alone promise that such payments will be pensionable.

In support of its claim, ACDSA only cites the provision in the agreement designating as compensation earnable "incentive pay or pay premiums that recognize special duties, qualifications, or skills." (ACDSA Opening Br. 33, citing 28 CT 8096, 8099, 8108.) But these payments do not fall within the scope of subdivision (b)(1). As the language in the agreement itself notes, incentive pay and pay premiums are paid *in recognition of* "special duties, qualification, or skills." They are not "paid

to enhance a member's retirement benefit." Consequently, any promise related to these payments is unaffected by subdivision (b)(1).

This conclusion is further buttressed by the trial court's finding that nothing in the settlement agreement contemplates the pensionability of irregular, ad hoc payments made to enhance a member's pension. (See 44 CT 12881 ["A review of the settlements that occurred after the *Ventura* opinion was issued shows that it was and is generally accepted between those that negotiate pension provisions and the retirement boards that unusual payments do not qualify as 'average' compensation as defined in subsection (a) of Section 31461"].) ACDSA fails to demonstrate that subdivision (b)(1) impairs any promise in the agreement or handbook.

#### 2. Payments for services rendered outside normal working hours

ACDSA similarly fails to show that the settlement agreement or handbook promises to make payments for services rendered outside normal working hours pensionable (in conflict with subdivision (b)(3) of section 31461). Even as it repeatedly asserts that the agreement "required ACERA to include . . . on-call payments" (ACDSA Opening Br. 33), it identifies no provision in the agreement in support. Indeed, no such provision exists. As the trial court noted, "The Alameda settlement did not make specific reference to items such as 'on call pay.'" (44 CT 12878.) And ACDSA does not even attempt to identify any promise in the handbook that was impaired by subdivision (b)(3).

Furthermore, to the extent that the agreement addresses pay for services rendered outside normal working hours in any way, it *excludes* such pay from pensionable compensation. For example, the agreement includes overtime pay—that is, "pay for hours worked above forty hours per week"—in pensionable compensation *only if* "those hours are *ordinarily* worked by the employee in the employee's permanent work

assignment, mandated by the County or applicable Memorandum of Understanding." (23 CT 6770, italics added.) In other words, to be pensionable under the agreement, pay must be for time "ordinarily worked" by similarly situated employees. Pay for services rendered outside time "ordinarily worked"—that is, outside "normal working hours"—in contrast, is excluded.

Because that exclusion is consistent with both the longstanding definition of "compensation earnable" and subdivision (b)(3) more specifically, subdivision (b)(3) does not impair any promise in the agreement.

### 3. Unused leave cashouts, in excess of the amount of leave both earned and payable during the final compensation period

According to ACDSA, the most significant impairment of vested rights arises from subdivisions (b)(2) and (b)(4) of section 31461. These subdivisions generally exclude from pensionable compensation payments for unused leave that are payable only upon retirement, that is, *after* the final compensation period. ACDSA argues that such exclusions violate a promise in the settlement agreement that unused leave cashouts *payable only upon retirement* will be pensionable. (ACDSA Opening Br. 37.)

But nowhere does the settlement agreement or handbook make such a promise. To the contrary, the agreement specifically limits "final compensation" to the average "compensation earnable" of an employee "*during the period* determined to be the Member's final compensation period." (23 CT 6770, italics added.) In other words, to be "final compensation" under the settlement agreement, an item of compensation must be paid—or at least payable—"during" the final compensation period. Compensation receivable only *outside* the final compensation period cannot be final compensation.

In support of the alleged promise, ACDSA relies upon a qualifier in the agreement that states: "vacation leave and/or sick leave paid as a lump sum shall be recognized as final compensation only to the extent that it is earned during the final compensation period." (ACDSA Opening Br. 31-32, citing 23 CT 6770.) But this qualifier simply excludes from "final compensation" cashouts for unused leave "earned" outside the final compensation period, even if the cashouts are received during the final compensation period. For example, an employee might be paid a cashout during the final compensation period for years of unused leave, some of which was accrued during that period and some outside that period.

Although the cashout is paid during the final compensation period, the entire cashout is not pensionable, because some of the leave behind the cashout was accrued *outside* the final compensation period. The qualifier cited by ACDSA thus provides that only the part of the cashout reflecting leave "earned during the final compensation period" shall be "final compensation."

In no way does this qualifier negate the overarching requirement that compensation be receivable during the final compensation period. Nor does it make any reference to leave cashouts payable *only upon retirement*. Indeed, as the trial court noted, the agreement throughout its entirety "fails to specifically discuss leave cash-outs that are only payable after the final compensation period has concluded. The definition of 'final compensation' agreed to in the settlement refers to such a pay-out as 'paid as a lump sum' but is silent as to the time of payment." (44 CT 12850.)[3] In sum, contrary to what ACDSA contends, the agreement does not discuss or reference

[3] The Court of Appeal also expressed uncertainty about whether the agreement referred to any compensation payable *only* upon retirement. (*Supra*, 19 Cal.App.5th at p. 102, fn. 16.)

payments made only upon retirement, let alone promise that such payments will be pensionable.

The alleged promise is further precluded by the agreement's specific mandate that the definitions of "compensation earnable" and "final compensation" used in the agreement "be interpreted consistently with CERL." (23 CT 6769-6770; see also 23 CT 6767-6768 [ACERA is required "to calculate each Member's Retirement Allowance on the basis of his or her 'final compensation,'" as defined by CERL]; 23 CT 6774 [requiring ACERA to "apply the New Definitions to the calculation of Retirement Allowances to be paid to all Members whose effective dates of retirement occur on or after October 1, 1997" "consistent[ly] with CERL"].) That is because CERL has always excluded from pensionable compensation leave cashouts that are payable *only* upon retirement. (*Alameda County*, *supra*, 19 Cal.App.5th at p. 103 ["even prior to [AB 197], the plain language of CERL excluded terminal pay from compensation earnable for pension purposes"].) As the Court of Appeal recognized, "CERL has always required that compensation must be *payable* during the final compensation period to be included in compensation earnable." (*Id.* at p. 102.) Consequently, the explicit instruction within the agreement to interpret its terms "consistently with CERL" forecloses any interpretation that would treat cashouts payable only upon retirement as "final compensation," contrary to CERL.[4] ACDSA's repeated insistence of such a "promise" within the agreement lacks merit.

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[4] Even in the absence of the parties' explicit direction, the definitions in the agreement would need to be interpreted "consistently with CERL," because "all applicable laws in existence when an agreement is made . . . necessarily enter into the contract and form a part of it." (*City of Torrance v. Workers' Comp. Appeals Bd.* (1982) 32 Cal.3d 371, 378.)

ACDSA's claim that the handbook contains such a promise is similarly unavailing. ACDSA points to provisions in the handbook that "advised members they could include vacation cash outs in the compensation used to calculate their benefits" and "encouraged members to use vacation accruals to get the most out of their retirement benefits." (ACDSA Opening Br. 34.) But even if statements to that effect constituted legally enforceable contractual promises (and they do not), they are perfectly consistent with subdivisions (b)(2) and (b)(4), which *permit* unused leave cashouts to be included in pensionable compensation, so long as they are equivalent to the amount payable during the final compensation period and only reflect leave earned during that period.

To be sure, there are statements in the handbook suggesting that cashouts for unused leave received at retirement can in some cases be included in final compensation. But nothing in the handbook promises that leave cashouts payable *only* at retirement will be pensionable, as ACDSA argues. Moreover, even if the handbook made such a promise (which it does not), there would still be no necessary conflict with AB 197. Subdivision (b)(4) allows "[p]ayments made at the termination of employment" to be pensionable so long as such payments "do not exceed what is earned and payable in each 12-month period during the final average salary period."[5] Nothing in the handbook promises members that cashouts at retirement can be included in final compensation *in excess of* what is earned and payable during the final compensation period. In other

[5] In rare cases, an employee may elect during the final compensation period to cash out the amount of unused leave permitted annually under the employee's MOU, but not actually receive the cashout itself until retirement. (17 CT 4937.) The cashout would thus be a "payment made at the termination of employment," but still be treated as pensionable because it was *payable* during the final compensation period and only reflects leave earned during that period.

words, there is no necessary conflict between the handbook and subdivision (b)(4).

Finally, to the extent that there is ambiguity in any of the handbook's provisions, the handbook expressly advises members at the very beginning of the handbook (under a section prominently entitled "IMPORTANT LEGAL DISCLAIMER") that those provisions should be understood consistently with CERL, and that CERL will always govern a member's benefits. (24 CT 7094 ["If conflict arises between this handbook and the CERL, the decision will be based on the CERL . . . and not on information contained in this handbook"]; see also 24 CT 7099 [stating that ACERA administers "the pension plan in accordance with the CERL," and performs its duties "in accordance with the CERL"]; 24 CT 7165 [defining "vested benefits" as only those "guaranteed under the 1937 Act County Employees Retirement Law"].) The handbook further advises members that "[t]he laws governing public retirement systems are complex"; that "[n]o statement in this handbook is a legally binding interpretation, enlargement, or amendment of the provisions in the CERL"; and that "[t]he information presented in this handbook should not be construed as legal advice or as a legal opinion on specific facts." (24 CT 7094.) Just as in the case of the settlement agreement, ACDSA's attempted reliance on the handbook to modify or enlarge CERL's provisions is foreclosed by the handbook's own terms.

### B. Because the Alleged Promises Have Always Been Contrary to Law, They Would Be Invalid in Any Event

Even assuming arguendo that the promises alleged to have been made by ACERA could be found in either the settlement agreement or the handbook, they would not establish vested pension rights.

In a system established under CERL, vesting is only possible where CERL itself creates an entitlement to a particular pension benefit. (See

*Medina v. Board of Retirement* (2003) 112 Cal.App.4th 864, 871.) Where the statute excludes a pay item from pensionable compensation, retirement boards have no authority to enlarge the scope of the statute or create an exception. (*City of San Diego v. Haas* (2012) 207 Cal.App.4th 472, 495 ["only the [legislative body] has the power to grant employee benefits, and [the board] exceeds its authority when it attempts to 'expand pension benefits' beyond those the [legislative body] has granted"]; *Oden v. Bd. of Admin.* (1994) 23 Cal.App.4th 194, 201 ["public agencies are not free to define their employee contributions as compensation or not compensation . . . the Legislature makes those determinations"].) As a result, any promises of benefits "inconsistent with" CERL do not establish vested pension rights. (*Alameda County, supra,* 19 Cal.App.5th at p. 105.)

ACDSA does not dispute that no vested pension rights could have arisen here that were inconsistent with CERL. Instead, it argues that the inclusion of the pay items in pensionable compensation *was* consistent with CERL. However, it fails to address any of the lower court's arguments regarding the exclusion of terminal pay, or support its argument with relevant authority.

**1. Payments to enhance a member's pension benefit and payments for services rendered outside normal working hours**

The Court of Appeal did not address the issue of whether ACERA specifically promised legacy employees the pay items excluded under subdivisions (b)(1) and (b)(3). However, the court concluded that, had those specific items been promised, their inclusion in pensionable compensation may have been allowed under pre-AB 197 law. The State has appealed this decision and urges the Court to reverse.

As discussed more extensively in the State's Opening Brief, the payments made to enhance a member's pension addressed by subdivision

(b)(1) are much narrower in scope than what the Court of Appeal understood. (State's Opening Br. 28-30.) When the scope of subdivision (b)(1) is properly construed, it is clear that CERL never contemplated treating the payments targeted by the statute as pensionable. (*Id.* at pp. 31-32.) Any alleged promise was therefore contrary to law.

As further discussed in the State's Opening Brief, the Court of Appeal also erred in holding that some payments for services rendered outside normal working hours—those for "on-call duty that is part of an employee's regular work assignment—were pensionable before AB 197. (State's Opening Br. 37-40.) They were not. The operative test set forth in the pre-AB 197 law was always whether a given pay item was based on "the average number of days ordinarily worked by persons in the same grade or class of positions during the period." (Former § 31461.) The term "'[o]rdinarily' in its customary usage means normally." (*O'Bryan v. Superior Court of Los Angeles County* (1941) 18 Cal.2d 490, 500-501.) Thus, CERL always looked at whether a pay item was based on the time "normally" worked by similarly-situated employees, and if it was not, excluded it from pensionable compensation.

The pre-AB 197 law never distinguished, as the Court of Appeal did, between pay for standby shifts voluntarily assumed by an employee and pay for other types of standby shifts that are "part of [the employee's] regular work assignment." Moreover, the lower court never explained why CERL allegedly treated pay for simply "standing by" outside normal working hours (i.e., *not* working) *more* advantageously than pay for *working* overtime. Nor did the two cases cited by the court support its reasoning. Indeed, in *Shelden v. Marin Cty. Employees Ret. Assn.* (2010) 189 Cal.App.4th 458, 463-464, the court held that the overtime pay at issue was *not* pensionable under CERL precisely because the overtime was outside of the employee's "normally scheduled or regular working hours."

For these reasons, any promise to nonetheless include standby or on-call pay in final compensation would have been inconsistent with CERL and therefore invalid.

#### 2. Unused leave cashouts, in excess of the amount of leave both earned and payable during the final compensation period

Unlike in the case of the pay items excluded by subdivisions (b)(1) and (b)(3), the Court of Appeal agreed with the State and Sanitary District that CERL always prohibited including leave cashouts payable only upon retirement. And because "terminal pay was never pensionable under CERL" (*supra*, 19 Cal.App.5th at p. 123), the court concluded that ACDSA and other unions could not establish a vested right to leave cashouts payable only at retirement, regardless of whatever had been promised. (See *id.* at pp. 102-105.)

Neither ACDSA nor any other party appealed that aspect of the Court of Appeal's decision in a petition for review in this Court or in an answer to one of the petitions. Accordingly, it is "not properly before" the Court. (*People v. Villa* (2009) 45 Cal.4th 1063, 1076; see Cal. Rules of Court, rule 8.516.) However, should the Court decide to reach the issue, it should affirm the lower court's conclusion, which is consistent with the conclusions of the two other appellate panels to look at the issue.

ACDSA relies on a tortured reading of CERL and the case law to argue that including terminal pay in final compensation was consistent with CERL. According to ACDSA, the inclusion of terminal pay was never *required* under CERL, but prior case law never foreclosed the possibility that ACERA *could* include it. (ACDSA Opening Br. 28.) However, as recognized by the Court of Appeal, as well as by the courts in *In re Retirement Cases* and *Salus*, the plain language of CERL has *always* clearly prohibited the inclusion of terminal pay, to the extent it was payable only at

retirement. "Pursuant to section 31461, compensation earnable is 'the average compensation . . . for *the period under consideration* (italics added) and that period . . . plainly excludes compensation that is not earned and payable prior to retirement." (*Alameda County*, *supra*, 19 Cal.App.5th at p. 103.) Thus, any cashouts only payable at separation or retirement are not pensionable. (*In re Retirement Cases*, *supra*, 110 Cal.App.4th at p. 475 [CERL's definition of "final compensation" "is not ambiguous; it plainly excludes [payments at] retirement and we will not rewrite the statute"]; *Salus*, *supra*, 117 Cal.App.4th at p. 740 [post-retirement payments for unused leave "are not part of an employee's final compensation within the meaning of CERL"].) That is why, even before AB 197's enactment, 18 of the 20 CERL counties understood that CERL did not permit the inclusion of such payments.

ACDSA fails to address any of these points. Instead, it points to various statutory provisions and case law that in no way address the pensionability of terminal pay. Section 31460.1 was a statute authorizing counties to exclude from pensionable compensation employer payments for flexible benefit programs. (Stats. 1990, ch. 142 (AB 3146), § 1.) It was later repealed and did not address terminal pay.

ACDSA further cites two statutory provisions that it concedes have never applied to ACERA members. (ACDSA Opening Br. 29-30.) Section 31461.1 extends authorization to Los Angeles County to exclude cafeteria and flexible benefit plan contributions, should the board of supervisors decide to do so. And section 31461.45 lists various pay items to be included in pensionable compensation, pursuant to a settlement agreement. Contrary to what ACDSA suggests, none of the items discussed are leave cashouts payable *only* upon retirement. And even if they were, section 31461.45 would show only that the Los Angeles County Employees' Retirement System needed specific legislative authorization in order to

enter into a settlement agreement inconsistent with CERL, and obtained it. ACERA, in contrast, never obtained similar legislative authorization.

ACDSA's broader argument appears to be that, while certain pay items must be treated as pensionable under CERL, the statute authorizes retirement boards to add any further pay items at their discretion. As the Court of Appeal recognized, this theory "quite simply . . . makes no sense given the plain language of CERL." (*Supra*, 19 Cal.App.5th at p. 94.) "[T]he language of CERL does not suggest a statutory structure setting forth a threshold for compensation earnable, while allowing additions at the discretion of the board beyond those required minimums." (*Id.* at p. 95.) "If CERL boards nevertheless possessed expanded discretion under *Guelfi* to include terminal pay in compensation earnable, such discretion would be in direct contravention of the CERL statutes defining final compensation." (*Ibid.*)

Again, ACDSA fails to address the lower court's analysis in any way. And it struggles to muster case authority in support of its theory, citing just three cases, two of which have nothing to do with pension law. *Howard Jarvis Taxpayers' Assn. v. Board of Supervisors* (1996) 41 Cal.App.4th 1363 is the only pension case, but the point relied upon by ACDSA is mere dictum that relies on *Guelfi*, which was overruled by this Court in *Ventura*.

In sum, "even prior to [AB 197], the plain language of CERL excluded terminal pay from compensation earnable for pension purposes." (*Alameda County, supra*, 19 Cal.App.5th at p. 103.) Any promise to treat cashouts payable only upon retirement as "final compensation" would have been contrary to CERL, and therefore invalid. (*Retired Employees Assn. of Orange County, Inc. v. County of Orange* (2011) 52 Cal.4th 1171, 1181 ["the law does not recognize implied contract terms that are at variance with the terms of the contract as expressly agreed or as prescribed by statute"].) That, in turn, is fatal to ACDSA's vested rights argument.

(*Medina*, *supra*, 112 Cal.App.4th at p. 871; see also *City of Huntington Beach v. Board of Administration* (1992) 4 Cal.4th 462, 472 ["Clearly, the jailers in this case have no vested right in previous erroneous classifications by the PERS Board"].)[6]

### C. Employees Did Not Contribute Toward the Benefits, But Even If They Had, Such Contributions Would Not Have Created Vested Pension Rights

Notwithstanding CERL's limitations, ACDSA claims that its employees have a right to the inclusion of leave cashouts payable only at retirement because "ACERA members' contribution rates reflected the cost of the increased terminal pay, including leave cashouts." (ACDSA Opening Br. 36.) This claim also lacks merit. As a threshold matter, ACDSA's assertion that employees contributed toward the cost of terminal pay is contradicted by the record. Yet, even if the assertion were true, ACDSA's theory reflects a basic misunderstanding of how public pensions under CERL work, and should be rejected.

#### 1. The record does not support ACDSA's assertion

ACDSA's claim that employees made additional contributions specifically to pay the costs of terminal pay is contradicted by the settlement agreement itself. Under the agreement's terms, employees do not have to make any additional contributions. Instead, under a provision with the heading "Payment for Increased Benefits," the agreement provides that "the financial obligation to be incurred by [ACERA] to pay the

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[6] ACDSA makes much of the fact that the settlement agreement was "court-approved." (ACDSA Opening Br. 31, 33.) But any portion of a settlement agreement that violates state law is not effective, even when a court has approved the agreement at issue. (See *Summit Media LLC v. City of Los Angeles* (2012) 211 Cal.App.4th 921, 934-937.) And the State was never a party to the agreement.

increases in Retirement Allowances contemplated by [the settlement agreement]" is to "be met . . . by the immediate recognition by [ACERA] of approximately two hundred and fifty-nine million dollars ($259,000,000) in deferred gains on [ACERA's] investments." (23 CT 6776.) Furthermore, in the future, only changes in "the rate at which *the County* would otherwise make Contributions to [ACERA]" are contemplated. (23 CT 6776, italics added.) ACERA's actuary confirmed the absence of any additional employee contributions. (23 CT 6798 [estimated cost impact of the proposed settlement agreement "reflect[s] no increase in member basic rates"].)

ACDSA offers several record cites, but none show that employees ever made additional contributions. ACDSA's citation to a 2011 "Review of Non-economic Actuarial Assumptions" (ACDSA Opening Br. 36) shows only that by the late 2000s ACERA's actuaries had developed "an actuarial assumption to anticipate [terminal pay's] impact on a member's retirement benefit." (23 CT 6854.) It does not indicate whether employers or employees ever contributed specifically toward terminal pay.[7] ACDSA also cites to a 2009 ACERA report describing employee and employer contribution rates. (ACDSA Opening Br. 36, citing 25 CT 7652.) However, the notes do not reference terminal pay, and provide no indication whether anyone is specifically contributing toward its pensionability. Two other citations to the record have nothing to do with

[7] The Court of Appeal noted that the costs of including terminal pay appeared to be "actuarially accounted for." (*Supra*, 19 Cal.App.5th at p. 127.) But this only means that the estimated costs were recognized, not that the liabilities were actually *funded*. Immediately before AB 197's effective date, a quarter of ACERA's "actuarially accounted-for" liabilities were *unfunded*. (See Segal Company, *Actuarial Valuation and Review as of December 31, 2012* (2013) p. iii <https://www.acera.org/sites/main/files/file-attachments/actuarial_valuation_report_2012.pdf> [as of July 19, 2018].)

ACERA and instead are about *CCCERA*. (ACDSA Opening Br. 36, citing 20 CT 5854, 25 CT 7462.)

Finally, ACDSA cites an ACERA board resolution that, in turn, references an outside recommendation that ACERA collect "appropriate" employee contributions on additional items of compensation in the aftermath of *Ventura*. (ACDSA Opening Br. 36, citing 28 CT 8099.) However, the April 8, 1999 resolution *pre-dates* the settlement agreement, which was executed on June 4, 1999. And as the settlement agreement itself suggests, the "recommendation" referenced in the April 8, 1999 resolution proved controversial and was not adopted. (See 23 CT 6771-6772 [discussing controversy over employee contributions].) Instead, ACERA decided to pay for the pensionability of terminal pay through deferred investment gains. (23 CT 6776.) In sum, ACDSA's basic premise that employees specifically contributed toward the costs of increased terminal pay lacks support in the record.

**2. Under CERL, employee contributions do not determine vested pension rights**

Even if ACDSA could show that employees or employers contributed toward the costs of increased terminal pay, such contributions would not support the establishment of vested pension rights inconsistent with CERL. Contributions do not determine vested pension benefits under CERL. (See *In re Retirement Cases*, *supra*, 110 Cal.App.4th at pp. 453-454 [holding that, even though members may have made contributions as if a different legal scheme were in effect, the only pension to which they were entitled was the one under the correct law].) Thus, even when a contribution rate is calculated incorrectly, it has no impact on the pension benefits to which employees are entitled. (*Ibid.*) A CERL employee only acquires "a right to a pension to be calculated *as mandated by CERL*." (*Id.* at p. 453, italics added; see also *Claypool v. Wilson* (1992) 4 Cal.App.4th 646, 662 ["The

contractual basis of a pension right is the exchange of an employee's services for the pension right *offered by the statute*," italics added].) That is also what employees here were told. (24 CT 7106 ["Employee contribution rates are set by law. . . . Increasing your contributions will *not* increase the benefit available to you at retirement," italics added].)

ACDSA ignores *In re Retirement Cases*, which addresses this specific issue, and instead relies solely upon *Pasadena Police Officers Assn. v. City of Pasadena* (1983) 147 Cal.App.3d 695. But that case is inapposite. It concerns retirees who, in retirement, elected to opt-in to a new statutory system for the calculation of their pension. Since they were already retired, they had not exchanged their labor for the new system's benefits, raising a question about whether their election into the new system had created a binding contract. (See *id.* at pp. 706-707.) The court held that because the retirees had relinquished benefits to which they had been statutorily entitled in favor of new statutory benefits, they satisfied the requirement that they provide consideration and created a binding contract. (*Id.* at p. 707.)

That analysis has no application here. Unlike in *Pasadena Police Officers*, the employees here never had a statutory right to opt-in to a non-CERL system for calculating their pension. Nor were the "alternative" benefits here ever statutorily authorized, as they were in *Pasadena Police Officers*.

## II. EVEN ASSUMING THERE WERE VESTED RIGHTS, THEY CONTAINED AN IMPLIED QUALIFICATION THAT THE LEGISLATURE MAY MODIFY THE SYSTEM FOR FUTURE PAY ITEMS NOT YET EARNED

Even if CERL did not previously bar all of the spiking practices now prohibited under AB 197, those provisions still could not have impaired any vested rights, because they only operate prospectively. (See *Marin*, *supra*, 2 Cal.App.5th at p. 708 ["The Legislature's change to the definition of compensation earnable was expressly made purely prospective by [AB

197]"].) Significantly, AB 197 does not affect the pension of anyone who retired before its effective date. Nor does it *retroactively* re-characterize the pensionability of any item that was earned and already included in an employee's final pensionable compensation before AB 197's effective date.

The Court of Appeal erred by disregarding AB 197's prospective character and simply *assuming* that AB 197 impaired vested rights. Believing spiking enhancements and certain standby payments were pensionable before AB 197, the court assumed that legacy employees automatically acquired vested rights to the inclusion of those payments in their *future* pensionable compensation, even if the payments have not yet been earned. (See *supra*, 19 Cal.App.5th at pp. 113, 122-123.) But no analysis of "the nature and extent of any contractual obligation" was done. (*Deputy Sheriffs' Assn.*, *supra*, 233 Cal.App.4th at p. 578.) Nor did the court provide any explanation for where such rights came from or how they were established.

In fact, as demonstrated above, ACERA never promised to provide the excluded benefits, as alleged by ACDSA. And it certainly never purported to guarantee employees the pensionability of those pay items in perpetuity, regardless of legislative changes. Rather, ACERA promised—and employees agreed—"to have their 'compensation earnable' and 'final compensation' *calculated pursuant to CERL*." (*In re Retirement Cases*, *supra*, 110 Cal.App.4th at pp. 453-454, italics added; 23 CT 6769-6770, 6774 [requiring "definitions of 'compensation earnable' and 'final compensation'" adopted in ACERA's policies and settlement agreement "to be interpreted consistently with CERL"].) Repeatedly and consistently, ACERA reinforced this understanding by advising employees that CERL's provisions would ultimately govern the calculation of their pension. (E.g., 24 CT 7094 ["If conflict arises between this handbook and the CERL, the decision will be based on the CERL"].)

CERL, in turn, "is subject to the implied qualification that the [Legislature] may make modifications and changes in the system." (*Miller v. State of California* (1977) 18 Cal.3d 808, 816; *Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 855.) The Legislature has never relinquished its "essential powers" to regulate county retirement systems (*Retired Employees*, *supra*, 52 Cal.4th at p. 1189), and in fact has exercised this power repeatedly to modify the parameters of the definition of pensionable compensation applying to active employees. (See, e.g., *Ventura*, *supra*, 16 Cal.4th at pp. 504-505 [discussing amendments in 1951, 1972, and 1993]; see also § 31461.5 [enacted in 1998 to clarify that "salary bonuses and any other compensation incentive payment" were not pensionable]; § 31461.6 [enacted in 2000 to clarify when overtime pay is pensionable].) Any policies regarding pensionable compensation were therefore "structured against the background of" this very extensive legislative regulation. (*Energy Reserves Group, Inc. v. Kansas Power and Light Co.* (1983) 459 U.S. 400, 416.) No policy was exempt from compliance with CERL *and its amendments*, and legacy employees understood that when they reached their final compensation period, the definition of pensionable compensation in effect would govern the calculation of their pension. (See *U.S. Trust Co. of New York v. New Jersey* (1977) 431 U.S. 1, 22 ["One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the State by making a contract about them," quotations omitted].)

That legacy employees lacked vested rights to the pensionability of future compensation is also consistent with well-established contract clause principles. The contract clauses generally do not protect public employees' rights to future items of compensation, which have not yet been earned through service. (See *United States v. Larionoff* (1977) 431 U.S. 864, 879 [prospective reductions of pay do not violate the Contract Clause, "even if that reduction deprived members of benefits they had expected to be able to

earn"]); *Taylor v. City of Gadsden* (11th Cir. 2014) 767 F.3d 1124, 1135 ["before a public employee renders services, the amount of promised compensation can be freely amended"].)

The unions' theory gets the logic behind vested pension rights backwards. Under the theory of vested pension rights, it is the performance of a service that "earns" compensation, and gives rise to a vested right to payment of deferred compensation for that service. (See *Miller*, *supra*, 18 Cal.3d at p. 815.) So where an employee has not yet provided a service, the employee could not possibly have earned any compensation (deferred or otherwise) for that service. The unions, in contrast, insist that the right to deferred compensation for a service may *precede* the actual performance of that service, and thereby block the Legislature from modifying the terms of compensation earned in the future for that service.

If accepted, the unions' proposed rule "would be a significant, unprecedented change that goes beyond any known theory of deferred compensation." (Monahan, *Statutes as Contracts? The "California Rule" and Its Impact on Public Pension Reform* (2012) 97 Iowa L. Rev. 1029, 1061.) The unions' theory is also inconsistent with the well-established "unmistakability" doctrine. Here, the Legislature has never so much as *suggested* relinquishing its sovereign power to modify the terms of future compensation, let alone expressed such an intent "clearly and unequivocally." (*Retired Employees*, *supra*, 52 Cal.4th at p. 1185.)

Finally, the unions' theory is not supported by this Court's jurisprudence. None of the cases cited by ACDSA address the issue of whether the Legislature can adjust the pensionability of a specific pay item before it is earned during the final compensation period. *Legislature v. Eu* (1991) 54 Cal.3d 492, is the lone case dealing with a purely prospective change to legacy employees' vested rights, but it does not support the unions' position. That case addressed the prospective *termination* of all

pension rights, and held that, to protect an employee's vested right from complete divestment, an employee may in some circumstances have a vested right to earn additional pension benefits through continued service. (See *id.* at pp. 530-532.) However, nothing in *Eu* holds that that an employee has a vested right to earn such additional benefits based on the continuation of every single term fixed in a statute until the employee retires. Even the employees in *Eu* did not take such an extreme position, which would conflict with this Court's allowance that "the amount, terms and conditions of [active employees' pension] benefits may be altered" (*Kern, supra*, 29 Cal.2d at p. 855) in order to adjust to "changing conditions" and "maintain the integrity of the system." (*International Assn. of Firefighters v. City of San Diego* (1983) 34 Cal.3d 292, 300.) The *Eu* employees asked only for recognition of the right "to earn future pension benefits though continued service, on terms *substantially equivalent* to those then offered." (54 Cal.3d at p. 528, italics added.) That standard is easily satisfied here, as there has been no change to the defined benefit formula, the longstanding "earned" and "payable" requirements, or the ability to include in pensionable compensation a wide variety of pay items.

Flexibility with respect to the pensionability of future remuneration for future service is consistent with the approach of not only this Court and the federal courts, but also state courts outside California that have addressed this issue. (See, e.g., *Moro v. State* (Or. 2015) 351 P.3d 1, 37 [rejecting claim that pension benefits cannot be "changed prospectively . . . for work that is yet to be performed"]; *AFT Michigan v. Michigan* (Mich. 2014) 846 N.W.2d 583, 594 [legislature "may properly attach new conditions for earning financial benefits which have not yet accrued"]; *Scott v. Williams* (Fla. 2013) 107 So.3d 379, 388-389 [legislature has authority "to amend a retirement plan prospectively, so long as any benefits tied to service performed prior to the amendment date are not lost or

impaired"].) Such flexibility is also consistent with basic notions of fairness. No unfairness or detrimental reliance arises when employees understand the non-pensionability of a payment *before* performing the service earning that payment.

By simply *assuming* that legacy employees had acquired vested rights to the future pensionability of spiking enhancements and standby pay not yet earned through services rendered, the lower court embraced a dangerously expansive theory of vested rights that threatens to divest legislative bodies of the power to address the deepening crisis of unfunded pension liabilities. Absent explicit promises, neither the federal nor state contract clause protects a right to the pensionability of un-accrued compensation. To avoid further "limit[ing] drastically the essential powers" of the elected branches (*Retired Employees*, *supra*, 52 Cal.4th at p. 1185), this Court should reverse the lower court.

## III. EVEN ASSUMING THERE WERE VESTED RIGHTS IMPAIRED BY AB 197'S EXCLUSIONS, THE EXCLUSIONS WERE PERMISSIBLE UNDER THE CONTRACT CLAUSES

Even assuming arguendo that AB 197 impacted legacy employees' vested rights to the pensionability of certain ad hoc and standby payments,[8] it would not follow that the statute violated the contract clause of the state or federal Constitution.

This Court has repeatedly noted that "[n]ot every change in a retirement law constitutes an impairment of the obligation of contracts . . . . Nor does every impairment run afoul of the contract clause." (E.g., *Allen II*, *supra*, 34 Cal.3d at p. 119.) The constitutional prohibition against impairing contracts "is not an absolute one and is not to be read with literal

[8] ACDSA's impairment argument is mostly about terminal pay. However, the Court of Appeal ruled there was no vested right to the pensionability of terminal pay, and ACDSA did not preserve the issue.

exactness like a mathematical formula." (*Ibid.*, quotations omitted.) Rather, it should always be "construed in harmony" with "the principle of continuing governmental power" (*id.* at p. 120), including "the essential attributes of sovereign power necessarily reserved by the States to safeguard the welfare of their citizens." (*U.S. Trust*, *supra*, 431 U.S. at p. 21.)

Disregarding these principles, the Court of Appeal remanded to the trial court to conduct a "systematic vested rights analysis" that would evaluate the impact of AB 197's exclusions on legacy employees "in the context of each county's particular CERL system." (*Supra*, 19 Cal.App.5th at p. 123.) In so doing, the court entirely ignored a threshold issue that, properly analyzed, would have obviated remand. That issue is the severity of the alleged impairment, which is fundamental because it "measures the height of the hurdle the state legislation must clear." (*Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 830, quotations omitted.) Severe impairment "will push the inquiry to a careful examination of the nature and purpose of the state legislation." (*Allied Structural Steel Co. v. Spannaus* (1978) 438 U.S. 234, 245.) "Minimal alteration of contractual obligations may end the inquiry at its first stage." (*Allen II*, *supra*, 34 Cal.3d 114, 119, quotations omitted.)

The Court of Appeal erred by failing to consider this threshold issue. Compounding its error, the Court of Appeal advised the trial court on remand to subject any impairment to heightened scrutiny, without regard to the impairment's severity, and to look upon "relatively modest" modifications as strongly suggestive of unconstitutional impairment. (*Supra*, 19 Cal.App.5th at p. 123.) This Court should reverse. To the extent that AB 197's exclusions affected vested rights, they were no more than a minimal alteration.

### A. AB 197's Exclusions Did Not Rise to the Level of Substantial Impairment

ACDSA recognizes that there is an initial severity threshold that must be satisfied before analyzing the reasonableness of any impairment. (ACDSA Opening Br. 37.) However, it fails to meet that threshold. ACDSA's argument that AB 197 substantially impaired legacy employees' vested pension rights largely rests on its assumption that, before AB 197's enactment, legacy employees had a vested right to the inclusion in their pensionable compensation of leave cashouts payable only upon retirement. (*Ibid.*)[9] But, as discussed above, the Court of Appeal rejected this assumption and held that legacy employees never acquired such a vested right. At the petition for review stage, no party sought to disturb the Court of Appeal's determination on this issue.

The only pay items that the Court of Appeal concluded may have been includible in legacy employees' pensionable compensation before AB 197 were payments made specifically to enhance a member's pension benefit and payments for on-call services provided by an employee as part of the employee's regular work assignment. (*Supra*, 19 Cal.App.5th at p. 122.) Assuming arguendo that ACERA promised the inclusion of these

[9] The only evidence offered by ACDSA in support of a "significant[] reduc[tion]" of legacy employees' pension benefits are two non-expert employee declarations found nowhere in the Clerk's Transcript. (ACDSA Opening Br. 15.) These declarations are riddled with inaccuracies and false assumptions. Both declarants assumed that they would be forced to retire in 2014 if AB 197 went into effect, and then grossly inflated their estimates of how much their pensions would be reduced by imagining a pension based on continuing to work for several more years (and "after three annual salary adjustments" in the future) and comparing it with the pension that they were told by vague, unnamed individuals they would receive if they retired immediately. Consequently, most of the estimated "reduction" has nothing to do with AB 197's provisions. In addition, the estimates erroneously assumed that AB 197 excludes *all* leave cashouts from pensionable compensation.

items to employees and that the Court of Appeal did not err in holding that such promises were consistent with CERL, the exclusion of these pay items would not have risen to the level of substantial impairment.

As this Court has repeatedly noted, until a pension becomes payable, an "employee does not have a right to any fixed or definite benefits but only to a substantial or reasonable pension." (*Betts v. Board of Administration* (1978) 21 Cal.3d 859, 863; *Miller, supra*, 18 Cal.3d at p. 816.) That right to a substantial or reasonable pension is not "rigidly fixed by the specific terms of the legislation in effect during any particular period in which [they] serve." (*Kern*, supra, 29 Cal.2d at p. 855.)

Applying these principles in *Packer v. Board of Retirement* (1950) 35 Cal.2d 212, 218-219, this Court upheld the constitutionality of statutory modifications of active peace officers' vested pension rights. Among other changes, the amendments substantially narrowed the circumstances under which a peace officer's widow or children could receive a pension (*id.* at p. 213), and lowered the defined pension benefit payable in cases where a peace officer's retirement "resulted from a nonservice disability" (*id.*at pp. 218-219). Nonetheless, the Court concluded that these changes did not amount to an unconstitutional impairment because "the basic conditions under which a county peace officer could obtain a pension were substantially unchanged." (*Id.* at p. 218.) Taking into account "the total value of all pension rights," the Court determined that it was "reasonably clear" that peace officers "retained rights to substantial pension benefits." (*Id.* at p. 219.)

This analysis is instructive here. That legacy employees can no longer on a prospective basis increase their pensions with ad hoc spiking enhancements or pay for standby shifts related to their regular work assignments did not meaningfully alter "the basic conditions" under which they could earn a pension. Under AB 197, pensionable compensation still

includes base salary, limited cashouts of unused leave, and premium payments. Compensation both earned and payable during the final compensation period continues to be pensionable. And both the definition of the final compensation period and the defined benefit formula applicable to legacy employees remain the same. In sum, the alleged modifications at issue here are different in kind from those in *Allen v. City of Long Beach* (1955) 45 Cal.2d 128 (*Allen I*), *Betts*, or *Eu*, all of which involved radical changes to active employees' defined benefit formulas. Here, legacy employees "retained rights to substantial pension benefits," even more so than the officers in *Packer*. And to the extent that there were changes, they were "mild," and "hardly burdensome" for legacy employees. (*City of El Paso v. Simmons* (1965) 379 U.S. 497, 516.)

The Legislature's amendments to CERL were also consistent with legacy employees' reasonable expectations. As discussed above, legacy employees "agreed to have their 'compensation earnable' and 'final compensation' calculated pursuant to CERL." (*In re Retirement Cases*, *supra*, 110 Cal.App.4th at pp. 453-454.) Because CERL "is subject to the implied qualification that the [Legislature] may make modifications and changes in the system" (*Kern*, *supra*, 29 Cal.2d at p. 855), and has in fact been amended repeatedly over the years, any assumption that the definition of pensionable compensation was immutable was not reasonable. (*Miller*, *supra*, 18 Cal.3d at p. 816 ["pension rights are not immutable"]; *Kern*, *supra*, 29 Cal.2d at p. 855 ["the amount, terms, and conditions of benefits may be altered"].) Particularly where alterations to that definition were modest, that should end the inquiry. (See *Allen II*, *supra*, 34 Cal.3d at p. 124 ["Laws which restrict a party to those gains reasonably to be expected from the contract are not subject to attack under the Contract Clause, notwithstanding that they technically alter an obligation of a contract,"

quotations omitted.]). The lower court erred in instructing the trial court otherwise.

### B. ACDSA's "California Rule" Argument Misconstrues This Court's Precedent

Were this Court to determine that AB 197's exclusions amounted to a substantial impairment of legacy employees' vested rights, ACDSA claims the impairment would have been unconstitutional because the State failed to provide any new comparable advantages. According to ACDSA, in *Allen I*, this Court announced "the California Rule," categorically *requiring* any impairment of a vested pension right to be offset by comparable new advantages. (ACDSA Opening Br. 39.) On the ground that legacy employees had vested rights to the pensionability of spiking enhancements, all standby pay, and terminal pay, ACDSA insists that AB 197's exclusions are subject to a test for "comparative advantages," fail that test, and thus violate the contract clause. (*Id.* at p. 52.)

As the Court of Appeal and other appellate panels have recognized, however, this argument misapprehends this Court's precedent. Whether comparative new advantages offset disadvantages resulting from the impairment of vested pension rights may be one of multiple factors to be considered in analyzing reasonableness. But none of this Court's precedent holds that *every* modification of a vested pension right must pass a test for comparable new advantages to be constitutional. Such a rule would "introduce an inflexible hardening of the traditional formula for public employee pension modifications," rendering pension systems incapable of adapting to changed fiscal or factual circumstances. (*Cal Fire Local 2881 v. California Public Employees' Retirement System* (2016) 7 Cal.App.5th 115, 131, review granted April 12, 2017 (S239958), quotations omitted.) Such a rule would also effectively block the State here from exercising its general police and regulatory powers because of an alleged private

contractual arrangement between a county and its employees. By doing so, the so-called "California Rule" would impermissibly "destroy . . . in its essential aspects" the State's "reserved power" "to safeguard the vital interests of its people." (*City of El Paso*, *supra*, 379 U.S. at pp. 508-509.)[10]

As this Court has always emphasized, public pension systems require "flexib[ility]" to adjust to "changing conditions" and "maintain the integrity of the system." (*International Assn.*, *supra*, 34 Cal.3d at p. 300; *Allen I*, *supra*, 45 Cal.2d at p. 131.) Consistent with general contract clause principles, the precedent of both this Court and the U.S. Supreme Court requires looking more broadly at the reasonableness and necessity of the impairment, not just at whether there are comparative new advantages. (See *Terry v. City of Berkeley* (1953) 41 Cal.2d 698, 702 ["reasonable changes detrimental to the pensioner may be made in pension provisions for public employees or their beneficiaries before the happening of the contingency"]; *U.S. Trust*, *supra*, 431 U.S. at p. 25 [noting even a substantial impairment may not run afoul of the contract clause if it was "reasonable and necessary to serve an important public purpose"].) What is indispensable is that modifications of pension rights "bear some material relation to the theory of a pension system and its successful operation." (*International Assn.*, *supra*, 34 Cal.3d at p. 301; *Allen I*, *supra*, 45 Cal.2d at p. 131.)

The absence of comparable new advantages, by contrast, is important, but not in itself fatal, as the Court of Appeal and others have correctly noted. (*Alameda County*, *supra*, 19 Cal.App.5th at p. 120; see also *Hipsher*

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[10] Many legal experts have criticized the rigid inflexibility of ACDSA's position, pointing out that it is contrary to contract clause principles, inconsistent with general contract and economic theory, and effectively depresses the salaries and benefits of newer generations of public employees. (See, e.g., Monahan, *Statutes as Contracts? The "California Rule" and Its Impact on Public Pension Reform* (2012) 97 Iowa L. Rev. 1029.)

*v. Los Angeles Cty. Employees Ret. Ass'n* (2018) 234 Cal.Rptr.3d 564, 573 ["a modification of vested pension rights need not invariably be accompanied by a comparable new advantage"]; *Cal Fire*, *supra*, 7 Cal.App.5th at p. 483 [agreeing that most case precedent uses formulation "'[s]hould' provide some new compensating benefit, not 'must' . . . and 'should' does not convey imperative obligation," but rather "is 'a recommendation,'" quoting *Marin*, *supra*, 2 Cal.App.5th at p. 699].) The contract clause is not a straitjacket; "the reservation of the essential attributes of continuing governmental power" must be "read into contracts as a postulate of the legal order. (See *Allen II*, *supra*, 39 Cal.3d at p. 120, quotations omitted; see also *id.* at p. 119 ["The Constitution is intended to preserve practical and substantial rights, not to maintain theories"].) Any absence of comparable advantages must therefore be balanced with other factors. If the impairment is limited and does not meaningfully alter an employee's right to a "substantial or reasonable pension" (*Miller*, *supra*, 18 Cal.3d at p. 816), or if it is reasonable and necessary to serve an important public purpose, it may be permissible under the contract clause.

To be sure, when no independent rationale for the impairment has been offered, the absence of comparable new advantages has proven dispositive in the impairment analysis. For example, in *Betts*, *supra*, 21 Cal.3d at p. 862, the Legislature amended the law governing the Legislators' Retirement System in 1974 to substitute a "fixed" pension in place of a "fluctuating" one. The new defined benefit formula also reduced the disability pension Betts was to receive by nearly 39 percent—an extraordinarily severe reduction, and particularly problematic because it came toward the end of Betts's career. (See *id.* at pp. 862-863 [salary on which pension to be based lowered from $35,000 to $21,499].) *Allen I* and *Abbott v. City of Los Angeles* (1958) 50 Cal.2d 438 had both already held that substituting a fixed pension for a fluctuating one was unreasonable

when not materially related to the integrity and successful operation of a pension system. (*Abbott*, *supra*, 50 Cal.2d at pp. 454-455.) But the only justification offered by the respondent retirement board was that 11 years earlier the Legislature had added a cost-of-living adjustment. (*Betts*, *supra*, 21 Cal.3d at p. 865.) This, the board claimed, offset the later dramatic alteration of Betts's pension formula and subsequent reduction in his benefit. (*Ibid.*) Predictably, this Court rejected such reasoning: a cost-of-living adjustment in 1963 could not serve as a comparative *new* advantage offsetting changes 11 years later. And *in the absence of any other reasons* to justify the impairment of Betts's vested pension rights, the Court concluded that the impairment was unreasonable. (See *id.* at pp. 866-868.)

*Olson v. Cory* (1980) 26 Cal.3d 532 posed a similar scenario. In that case, the Legislature enacted a law limiting annual cost-of-living increases in judicial salaries. (*Id.* at p. 537.) Because pensions for retired judges were tied to salaries of incumbent judges, the new limits also effectively limited cost-of-living adjustments for retired judges' pensions. (*Id.* at pp. 540-541.) Again, the respondents in the case "offer[ed] no reason or justification for the state action"; they argued only that no vested rights had been impaired. (*Id.* at pp. 539, 541.) After disagreeing that no vested rights had been impaired, this Court concluded that, *in the absence of any justification for the impairment* or comparable new advantages, the law was unconstitutional. (*Id.* at p. 541.)

In sum, neither *Betts* nor *Olson* supports ACDSA's contention that an impairment of a vested pension right can only be constitutional if offset by comparable new advantages. In both cases, the Court was open to considering justifications for the impairments at issue, but those tasked with

defending the impairments failed even to *attempt* to justify the necessity of the impairments.[11]

*Allen I* and *Abbott* also fail to support the Union's position, because in neither case did this Court have occasion to consider whether a modification might be reasonable if, like here, it was supported by compelling reasons materially related to the successful operation of the pension system. In both cases, a city altered the defined benefit formula so that employees would receive a pension that was fixed upon retirement, not one that fluctuated upwards as city salaries increased. The consequences of this change were serious in light of the inflationary trends of the post-World War II era, which easily could erase half the value of a pension within a decade. (*Abbott, supra*, 50 Cal.2d at p. 484; *Allen I, supra*, 45 Cal.2d at p. 132.) Yet, there was "no showing [in either case] that the . . . amendments [bore] any material relation to the integrity or successful operation or to the preservation or protection of the pension program applicable to [the] plaintiffs." (*Abbott, supra*, 50 Cal.2d at p. 455.) It was in light of that failure that this Court held in both cases that "the substitution of a fixed for a fluctuating pension is not permissible unless accompanied by commensurate benefits." (*Id.* at p. 454.)

ACDSA also relies upon *Allen II*. But the point noted by ACDSA is clearly "dicta" (*Hipsher, supra*, 234 Cal.Rptr.3d at p. 572), and the case does more to undermine ACDSA's position here than support it. In *Allen II*, a new law withheld from retired former legislators an unexpected windfall. (*Supra*, 34 Cal.3d at p. 125.) By withholding the windfall, the law modified what had been the vested pension rights of the retirees. Contrary to ACDSA's theory, however, this Court did not require

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[11] *Olson* is further distinguishable because the vested pension rights impaired by the new law were those of judges who had already retired, not of active employees. (*Supra*, 26 Cal.3d at p. 540 & fn. 5.)

comparative new advantages to offset the disadvantages resulting from the modifications. Otherwise, "the retirees in that case would have prevailed on appeal." (*Hipsher*, *supra*, 234 Cal.Rptr.3d at p. 573.) Instead, this Court considered whether retiree expectations of the windfall benefits were reasonable. Finding them not to be so, the Court upheld the law. (See *id.* at pp. 123-125.)

Finally, ACDSA's reliance on *Eu* is misplaced. As this Court emphasized in *Eu*, *supra*, 54 Cal.3d at p. 530, the limitations on legislators' pension rights in the case did not seek to "modify" the Legislators' Retirement System, but rather to "*terminate* that system entirely as to additional benefits accruing for future services," which in turn threatened to entirely *divest* legislators of the benefits they had already accrued, though were not yet eligible to receive. (*Id.* at p. 531.) But when the State has established a pension plan for employees, "it cannot simply "*abandon* that plan . . . without providing them comparable new benefits." (*Ibid.*, italics added.)

In contrast to the limitations at issue in *Eu*, AB 197's exclusions did not jeopardize the ability to earn a substantial CERL pension going forward. Nor did it threaten to divest employees of benefits they had already legitimately accrued. *Eu* therefore does not control this case. Moreover, to the extent it suggests circumstances where comparable new advantages are needed, they are where reductions in pension benefits are "substantial" and absolute divestment of pension rights is a possibility. (*Supra*, 54 Cal.3d at p. 521.)

As the Court of Appeal recognized, ACDSA's interpretation of this Court's precedent lacks merit. That precedent does not adopt the "comparable advantages" test urged by ACDSA, but favors instead examining whether an impairment of vested rights is justified under the specific circumstances of a case.

### C. AB 197's Exclusions Were Reasonable and Necessary to Serve Important Public Purposes

ACDSA argues that in any case AB 197's exclusions were not reasonable or necessary. According to ACDSA, the State was merely trying to save money when it enacted AB 197. (ACDSA Opening Br. 41-42.) That impermissible purpose triggers "strict scrutiny," and under such scrutiny, the application of AB 197's exclusions to legacy members cannot survive. (*Id.* at p. 45.)

ACDSA's core premise, however, is incorrect. It ignores AB 197's legislative history, which makes clear that the main purpose of AB 197 was *not* to save the State money. It was to end abusive pension-spiking practices within CERL systems that were ripping off taxpayers, undermining the trust of public employees and the general public alike, and eroding the fiscal integrity of public pension systems.

Before AB 197, "spiking games" had become "widespread throughout local government," enabling employees to take advantage of unforeseen loopholes and spike their pensions in ways never contemplated by the Legislature. (*Marin*, *supra*, 2 Cal.App.5th at p. 682 & fn. 2, quotations omitted.) These games "tainted" public pension systems, generated "public outrage," and fueled the increasingly widespread view that public employee pensions were "excessive" and abusive. (*Id.* at p. 682, fn. 2, quoting legislative history; Beermann, *The Public Pension Crisis* (2013) 70 Wash. & Lee L. Rev. 3, 21.)

Public employees themselves shared much of this cynicism. Public employees in at least 17 of the 20 CERL counties had long understood that the law *prohibited* them from including cashouts payable only at retirement in their pension calculations. But, in Alameda County and two others, the law was flouted, such that certain public employees could use any one of a number of "stratagems and ploys" to inflate their pensions in ways that

their peers could not. (*Marin*, *supra*, 2 Cal.App.5th at p. 679.)[12] "Such inconsistency in the application of a single state statute [was] inappropriate, if not impermissible." (*Irvin v. Contra Costa County Employees' Retirement Association* (2017) 13 Cal.App.5th 162, 172.)

In other ways as well, the law was applied inconsistently across counties and within them. For example, pay for *working* overtime was generally excluded from pensionable compensation. But pay for merely "standing by" outside normal working hours sometimes *was* included.

Finally, "these abusive practices" and inconsistencies were contributing to "unsustainable pension formulas for both current and future workers." (*Marin, supra*, 2 Cal.App.5th at pp. 681-682, quotations omitted.)[13] The Legislature was advised that "[u]nless aggressive reforms are implemented now, the problem will get far worse, forcing counties and cities to severely reduce services and [lay off] employees to meet pension obligations." (*San Joaquin County Correctional Officers Assn. v. County of San Joaquin* (2016) 6 Cal.App.5th 1090, 1095, quotations omitted.)

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[12] In Contra Costa County, employees hired after 2011 were prohibited from including cashouts payable only upon retirement in pensionable compensation, while those hired before 2011 could continue to do so. No change to CERL explained this shift.

[13] "In a 2015 report, the [Marin County Civil Grand Jury] noted that the granting of largely unpublicized 'pension enhancements . . . contributed to the increase of the unfunded pension liability of [the Marin County Employees' Retirement Association] . . . . This increase . . . may place the future financial viability of the pension plans at significant risk. Additionally, such an impact may impair the governments' ability to provide the broad range of essential services that citizens are expecting . . . .'" (*Marin*, *supra*, 2 Cal.App.5th at p. 686, fn. 7, quoting Marin County Civil Grand Jury, Pension Enhancements: A Case of Government Code Violations and a Lack of Transparency (2015) p. 2.)

Under these circumstances, the Legislature's enactment of AB 197 was both reasonable and necessary. Only by ending the "ability for employees to manipulate their final compensation calculations" (*Marin*, *supra*, 2 Cal.App.5th at p. 682, fn. 2, quoting legislative history) could the Legislature advance "the legitimate state interest" of eliminating the "unforeseen windfall[s]" unfairly enjoyed by certain employees in certain counties (*Energy Reserves*, *supra*, 459 U.S. at 412). Clarifying the law in this way also served "the important public purpose[s]" of facilitating the consistent application of the law across all CERL counties, protecting "the integrity of public pension systems," and restoring the public's trust. (*Hipsher*, *supra*, 234 Cal.Rptr.3d at p. 571.) And by helping "resurrect[] the actuarial viability of public retirement systems," AB 197 advanced the "compelling state interest" of "avoiding the draconian consequences that [would] occur if public pension liabilities remain[ed] underfunded." (*McGlynn v. State of California* (2018) 21 Cal.App.5th 548, 565, review granted June 27, 2018 (S248513).)

Furthermore, while AB 197's exclusions easily satisfy the requirement of reasonableness and necessity at *any* level of scrutiny, there are compelling reasons to defer to the Legislature's judgment here. The relative modesty of AB 197's exclusions suggests that "the height of the hurdle the state legislation must clear" is relatively low. (*Calfarm*, *supra*, 48 Cal.3d at p. 830.) And because the State was not acting "to profiteer or otherwise serve its own pecuniary interests" (*Houlton Citizens' Coal v. Town of Houlton* (1st Cir. 1999) 175 F.3d 178, 191), there is no reason why this Court should second-guess the Legislature's use of its police power "to achieve the legitimate purpose of promoting the welfare of its people." (*Interstate Marina Dev. Co. v. Cty. of Los Angeles* (1984) 155 Cal.App.3d 45, 448; see also *U.S. Trust*, *supra*, 431 U.S. at p. 25; *City of El Paso*, *supra*, 379 U.S. at pp. 508-509 [legislature has "wide discretion . . . in

determining what is and what is not necessary," quotations omitted].) "The States must possess broad power to adopt general regulatory measures without being concerned that private contracts will be impaired, or even destroyed as a result." (*U.S. Trust*, *supra*, 431 U.S. at p. 22.) This Court should reverse the lower court and conclude that any impairment of vested rights did not violate the contract clause of the state or federal Constitution.[14]

## CONCLUSION

For the foregoing reasons, this Court should reverse the judgment of the Court of Appeal as to any limitation on AB 197's application to legacy employees.

Dated: July 19, 2018

Respectfully submitted,

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[14] ACDSA's further argument that AB 197's exclusions "were *per se* unreasonable because they were not temporary in nature" (ACDSA Opening Br. 51) misreads the law. "[T]he public purpose need not be addressed to an emergency or temporary situation." (*Energy Reserves*, *supra*, 459 U.S. at p. 412.)

## CERTIFICATE OF COMPLIANCE

I certify that the attached ANSWERING BRIEF ON THE MERITS uses a 13 point Times New Roman font and contains 13,996 words.

Dated: July 19, 2018

PETER A. KRAUSE
Legal Affairs Secretary

/s/ Rei Onishi

REI R. ONISHI
Deputy Legal Affairs Secretary
*Attorneys for Intervenor and Respondent State of California*

## PROOF OF SERVICE

*Alameda County Deputy Sheriffs' Association, et al. v. Alameda County Employees' Retirement Assn., et al.*

Case No. S247095

I am employed in the Office of Governor Edmund G. Brown Jr. I am over the age of 18 years and not a party to this matter. My business address is State Capitol, Suite 1173, Sacramento, CA 95814. On July 19, 2018, I served the State of California's ANSWERING BRIEF ON THE MERITS by the methods indicated below:

☑ by placing the document(s) listed above in a sealed envelope with postage thereon fully prepaid, in the United States mail at Sacramento, California addressed to the four courts involved in this appeal as set forth below. I am readily familiar with the office's practice of collection and processing of correspondence for mailing. Under that practice, it would be deposited with the U.S. Postal Service on that same day with postage thereon fully prepaid in the ordinary course of business.

☑ by causing TrueFiling to e-serve this document on all the email addresses listed on TrueFiling for this appeal, including the parties listed below at the email addresses indicated.

**SEE ATTACHED SERVICE LIST**

I declare under penalty of perjury under the laws of the State of California that the above is true and correct. Executed on July 19, 2018, at Sacramento, California.

/s/ Alexander Ritchie

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ALEXANDER RITCHIE

**SERVICE LIST**

*Alameda County Deputy Sheriffs' Association, et al. v. Alameda County Employees' Retirement Assn., et al.*

Case No. S247095

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| Clerk of the Superior Court<br>Contra Costa County Superior Court<br>725 Court Street<br>Martinez, CA 94553 | **By U.S. Mail only** |
| Clerk of the Superior Court<br>Alameda County Superior Court<br>René C. Davidson Courthouse<br>1225 Fallon Street<br>Oakland, California 94612 | **By U.S. Mail only** |
| Clerk of the Superior Court<br>Merced County Superior Court<br>2260 N Street<br>Merced, CA 95340-3744 | **By U.S. Mail only** |