No. S239958

IN THE SUPREME COURT OF CALIFORNIA

CAL FIRE LOCAL 2881, *et al.*,

Petitioners and Appellants,

v.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CalPERS),

Defendant and Respondent,

and

THE STATE OF CALIFORNIA,

Intervener and Respondent.

SUPREME COURT
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After A Decision By The Court Of Appeal,
First Appellate District, Division Three, Case No. A142793
Alameda County Superior Court, Case No. RG12661622,
The Honorable Evelio Grillo, Judge Presiding

APPLICATION FOR PERMISSION TO FILE AMICUS CURIAE BRIEF AND PROPOSED BRIEF OF AMICUS CURIAE PACIFIC RESEARCH INSTITUTE IN SUPPORT OF INTERVENER AND RESPONDENT STATE OF CALIFORNIA

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APPLICATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF

Pacific Research Institute ("PRI") respectfully requests permission to file the attached amicus curiae brief in support of the Intervener and Respondent, the State of California, pursuant to California Rules of Court, rule 8.520(f).[1]

Founded in 1979 and based in San Francisco, PRI is a nonpartisan, nonprofit section 501(c)(3) organization that champions liberty and free-market solutions to the issues that impact the daily lives of all Americans. Among PRI's many endeavors is its research into (1) pension reform, (2) health care reform, (3) reform of the California economy, and (4) education reform. Its activities include research papers on public policy issues, news columns and articles, featured speakers, media commentary and podcasts, invited legislative testimony, and amicus curiae briefs.

PRI's study of California's public employee pension systems suggests that there is a serious risk of unfunded pension liabilities crowding out other important services for California citizens, which, in turn, would require a substantial increase in taxes (with its concomitant, adverse impact on the

---

[1] No party or any party's counsel authored this amicus brief, in whole or in part, or made a monetary contribution intended to fund the preparation or submission of this brief. The following persons, however, made monetary contributions intended to fund in part the preparation of the brief: George H. Hume, G. Leonard Baker, Jr., Tench Coxe, and Sandy Dean. (See Cal. Rules of Court, rule 8.520(f)(4).)

economy) or a substantial reduction in services. PRI submits this amicus curiae brief because a ruling in this case against the State of California would hinder the Legislature's ability in the future to exercise its constitutional authority to address these unfunded liabilities and control the State's budget.

Accordingly, PRI respectfully requests leave to file this amicus brief in order to address the following topics:

1. The magnitude and consequences of California's unfunded pension liabilities;

2. The impact of an adverse ruling in this case on the Legislature's and Governor's efforts to repeal or control pension spiking techniques;

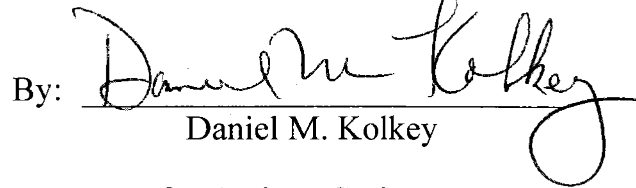
3. Harmonization of the case law governing the U.S. and California Constitutions' contract clauses with the case law governing the impairment of public employee pension rights, given that California's case law regarding the impairment of pension rights has strayed from contract clause jurisprudence; and

4. New and refined arguments in support of the Legislature's authority to repeal the statutory offer to purchase pension "airtime" credits.

Dated: February 21, 2018

Respectfully submitted,

GIBSON, DUNN & CRUTCHER LLP



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I. INTRODUCTION

California's public employee pension systems are in staggering financial trouble. Fueled by expanded retiree benefits in the late 1990s and the economic crisis of 2008-2009, pensions for California's public employees – including the California Public Employees' Retirement System ("CalPERS") and the California State Teachers' Retirement System ("CalSTRS") – now face a shortfall in the *hundreds of billions* of dollars. Without dramatic fixes, California will be faced with the dilemma of either imposing the *largest* tax increase in its history or making devastating spending cuts, including service reductions and layoffs. The only way out is to recognize that not all legislation relating to public employee benefits creates vested contract rights and to not treat the California Constitution's contract clause as applying differently to pension contracts than contracts in general.

Unfortunately, the California Constitution's contract clause has proven complicated to navigate in making changes to the public employee pension system, as evidenced by this case. Although the contract clauses in the U.S. and California Constitutions are supposed to be interpreted *similarly*, California cases have strayed from applying these well established standards when addressing public pension rights. For instance, in the context of public employee pensions, some California cases have *assumed vested contract rights* without first finding unambiguous evidence of a legislative

intent to grant such *contract* rights. Other California cases have failed to provide guidance as to what type of contractual impairment is *substantial* for purposes of finding a contract clause violation and have suggested that permissible substantial impairments should be accompanied by "comparable new advantages" (*Betts v. Board of Administration of Public Employees' Retirement System* (1978) 21 Cal.3d 859, 864 (*Betts*)) when logically there cannot be a substantial impairment if there is a *comparable* new advantage.

In this brief, PRI will demonstrate that the Legislature's repeal of the option to purchase airtime credits in the Public Employees' Pension Reform Act of 2013 ("PEPRA") is not a violation of the contract clause for the following reasons:

First, a public employee asserting a vested contract right must show that the Legislature "clearly and unequivocally expressed" the intent to grant a contract right. (*Retired Employees Ass'n of Orange County, Inc. v. County of Orange* (2011) 52 Cal.4th 1171, 1185 (*Retired Employees*).) Here, no legislative intent to grant *a contract* right was expressed or implied by the mere *statutory offer* to buy airtime: Unexercised offers, by their very nature, are not intended to create contracts. And the airtime credits were specifically intended to be sold *without any cost to the State*, thus making it highly unlikely that the Legislature intended to create a vested right *against* the State to sell them when it turned out they were costing the State money.

Second, even if the statutory *offer*, in and of itself, created a vested *contract* right, an impairment of a contract right must be *substantial* in order to violate the contract clause. (*San Francisco Taxpayers Ass'n v. Board of Supervisors* (1992) 2 Cal.4th 571, 584 (*San Francisco Taxpayers*); *General Motors Corp. v. Romein* (1992) 503 U.S. 181, 186 (*General Motors*).) The withdrawal of the *offer* to buy airtime credits could not be a *substantial* impairment of *pension rights* because (1) "[p]ension rights . . . are deferred compensation earned immediately upon the performance of services for a public employer" (*Miller v. State of California* (1977) 18 Cal.3d 808, 814 (*Miller*)), and airtime credits were not earned as a form of deferred compensation, such that withdrawal of the offer to buy airtime could substantially impair the employee's pension rights, and (2) airtime credits were not a substantial pension benefit because they were to be paid *wholly* by the employee.

Third, even if the statutory offer to sell airtime credits granted a vested contract right, *and* its repeal was a substantial impairment, impairment of a contract is constitutional if it is *reasonable* and *necessary* to serve an important public purpose. (*U.S. Trust Co. of New York v. New Jersey* (1977) 431 U.S. 1, 22-23 (*U.S. Trust*); *Allen v. City of Long Beach* (1955) 45 Cal.2d 128, 131 ("*Allen I*").) Ending the airtime credit program was reasonable and necessary to serve an important public purpose because the program was an

unearned benefit that was already costing the State significant additional sums in an already-underfunded system.

Fourth, the case law suggests that to be sustained as a reasonable change in a pension plan, any change that results in a disadvantage to employees "should be accompanied by comparable new advantages" (*Allen I*, *supra*, 45 Cal.2d at p. 131), but this factor has been misapplied. The additional element of "comparable new advantages" – which some lower courts have interpreted as a recommendation and not a mandate – can only be reconciled with contract clause jurisprudence if the *comparable* advantage offsets the substantial nature of the impairment, such that it is no longer substantial and thus not a violation of the contract clause. There should be no need to require or encourage a comparative new advantage if (1) the impairment is not substantial in the first instance, or (2) the substantial impairment is both reasonable and necessary to protect the solvency of previously earned pension benefits.

For all of these reasons, the Court should reject Petitioners' challenge to the Legislature's lawful authority to repeal the statutory offer of airtime credits, affirm the Court of Appeal's decision, and clarify the contract clause jurisprudence.

II. CALIFORNIA FACES A DANGEROUSLY UNDERFUNDED PENSION SYSTEM THAT THREATENS THE STATE'S ENTIRE ECONOMY

A. California's Pension Benefits Are Unsustainable.

California's pension systems are facing an imminent fiscal crisis. The State expanded retiree benefits in 1999 (Sen. Bill No. 400 (1999-2000 Reg. Sess., Stats. 1999, Ch. 555), relying on the extraordinary returns in the stock market associated with the technology bubble of the 1990s. But the assumptions behind those enhanced benefit levels proved incorrect.

In addition, California has consistently failed to make sufficient annual contributions to its pension plans over the past decade. As described in a study by PRI, in 2013, California contributed only 70% of the actuarially required annual contribution for its state-run pension systems, and had not been covering the actuarially required contributions for over a decade. (Wayne Winegarden, *California's Pension Crowd-Out* (2016) pp. 7, 18, citing The Pew Charitable Trusts, *The State Pensions Funding Gap: Challenges Persist* (2015).) These twin problems – unwise expansion and contribution shortfalls – have led to massive underfunding. (Winegarden, *supra*, at pp. 7-8.)

The magnitude of the unfunded pension liability problem in California is "staggering," leaving some commentators to question whether the State should declare bankruptcy. (Maria O'Brien Hylton, *Combating Moral*

Hazard: The Case for Rationalizing Public Employee Benefits (2012) 45 Ind. L. Rev. 413, 444.)

According to PRI, as of 2014, California had around $170 billion in unfunded pension liabilities for its state-run plans, equal to 7 percent of total state GDP, or *125 percent of total state tax revenues*! (Winegarden, *supra*, at pp. 9, 18-19.)[2] If one accounts for the risk that the rate of expected return could be lower than anticipated, California's unfunded pension liabilities could be as high as $300 to $600 billion, or between 13 and 28 percent of total state GDP as of 2014. (*Id.* at pp. 10, 24-27.)

Although CalPERS's financial reports declared its total unfunded liabilities as $38.6 billion as of 2008, a 2010 analysis by the Stanford Institute for Economic Policy Research estimated that this figure, when properly adjusted for investment risk, was in fact a staggering $239.7 billion – over six times the official deficit. (Howard Bornstein et al., *Going for Broke: Reforming California's Public Employee Pension Systems*, Stanford Institute for Economic Policy Research ("SIEPR") (April 2010) p. 2, cited in *Marin Ass'n of Public Employees v. Marin County Employees' Retirement Ass'n* (2016) 2 Cal.App.5th 674, 681, review granted Nov. 22, 2016, S237460 (*Marin Ass'n of Public Employees*).)

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[2] That figure was $174 billion as of 2015. (Winegarden, *supra*, as updated Jan. 15, 2018.)

The same analysis found that CalSTRS had risk-adjusted unfunded liabilities of $156.7 billion (despite stating its unfunded liabilities as only $16.2 billion on its financial reports). (Bornstein, *supra*, at p. 2.)[3]

In total, the risk-adjusted unfunded liabilities for the state-run CalPERS, CalSTRS, and University of California pension systems are a staggering $425.2 billion. (Bornstein, *supra*, at p. 2.) This figure falls squarely within PRI's maximum range of between $300 billion to $600 billion. (Winegarden, *supra*, at pp. 10, 27.)

Moreover, California's county employee retirement systems and independent local government pension systems add another risk-adjusted $195.2 billion in unfunded liabilities to the State's future pension burdens. (Nation, *The Funding Status of Independent Public Employee Pension Systems in California*, Stanford Institute for Economic Policy Research (Nov. 2010) p. 2, cited in *Marin Ass'n of Public Employees*, *supra*, 2 Cal.App.5th at p. 681.)

In sum, researchers using the government's assumptions about the correct discount rate have estimated unfunded pension liabilities in state-run

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[3] As of 2016, the Legislative Auditor's Office estimated that the unfunded liabilities for CalSTRS totaled $97 billion, well above CalSTRS's own figure, having grown by $21 billion in the prior year alone. (*CalSTRS Funding: An Update*, California Legislative Analyst's Office (May 2017) p. 1.)

systems to be between $130 and $217 billion, and researchers adjusting those assumptions for risk have placed the sum as high as $640 billion. (Winegarden, *supra*, at pp. 25-28.)[4] The bottom line is not in dispute: Each study demonstrates that the scope of the problem is massive.

B. Unfunded Pension Benefits Will Crowd Out Necessary Services.

These unfunded pension liabilities are a "ticking fiscal time bomb for state and local governments." (Jack M. Beermann, *The Public Pension Crisis* (2013) 70 Wash. & Lee L. Rev. 3, 13.)

The problem is particularly acute in California. In 2011, the Little Hoover Commission – an independent state government oversight agency – found that the State's public pension system lacks discipline, oversight, and accountability, that "[t]he math doesn't work," and that if the State fails to address its unfunded pension liability problem, "[p]ension costs will crush government." (Little Hoover Com., *Public Pensions for Retirement Security* (Feb. 2011) pp. iii-iv.) Digging out of the current pension liability hole will require drastic action.

According to PRI's analysis, covering the state's unfunded pension liabilities through tax revenues, rather than reform, would require the *largest*

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[4] But as of fiscal year 2013, the Stanford Institute for Economic Policy Research estimated that the total risk-adjusted pension debt of California, using a 3.25% discount rate, including state and county pension systems, had grown to $992.4 billion. (SIEPR, *California Pension Tracker* http://www.pensiontracker.org/index.php [as of Jan. 23, 2018].)

tax increase in California history – \$28.3 billion *per year* for the *next 30 years*. (Winegarden, *supra*, at pp. 10-11.) And that tax increase would cause California's economy to *shrink 21 percent* over the next 30 years, compared to its current projected growth (*ibid.*), costing residents their *future* economic opportunities – in order to pay for their *prior* obligations.

Alternatively, California could choose to cut total state and local spending more than 8% across the board. (Winegarden, *supra*, at p. 11.) Those cuts would affect every aspect of the services that the State provides to its citizens, including (among other things) "a \$5.4 billion cut to the school budget, a \$4.9 billion cut in spending on income support programs, a \$2.9 billion cut to the higher education budget, and a \$1.9 billion cut to California's hospital systems," compared to current projections. (*Ibid.*) Or California could make the necessary payments "by eliminating all expenditures on hospitals and fire services . . . ; or eliminat[ing] all expenditures on police protection, parks and recreation, and judicial and legal expenditures." (*Id.* at p. 40.) In short, California's state, county, and local governments would "have to pull heavily from other parts of their budgets to afford the bill." (Little Hoover Com., *supra*, at p. 24.)

III. THE LEGISLATURE NEEDS THE FLEXIBILITY TO CURTAIL PENSION SPIKING AND PROTECT THE SOLVENCY OF THE PUBLIC PENSION SYSTEM

Pension spiking *must* be addressed as part of any plan to stabilize California's pension system. The 2011 Little Hoover Commission report

stated bluntly that "[t]he spiking games must end," noting that benefit levels for top-earning managers have caused "considerable anger in the public," and that the problems with pension spiking in the State's pension system have "eroded taxpayer support." (Little Hoover Com., *supra*, at p. 46.)

To fix the spiking problem, the Commission stated that "[p]ensions must be based only on actual base salary" averaged over multiple years, and "not padded with other pay for clothing, equipment or vehicle use, or enhanced by adding service credit for unused sick time, vacation time or other leave time." (Little Hoover Com., *supra*, at p. 46.)

Later in 2011, Governor Jerry Brown released a twelve-point reform plan for the public pension system, including recommendations to require that the compensation used to calculate benefits be based on a three-year average in order to discourage "games and gimmicks in the last year of employment" and to require that those calculations use "the normal rate of base pay," thereby preventing benefits from being "manipulated by supplementing salaries with special bonuses, unused vacation time, unused overtime and other pay perks." (Gov. Jerry Brown, *Twelve Point Pension Reform Plan* (Oct. 27, 2011) at pp. 2-3.)

In 2012, the Legislature passed PEPRA, which included a range of reforms for the pension system, particularly for employees hired after January 1, 2013, as a step to curtail pension spiking impacting CalPERS and CalSTRS. Among PEPRA's reforms are the following:

First, the new law eliminated the offer of airtime credits in the CalPERS system. The airtime credit program had allowed members to increase their pension benefits by purchasing credits for extra years of service unrelated to their *actual* years of service with the State. Moreover, CalPERS members had been allowed to purchase airtime credits below actual cost – despite a statutory mandate that the credits be sold at no cost to the State – giving certain employees a windfall that the Legislature never intended.

Second, PEPRA altered the method by which the "salary base" was calculated for new members entering the system after January 1, 2013, eliminating the inclusion of one-time payments for determining an employee's pension benefits. For instance, PEPRA calculates the "final compensation" salary base for new members as the average of their compensation over a three-year period (Gov. Code, § 7522.32),[5] thereby tying pension benefits to the normal compensation for the employee's services without the use of one-time salary gimmicks. It also limited "pensionable compensation" for new CalPERS members to the "normal monthly rate of pay or base pay" paid to all similarly situated employees, and explicitly excluded several specific forms of compensation that would

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[5] Unless specified otherwise, all subsequent statutory references are to the Government Code.

previously have been used to spike pension benefits. (§ 7522.34, subds. (a), (c).)

PEPRA also added explicit anti-spiking provisions that allow the CalPERS board to exclude from a salary base of new members entering the system after January 1, 2013, any compensation that is "paid to increase a member's retirement benefit" or is otherwise inconsistent with the requirement that pensions be based on the normal base pay. (§ 7522.34, subds. (c)(1), (11), (12).)

Third, PEPRA eliminated the ability of new CalPERS members to inflate their final-year salaries by counting payments for unused vacation, annual leave, or sick time. (§ 7522.34, subd. (c)(5); see *San Diego County Employees Retirement Ass'n v. Superior Court* (2011) 196 Cal.App.4th 1228, 1243-44 [describing this form of pension spiking].)

Fourth, PEPRA eliminated a program called Employer Paid Member Contributions ("EPMC"), under which an employer's contribution to the pension system could be counted as employee compensation in the employee's final year. A 2014 audit by the State Controller's Office found that dozens of entities within CalPERS were using this form of pension spiking and estimated that the EPMC program had created up to $796 million in additional pension liabilities over twenty years. (Betty Yee, *Controller Finds Pension Spiking Vulnerabilities at CalPERS*, California State

Controller (Sept. 9, 2014), http://www.sco.ca.gov/PDF-Var/eo_pressrel_15451.pdf.)

PEPRA also eliminated the airtime credit program within CalSTRS, and enacted salary-base reforms for new CalSTRS members similar to the reforms applicable to new CalPERS members. (See Educ. Code, § 22119.3, subd. (b).)

While petitioners seek to isolate the costs saved by the elimination of the airtime credits program alone, PEPRA's reforms must be viewed as a package of reforms that together advance the Legislature's goal of curtailing abuses of the public pension system that have further undermined its solvency.

IV. THE FEDERAL AND STATE CONSTITUTIONS' CONTRACT CLAUSES ARE SIMILARLY INTERPRETED

A. The Federal Standard.

Under the United States Constitution, no state may pass a "law impairing the obligation of contracts." (U.S. Const., art. I, § 10, cl. 1.) Determining whether this prohibition is violated entails a multi-part inquiry:

First, there must be a contract that is impaired. (U.S. Const., art. I, § 10, cl. 1.)

Second, the court determines "whether the state law has, in fact, operated as a substantial impairment of a contractual relationship." (*Allied Structural Steel Co. v. Spannaus* (1978) 438 U.S. 234, 244 (*Allied Structural*

Steel).) The impairment is deemed substantial where it defeats a party's reasonable expectations. (*Energy Reserves Group, Inc. v. Kansas Power & Light Co.* (1983) 459 U.S. 400, 411, 416 (*Energy Reserves*).) It is also substantial "where the right abridged was one that induced the parties to contract in the first place . . . or where the impaired right was one on which there had been reasonable and especial reliance." (*Baltimore Teachers Union v. Mayor & City Council of Baltimore* (4th Cir. 1993) 6 F.3d 1012, 1017.) Generally speaking, "[t]he severity of the impairment is said to increase the level of scrutiny to which the legislation will be subjected." (*Energy Reserves*, *supra*, 459 U.S. at p. 411.)

Third, if there is a substantial impairment, the court determines whether the State has "a significant and legitimate public purpose behind the regulation . . . such as the remedying of a broad and general social or economic problem." (*Energy Reserves*, *supra*, 459 U.S. at pp. 411-412.)

Fourth, and finally, if there is a significant, legitimate public purpose, the court decides whether "the means chosen to accomplish this purpose [are] reasonable and necessary." (*Buffalo Teachers Federation v. Tobe* (2d Cir. 2006) 464 F.3d 362, 368 (*Buffalo Teachers Federation*); see also, e.g., *Matsuda v. City & County of Honolulu* (9th Cir. 2008) 512 F.3d 1148, 1152 [articulating the same test].)

When a contract involving a state's own financial obligations is at issue, the test is the same: The contract clause "is not an absolute bar to

subsequent modification" of those obligations – "[a]s with laws impairing the obligations of private contracts, an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose." (*U.S. Trust*, *supra*, 431 U.S. at p. 25.)

B. California's Standard.

California courts read the California Constitution's similarly phrased contract clause similarly to the federal analogue. (Cal. Const., art. I, § 9.)

Indeed, this Court has acknowledged that the State contract clause is a "parallel proscription" to the federal contract clause prohibiting states from passing laws "impairing the obligation of contracts." (*Allen v. Board of Administration* (1983) 34 Cal.3d 114, 119 ("*Allen II*").) And this Court has followed the U.S. Supreme Court's key contract clause decisions in analyzing contract clause claims. (See, e.g., *Sonoma County Organization of Public Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 305-309 [examining U.S. Supreme Court contract clause decisions and noting that "[s]imilar factors have been applied in California decisions"].)

Thus, California courts have regularly applied the analysis employed under the federal contract clause decisions to evaluate possible violations of the California contract clause. (See, e.g., *Fourth La Costa Condominium Owners Ass'n v. Seith* (2008) 159 Cal.App.4th 563, 584 [setting forth the analysis for federal contract clause questions and explaining that "[t]he same analysis is applicable to the state constitution's contract clause"] (*Fourth La*

Costa); *Hall v. Butte Home Health, Inc.* (1997) 60 Cal.App.4th 308, 319 ["The analysis is substantially the same under the California Constitution"]; see also *San Francisco Taxpayers*, *supra*, 2 Cal.4th at p. 584 ["The threshold inquiry under the contract clause is 'whether the state law has, in fact, operated as a substantial impairment of a contractual relationship,'" quoting *Allied Structural Steel*, *supra*, 438 U.S. at p. 2441].)

Accordingly, generally speaking, there should be no difference between the federal and California Constitutions' application of the contract clause.

V. CALIFORNIA'S CONTRACT CLAUSE JURISPRUDENCE HAS STRAYED FROM THE FEDERAL JURISPRUDENCE IN THE AREA OF PUBLIC PENSION RIGHTS

Notwithstanding the prior discussion, various California decisions regarding the impairment of public pension rights have strayed from the federal standards under the contract clause.

These decisions have *presumed* the existence of a contractual right arising from a statute without first making the requisite finding of a clear and unambiguous legislative intent to create a contract right; they have not focused on whether the challenged contract constitutes a *substantial* impairment of a contractual obligation; and they have added a recommendation that any substantial impairment should be accompanied by "comparable new advantages" (*Betts*, *supra*, 21 Cal.3d at p. 864).

Such decisions undermine the Legislature's authority to enact policies without binding future Legislatures and unduly limit its flexibility in supporting a financially sound public employee pension system.

A. Contract Clause Jurisprudence Presumes That Statutes Are Not Intended To Create Private Contract Rights Except Where Such Intent Is Unequivocally Expressed.

Because the primary function of a legislature is not to make contracts, but rather to establish policy, "'it is presumed that a statutory scheme is not intended to create private contractual or vested rights and a person who asserts the creation of a contract with the state has the burden of overcoming that presumption.'" (*Retired Employees*, *supra*, 52 Cal.4th at pp. 1185-86, quoting *Walsh v. Board of Administration* (1992) 4 Cal.App.4th 682, 697.)

Moreover, "[i]t is the general rule that one legislative body cannot limit or restrict its own power or that of subsequent Legislatures and that the act of one Legislature does not bind its successors." (*Ex Parte Collie* (1952) 38 Cal.2d 396, 398 (*Collie*); see also *Rossi v. Brown* (1995) 9 Cal.4th 688, 715.) The Legislature is therefore permitted to amend its prior policy decisions, which are "inherently subject to revision and repeal." (*Retired Employees*, *supra*, 52 Cal.4th at pp. 1185-86, quoting *National R. Passenger Corp. v. A.T. & S.F.R. Co.* (1985) 470 U.S. 451, 466 (*National R. Passenger*).)

Accordingly, because the Legislature is a policymaking body and its primary function is not to make contracts, and because subsequent legislatures are free to amend the policies of their predecessors, California statutes are presumed *not* to create contracts absent a clear and unmistakable showing of intent. (*Retired Employees, supra*, 52 Cal.4th at pp. 1185-86.)

As a general matter, that rule is no less true in the context of employee benefits. (*Retired Employees, supra*, 52 Cal.4th at pp. 1185-86.) "'[T]o construe laws as contracts when the obligation is not clearly and unequivocally expressed would be to limit drastically the essential powers of a legislative body.'" (*Ibid.*, quoting *National R. Passenger, supra*, 470 U.S. at p. 466.)

Significantly, this Court has recognized that "[t]he rule permitting modification of pensions is a necessary one since pension systems must be kept flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system and carry out its beneficent policy." (*Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 854–55 (*Kern*).)

Nonetheless, as noted in the next subsection, some California cases addressing pension rights have ignored this requirement that the Legislature express a clear and unequivocal legislative intent to grant a contract right before determining whether there was an impairment of that right under the contract clause.

B. California's Recent Pension Rights Cases Depart From The Fundamental Principles Of Contract Clause Analysis.

Although California's contract clause cases follow the longstanding precedents of this Court and the U.S. Supreme Court, in the area of public employee pension rights, that jurisprudence has strayed from the similarly worded federal standards, without a considered reason.

In 1917, in *O'Dea v. Cook* (1917) 176 Cal. 659, 661, this Court first ruled that pension statutes might create contracts.

In 1936, a court of appeal stated that the right to a pension "becomes a vested one upon acceptance of employment," and this Court adopted that decision as its own without additional comment. (*Dryden v. Board of Pension Commissioners of City of Los Angeles* (1936) 6 Cal.2d 575.)

In *Kern, supra*, 29 Cal.2d at p. 855, this Court ruled that "it appears, when the cases are considered together, that an employee may acquire a vested contractual right to a pension but that this right is not rigidly fixed by the specific terms of the legislation in effect during any particular period in which [the employee] serves. The statutory language is subject to the implied qualification that the governing body may make modifications and changes in the system. The employee does not have a right to any fixed or definite benefits, but only to a substantial or reasonable pension. There is no inconsistency therefore in holding that [the employee] has a vested right to a

pension but that the amount, terms and conditions of the benefits may be altered."

Thus, *Kern* is a straightforward application of the rule that one legislature may not bind a future legislature, that the current legislature *does not intend* to prohibit a future legislature from making prospective changes, and that therefore an employee has no right to a fixed benefit but a substantial and reasonable one.

However, this Court's pension rights jurisprudence began to change starting with *Allen I.* There, this Court held that an employee's vested contractual pension rights may be modified prior to retirement if the modifications are "reasonable," but in determining whether a modification is reasonable, this Court stated that a modification "must bear some material relation to the theory of a pension system and its successful operation," and that a modification resulting in a disadvantage to employees "should be accompanied by comparable new advantages." (*Allen I, supra,* 45 Cal.2d at p. 131.)

Still, courts applying that ruling have recognized that a "precise dollar balance" between the modification and the new advantage is not required so long as the modification does not frustrate the reasonable expectations of the parties. (*Frank v. Board of Administration* (1976) 56 Cal.App.3d 236, 244.)

Nonetheless, the Court in *Allen I* skipped the first step in the constitutional analysis by assuming that a city charter amendment had altered

a contract without first analyzing whether the government had in fact *intended* the pension provisions at issue to grant *contract* rights. (*Allen I*, *supra*, 45 Cal.2d at p. 130.) Instead, the *Allen I* decision contained no discussion of the government's intent, much less any finding that the contractual intent with respect to the provisions at issue was unequivocal. (*Ibid.*)

In *Betts, supra,* 21 Cal.3d at page 866, this Court ruled that an employee's contractual pension expectations "are measured by benefits which are in effect not only when employment commences, but which are thereafter conferred during the employee's subsequent tenure" – although it did so in a case where the employee had earned his benefits and had left office prior to the adverse modification about which he complained.

Moreover, unlike the change to the airtime credit program, *Betts* was a case where the Legislature *reduced* pension benefits that Mr. Betts *had earned* based on his employment during an earlier period of time. (*Betts*, *supra*, 21 Cal.3d at p. 862.) Although the decision in *Betts* has been read as prohibiting *prospective* changes to pension benefits, it in fact considered a *retroactive* change. The "benefits . . . thereafter conferred" language in the decision referred not to future potential accumulation of benefits but rather to the calculation of benefits for a period *after* Mr. Betts was hired but *prior* to the Legislature's formula change. The Court in *Betts* made no finding that

the Legislature had any intent to create a contractual right that continued indefinitely.

In *Legislature v. Eu* (1991) 54 Cal.3d 492, 530 (*Eu*), this Court recognized an employee's "vested right to earn, through continued service, additional pension benefits in an amount reasonably comparable to those available when he or she first took office," notwithstanding the passage of Proposition 140, which terminated future retirement benefits after the measure's passage, other than federal Social Security. However, the Court conducted no analysis of whether the Legislature had intended to create such a vested right to *future* benefits and *assumed* that such a right was "vested" (*id.* at pp. 528-31), notwithstanding a contrary constitutional provision that specified that the Legislature may limit the retirement benefits payable to members of the Legislature prior to their retirement. (Cal. Const., art. IV, § 4.) As in *Betts*, this analysis *presumed* the Legislature's intent and conflated benefits *already earned* with additional benefits that *might be earned.*

Thus, several California courts have assumed vested contract rights for public employees without first making a finding of clear and unambiguous legislative intent to grant a contract right. (E.g., *Allen I, supra*, 45 Cal.2d at p. 130.) And unlike federal decisions interpreting the contract clause, California courts began to protect some future, unearned benefits from being altered. Finally, *Allen I* added a "comparable new advantage"

element, which as explained in section VI, does not fit logically into the jurisprudence.

These approaches are inconsistent with contract clause jurisprudence outside of the pension context, where the Court continues to mirror and apply the U.S. Supreme Court's contract clause jurisprudence. (E.g., *San Francisco Taxpayers*, *supra*, 2 Cal.4th at pp. 583-84.)

As shown in the next section, the application of long-standing principles of contract clause jurisprudence and legislative authority demonstrate that the Legislature could constitutionally repeal the airtime credit program.

VI. THE LEGISLATURE'S REPEAL OF THE OPTION TO PURCHASE AIRTIME CREDITS DOES NOT VIOLATE THE CONSTITUTION'S PROHIBITION ON THE IMPAIRMENT OF CONTRACTS

The Legislature's decision in PEPRA to repeal the option to purchase airtime credits was constitutional. First, there was no clear and unmistakable intent on the part of the Legislature to grant vested contract rights in the form of an *unexercised offer* to sell airtime credits at no cost to the State. (PEPRA left unchanged the pension benefits of employees who purchased airtime credits and thus accepted the offer and formed a contract.)

Second, even if the unexercised option to purchase airtime credits was a contractual right, petitioners' claim still fails because the revocation of the airtime credit offer was not a "substantial" impairment of any employee's

pension rights: The "pension" benefits offered by purchasing airtime credits would not have been earned and were not supposed to cost the State anything. Withdrawal of a cost-neutral offer of unearned pension benefits could not be a substantial impairment of the right to pension benefits.

Third, even if PEPRA did substantially impair any contract rights by repealing the airtime credit program, the repeal was reasonable and necessary to maintain the solvency of the State's pension systems and thus constitutional.

A. The Unexercised Option To Purchase Airtime Credits Was Not A Vested Contract Right.

The unexercised option to purchase airtime credits was not a vested contract right because there was no clear and unmistakable *intent* on the part of the Legislature to *grant contract rights* pursuant to the unexercised offer of airtime credits. (*Retired Employees*, *supra*, 52 Cal.4th at pp. 1185-86.)

As noted earlier, "'the intention of the Legislature . . . to create contractual obligations, resulting in extinguishment to a certain extent of governmental powers, must clearly and unmistakably appear.'" (*Retired Employees*, *supra*, 52 Cal.4th at p. 1186, quoting *Taylor v. Board of Education* (1939) 31 Cal.App.2d 734, 746.) An intent to create a contractual right can be implied from a statute, but only if the statute "'contains an unambiguous element of exchange of consideration by a private party for consideration offered by the state.'" (*Retired Employees*, *supra*, 52 Cal.4th

at p. 1186, quoting *California Teachers Ass'n v. Cory* (1984) 155 Cal.App.3d 494, 505.) Petitioners have the "heavy burden" to demonstrate the legislative body's intent to create vested rights. (*Id.* at p. 1190.)[6] But there was no clear and unmistakable evidence of legislative intent to grant a vested pension right to accept the offer to buy airtime credit.

First, pension benefits are deferred compensation that become vested when an employee "perform[s] substantial services for his employer." (*Kern, supra,* 29 Cal.2d at p. 855.) But in the case of airtime credits, the offer was not a form of deferred compensation. And an employee's performance of services at his or her job did not act to accept the State's offer to sell airtime credits. Thus, the offer was not part of the employee's pension rights.

Second, it is uncontested that the airtime credits offered by the State were designed to be sold *without any cost to the State*. (§ 21052.) Unlike a provision in which an employee exchanges his services for a pension benefit, the airtime credit provision involves the employee paying "an amount [of money] equal to the increase in employer liability" (*ibid.*), without any

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[6] Although petitioners appear to have abandoned their argument that the airtime credit provision created *implied* contract rights, they point to no language by which the Legislature *expressly* created a contract right. (RBM 10-13.) Yet, if the Legislature created a vested contractual right with its offer to sell airtime credits, it did so by implication, notwithstanding petitioners' pleas to the contrary.

additional consideration being given to the employee in exchange.[7] Accordingly, the fact that the offer of airtime credits was made *only* on terms designed to create no additional costs for the State negates an implication of an unambiguous intent to make the airtime credit offer a vested contract right against the State.

Third, the very nature of an offer to purchase airtime credits shows there was no intent to grant a contract right. An offer becomes a binding and enforceable contract only upon acceptance. (17 C.J.S. Contracts § 48.) An offer "may be revoked by the offeror any time prior to acceptance," and this Court has held that this general principle applies to offers made by the Legislature. (*T. M. Cobb Co. v. Superior Court* (1984) 36 Cal.3d 273, 278 (*T. M. Cobb*).) Turning an unaccepted offer into a vested contract right is a contradiction in terms.

Indeed, the State's offer of airtime credits remained an offer and not a contract until an employee filed the appropriate paperwork and purchased the credits. The airtime statute provided that an employee had the ability to

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[7] The fact that some airtime credits were sold below cost does not mean that the State provided consideration under the statute, as the sale of underpriced credits was contrary to the statutory text. Employees had no right to receive a windfall by electing to purchase airtime credits. As the trial court correctly noted, the purchase of credits at less than their fair value "reflects the mis-pricing of Airtime by CalPERS rather than the intent of the legislature." (JA 364.)

"elect . . . to make contributions" and in return "receive . . . additional retirement service credit." (§ 20909, subd. (a).) This election was done "by making the contributions as specified" (§ 20909, subd. (b)), and the election was explicitly conditioned on being "effective only if accompanied by" payment (§ 21050(a)). For employees who did not accept that offer by purchasing airtime credits, no contract was formed that could be impaired.[8]

Fourth, nothing in the statute indicates legislative intent to make the offer of airtime credits *irrevocable*. (*T. M. Cobb*, *supra*, 36 Cal.3d at p. 278 [stating that if the Legislature had intended to make certain statutory offers irrevocable, "it would have expressly and unequivocally said so"].)

This can be contrasted with an option contract by which a party can provide consideration in order to keep the offer open. (*Arden Group, Inc. v. Burk* (1996) 45 Cal.App.4th 1409, 1414 ["An option is an agreement to keep a specific offer open for a specified period."].) Here, the terms of the statute do not allow employees to give the State additional consideration to keep the airtime credit purchase offer open.[9]

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[8] Petitioners concede that the contributions necessary to purchase the airtime credits were part of the "acceptance and consideration" of the State's offer. (RBM 12.) Thus, even under petitioners' own reading of the statute, no contract was formed with respect to any employee who did not make such a purchase.

[9] Petitioners point to the five-year eligibility requirement in section 20909 as "consideration" (RBM 13), but that clause merely defined which employees could accept the State's offer. (*Cal Fire Local 2881 v.*

Contrary to petitioners' view, the provision in section 20909 allowing an employee to elect to purchase airtime credits "at any time prior to retirement" does not make the State's offer irrevocable. (See RBM 17-18.) That provision – which is not coupled with any consideration given by the employee – should be given a straightforward interpretation of creating a temporal limitation that prevents an employee from accepting the State's offer after he has already retired. (§ 20909.) Nothing in the statutory text indicates a "clearly and unequivocally expressed" intent that the State's offer was irrevocable and extended beyond a time at which the Legislature might amend the statute and revoke the offer. (*Retired Employees*, *supra*, 52 Cal.4th at 1186.)[10]

In sum, given the clear textual and structural signs that the airtime credit offer was not, in and of itself, a contract right, petitioners have not met the "heavy burden" of demonstrating the Legislature's intent to create vested

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California Public Employees' Retirement System (2016) 7 Cal.App.5th 115, 127 [agreeing with the trial court that "this phrase means just what it says and no more"], review granted Apr. 12, 2017, S239958.) As the trial court noted, this requirement was added by the Legislature to ensure that the State's offer of the ability to purchase airtime credits complied with the federal tax code. (JA 400-401.) Petitioners have not demonstrated that this phrase was intended to create an option contract.

[10] Petitioners concede that the offer to purchase airtime credits is not deferred compensation. (JA 328.) This vitiates any argument that the legislative scheme created a vested contractual right by which employees could exchange their continued services for the option to purchase credits at some later date.

contract rights by merely making the yet unexercised offer. (*Retired Employees*, *supra*, 52 Cal.4th at p. 1190.) Given the presumption that one legislature cannot bind a future legislature, the best reading of section 20909 is that the Legislature created an offer that was valid only until such time at which the Legislature might revoke it, which the Legislature did with PEPRA.

B. Even If The Unexercised Option To Purchase Airtime Credits Was A Vested Contractual Right, Its Repeal Was Not A Substantial Impairment In Violation Of The Contract Clause.

Even if the State's offer to allow employees to purchase airtime credits was a vested contract right, the Legislature's decision to revoke that unexercised offer through PEPRA could not be a substantial impairment of a pension right because airtime credits were not tied to services provided by the employee, and were designed to be sold at no cost to the State. Withdrawal of a cost-neutral offer that was not earned by the employee's service cannot be considered a *substantial* impairment of vested pension rights.

Alternatively, California should conform to the federal contract clause jurisprudence by holding that the Legislature may make *prospective* changes to contracts. (E.g., *U.S. Trust*, *supra*, 431 U.S. at p. 18 & fn. 15.) That rule avoids the one-way ratchet in which any benefit offered automatically

becomes permanent, while still protecting all pension benefits that have already been earned.

1. Any impairment in vested rights was not substantial.

An impairment must be substantial in order to violate the contract clause. (*Fourth La Costa*, *supra*, 159 Cal.App.4th at p. 584.) The Legislature's repeal of the mere offer of unearned retirement credits at the employee's cost was not a substantial impairment of any pension right.

"The Constitution is intended to preserve practical and substantial rights, not to maintain theories." (*Allen II*, *supra*, 34 Cal.3d at p. 124, quoting *Davis v. Mills* (1904) 194 U.S. 451, 457; internal quotation marks and citation omitted.) Thus, in determining whether an impairment of a contract violates the contract clause, a court must ask "whether the impairment is substantial." (*General Motors*, *supra*, 503 U.S. at p. 186; *Energy Reserves*, *supra*, 459 U.S. at p. 411.)

California generally follows that rule. In *San Francisco Taxpayers*, this Court stated that "[t]he threshold inquiry under the contract clause is 'whether the state law has, in fact, operated as a substantial impairment of a contractual relationship.'" (*San Francisco Taxpayers*, *supra*, 2 Cal.4th at p. 584, quoting *Allied Structural Steel*, *supra*, 438 U.S. at p. 244; see also *Amador Valley Joint Union High School District v. State Board of Equalization* (1978) 22 Cal.3d 208, 241 [quoting *Allied Structural Steel* for

the proposition that the contract clause applies only to a substantial impairment].) Although petitioners, relying heavily on *Allen II* (OBM 22), drop the "substantial impairment" requirement from their formulation of the constitutional test for a modification of a vested pension right, they do not actually argue that this Court should depart from the "substantial impairment" standard used by the U.S. and California Supreme Courts.

Repealing the airtime credit program was not a *substantial* impairment of petitioners' pension rights. *First*, the terms of the State's offer itself demonstrate that the offer did not have substantial value, because the statute only permitted the purchase of airtime credits at full value. As the trial court concluded, "[t]he purchase of Airtime should not have resulted in a monetary advantage to employees and, correspondingly, the elimination of Airtime should not have resulted in a monetary disadvantage to employees." (JA 363.)

Second, because the pension benefits embodied in the offer were *not earned* by service to the State, there was no substantial impairment of the promise of deferred compensation.

Finally, with respect to employees who did purchase airtime credits, PEPRA did not alter those employees' pension benefits at all.

2. Alternatively, California should follow federal authority that prospective changes to contracts do not constitute substantial impairments.

Federal authorities hold that *prospective* changes to pension benefits – which do not affect pension benefits that have been earned through the past performance of services – do not constitute substantial impairment. (*U.S. Trust, supra,* 431 U.S. at p. 18 & fn. 15.)

In contrast, California's jurisprudence has turned into a one-way ratchet that operates against the interest of taxpayers – any new benefit is immediately made permanent for all *current* employees, regardless of how the benefit affects the State's finances when implemented or how the conditions that informed the State's previous generosity changed. Such a ratchet is particularly inappropriate for benefits that are enhanced only *during* the employee's tenure, after an employee has already agreed to the terms of his or her employment (since the employee could not have had a reasonable expectation of such an enhancement at the time the employment commenced). (*Allen II, supra*, 34 Cal.3d at pp. 122, 124 [setting forth "the well established constitutional principle that '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'"], quoting *El Paso v. Simmons* (1965) 379 U.S. 459, 515 (*El Paso*).)

Federal cases interpreting the contract clause hold that the Constitution does not prevent the states from taking actions that work prospectively. (*U.S. Trust, supra,* 431 U.S. at p. 18 fn. 15 ["States undoubtedly have the power to repeal the covenant prospectively"], citing *Ogden v. Saunders* (1827) 25 U.S. 213, 241.) Federal courts also consider the prospective nature of a law as a factor suggesting that the resulting "impairment" of a contract is reasonable. (*Buffalo Teachers Federation, supra*, 464 F.3d at p. 371.) Other states follow this rule, as well. (E.g., *Subway-Surface Supervisors Ass'n v. N.Y.C. Transit Authority* (1978) 44 N.Y.2d 101, 112 [upholding as constitutional a wage freeze law and describing as significant in the court's reasonableness analysis that a wage freeze "was prospective in nature"].)

California should follow the federal decisions on this point. The Legislature's right to make prospective changes to the terms of employment is an important aspect of the Legislature's power to make policy. If the California Legislature wishes to grant public employees a right to benefits that is unalterable for the entire term of employment, it is capable of clearly stating its intent to do so. (See *Retired Employees*, *supra*, 52 Cal.4th at pp. 1185-86.) But if the Legislature does not explicitly state such an intent, courts should presume that the terms of an employment contract may be altered with respect to the *future* period of an employee's tenure.

That is the rule for every other term of employment, including salary. For instance, no employee has a vested contractual right to continue in public employment. (*Miller, supra,* 18 Cal.3d at p. 813.) The ability of the Legislature to alter pension arrangements with respect to *continued future service* should conform to the rule that future employment, or any particular future salary or other benefit, is not guaranteed.

Adopting the position that pension benefits may be modified prospectively with respect to the benefits linked to future service would harmonize the rule that pension rights may be modified with the rules that prohibit the impairment of pension benefits that have already been earned in exchange for services.

C. Even If Eliminating The Airtime Credit Program Was A Substantial Impairment, The Repeal Had A Legitimate Public Purpose Accomplished By Reasonable Means.

Even if the airtime credit offer was a vested contractual pension right, *and* even if its repeal was a substantial impairment of employees' contractual rights, the Legislature's decision to modify the program was constitutional so long as the modification had a "significant and legitimate public purpose" accomplished by reasonable means. (*Fourth La Costa, supra*, 159 Cal.App.4th at p. 584.)

"'To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages.'" (*Betts, supra*, 21 Cal.3d at p. 864, quoting *Allen I, supra*, 45 Cal.2d at p. 131; original italics omitted.)

The record in this case makes clear that the decision to eliminate airtime credits was a reasonable response to the threat posed by the airtime credit program and other pension spiking techniques and served a legitimate public purpose.

Simply put, the airtime credit system, whatever its merit in the abstract, did not work in practice as it was intended. When the Legislature

introduced the airtime credit program, it mandated that the credits be available for purchase only at a cost of "an amount equal to the increase in employer liability." (§ 21052.) The program was not meant to create any unfunded pension liability for the State, since the future payments due to retirees as a result of the credits would be entirely covered by the purchase price of the credits. (See *ibid.*) As a corollary, the program, at least as designed, did not provide any financial advantage to employees, who, after all, were meant to purchase the credits at the full cost of their expected additional future benefits. As the trial court found, there was "no indication that the legislature intended the option to . . . provide a financial benefit to employees." (JA 357.)

In practice, however, CalPERS members were allowed to purchase airtime credits at a discount, resulting in a financial windfall for employees (and a corresponding unexpected loss for California taxpayers). Evidence in the record indicates that CalPERS "was selling $1.00 worth of benefits for between $0.72 and $0.89." (JA 364.) In other words, for every dollar of airtime credit purchased, the program saddled the State with additional unfunded future liabilities. (*Ibid.*)

Thus, the repeal of the airtime program served an important public purpose and was reasonable for at least three reasons. *First*, the airtime credit program was contrary to the proper design of a pension system from the beginning, because it uncoupled pension benefits from actual service. As the

trial court found, the airtime credit program "departed from the theory of a pension system" because it "broke the link between work performed and benefits earned." (JA 363.) Eliminating a provision that departs from the fundamental theory of how pension systems should work serve an important public purpose.

Second, the repeal of the airtime credit offer fixed a flaw that exacerbated unfunded pension liabilities and threatened the Legislature's ability to preserve a pension system and control the State's finances. The sale of airtime credits at less than the "increase in employer liability" (§ 21052) created additional, unexpected costs to the pension system. In short, flaws in the airtime credit program exacerbated an already fraught situation in California's pension systems. (See part II, *ante*.)

Third, the airtime credit program also threatened to harm other public employees who either chose not to purchase the airtime credits or were financially unable to do so. Because the credits were sold below cost, the program could potentially increase the pension contributions of those employees in order to cover the windfalls granted to credit purchasers. (JA 364 fn. 9 [noting the underpricing of airtime credits raised the concern that "the transfer of CalPERS assets to certain government employees at less than the fair price was at the expense of CalPERS and its other participants"].) By fixing these serious problems, repeal of the airtime credit program served an important and legitimate public purpose.

Fourth, the sale of airtime credits below cost was contrary to the Legislature's intent, and the repeal served an important public purpose by correcting that problem and ensuring that the pension laws operate as intended. (See *Allen I*, *supra*, 45 Cal.2d at p. 131.) The Legislature "did not intend for CalPERS to misprice sales of Airtime" (JA 365), and petitioners make no argument to the contrary. Repeal of the airtime credit program promoted the proper functioning of the pension system as the Legislature intended. (JA 363 [finding that PEPRA "eliminated something that . . . was in fact detrimental to the successful operation of the pension system"].)

Contrary to petitioners' argument, the Legislature was not required to make any explicit factual findings in support of the repeal of the airtime credit program. (See OBM 41.) The Legislature is not required to make findings when passing legislation. To the extent a law depends on certain facts, courts must presume that the Legislature found those facts to exist. (*Taylor v. Cole* (1927) 201 Cal. 327, 337-338 ["If evidence was required, it must be supposed that it was before the Legislature when the act was passed, and if any special finding was required to warrant the passage of the particular act, it would seem that the passage of the act itself might be equivalent to such finding"]; *Stevenson v. Colgan* (1891) 91 Cal. 649, 652-653.)

Thus, the Legislature implicitly found that the repeal of the airtime program was reasonable and necessary to serve an important public purpose,

because the Legislature is presumed to act in accordance with the Constitution, including with any requirement imposed by the contract clause. (See *People v. Navarro* (1972) 7 Cal.3d 248, 260.) Moreover, the facts in the record here bolster, rather than diminish, these implicit findings, and petitioners have not met their burden to rebut it.

Petitioners are also incorrect that the monetary savings from eliminating the airtime credit program are not sufficient to serve an important public purpose. (See RBM 34 [arguing that the State failed to show an "emergency" circumstance].) This argument is defeated by the reality that California's massive unfunded liabilities are not going to be fixed in one step. As with balancing a budget, fixing the issues with California's pension systems will require many different reforms. The fact that any single reform may not be sufficient to bring the pension system back to solvency does not make that reform unconstitutional. In short, maintaining the solvency of the State's pension plans is an important public purpose, and the Legislature has the power to take the first of many steps necessary to ensure that California pension plans survive.

D. The "Comparable New Advantage" Factor Should Be Read As One Factor In Determining Whether An Impairment Of Contract Was Substantial.

Petitioners are also incorrect that an impairment that is reasonable and necessary to the successful operation of the pension system *must* simultaneously offer a comparable new advantage in place of the repealed provision.

In 1955, this Court stated that "[t]o be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees *should* be accompanied by comparable new advantages." (*Allen I*, *supra*, 45 Cal.2d at p. 131, italics added.)

In 1983, in *Allen II*, the Court restated that standard using the word "must" instead of "should" in the final clause. (*Allen II, supra,* 34 Cal.3d at p. 120.) But *Allen II* cites *Allen I* as support for that proposition, suggesting that it did not mean to depart from the use of "should" – a permissive and aspirational term. (*Allen I*, *supra*, 45 Cal.2d at p. 131.) As the Court of Appeal recently concluded that there is little reason to think that *Allen II* "was meant to introduce an inflexible hardening of the traditional formula for public employee pension modification." (*Marin Ass'n of Public Employees*, *supra*, 2 Cal.App.5th at p. 699.)

Moreover, the phrasing in *Allen II* was not a holding, because the Court in fact *rejected* the retirees' constitutional claim in that case without any discussion of the existence of "comparable new advantages." (*Allen II*, *supra*, 34 Cal.3d at p. 125.) The reason there was no discussion is that the statutory provision at issue contained no "new advantages" whatsoever to counterbalance the alleged contractual interference. (See *id.* at p. 118.) Thus, the factual context of *Allen II* cuts against petitioners' reading of the decision as imposing a new quid-pro-quo requirement: "If the court intended 'must' to have a literal meaning, the retirees would have won. They lost." (*Marin Ass'n of Public Employees*, *supra*, 2 Cal.App.5th at p. 699.)

More fundamentally, a mandatory and strict reading of the "comparable new advantage" factor makes no sense for several reasons:

First, if the "changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages" (*Allen I*, *supra*, 45 Cal.2d at p. 131), there could not be any "substantial impairment" from the very legislative change that neutralizes the disadvantage. Under the contract clause, if the impairment is not substantial, the courts would not go to the next step whether the change serves a legitimate public interest and that the change is reasonable. Yet, the test in *Allen I* suggests that the "comparable new advantages" are considered in the context of whether the change serves the legitimate public purpose of promoting the successful operation of the pension system.

Second, a requirement that any change be accompanied by a *comparable* new advantage would significantly hamper the Legislature's ability to solve the existing problems in the State pension system, including pension spiking. Since any modification to a pension system that contributes to its successful operation must reduce its unfunded liabilities, a requirement to add a comparable new advantage to compensate for the change that eliminates spiking would likely neutralize the improvements to the system's solvency achieved by the change.

The Court can avoid this problem by reading the "comparable new advantage" condition as being one factor in the determination of whether an impairment to a contract is *substantial* in the first instance. If the "comparable new advantage" is truly comparable, the overall legislative modification would not be a *substantial* impairment.

Third, a requirement that any reasonable and necessary modification of a pension system be accompanied by a "comparable new advantage" to the employee (beyond improving the pension system's solvency) would impose a de facto command upon the Legislature to draft specific additional compensatory terms into any legislation altering pension benefits. But this type of mandatory command to the Legislature is beyond the judicial power vested in the courts of this State. (*Monarch Cablevision, Inc. v. City Council, City of Pacific Grove* (1966) 239 Cal.App.2d 206, 211 [stating that a court "may not command or prohibit legislative acts" because doing so "would

violate the basic constitutional concept of the separation of powers among the three coequal branches of the government"]; *French v. Senate of State of California* (1905) 146 Cal. 604, 607 ["An attempt by this court to direct or control the Legislature, or either house thereof, in the exercise of the power, would be an attempt to exercise legislative functions, which it is expressly forbidden to do."].) Indeed, this Court did not require the Legislature to draft new language in order to enact the pension law at issue in *Allen II*, and amicus can find no case in which the Court has done so in any context.

Fourth, a rule requiring mandatory new benefits is not necessary to protect pension rights. If the absence of new benefits accompanying the removal of a pension benefit means that the repeal results in harsh consequences or strays from the character of a proper pension system, those are factors that may show that the Legislature's action is a substantial and unreasonable impairment.

A mandatory "*comparable* new advantage" rule is particularly improper when the provision to be repealed is *contrary* to the successful operation of the pension system and the Legislature's fix works only prospectively. There is no right to the continuation of specific windfall payments, like the airtime credit offer at issue here, that go beyond the right to a reasonable pension. After all, the right to a pension "is not rigidly fixed by the specific terms of the legislation in effect during any particular period in which [the employee] serves," because those terms are "subject to the

implied qualification that the governing body may make modifications and changes in the system." (*Kern*, *supra*, 29 Cal.2d at p. 855.) As this Court stated in *Allen II*, its decisions "have never given a law which imposes unforeseen advantages or burdens on a contracting party constitutional immunity against change." (*Allen II*, *supra*, 34 Cal.3d at p. 120, quoting *El Paso*, *supra*, 379 U.S. at p. 515; see also *Allen II*, 34 Cal.3d at p. 125 [stating that the respondents were not entitled to "a bonanza far outstripping any reasonable expectation"].) Nothing in *Allen II* or any other case cited by petitioners requires the State to replace specific flawed terms in the pension laws. Such a rule would unconstitutionally handicap future legislatures, which are not bound to the policy decisions of their predecessors. (See *Collie*, *supra*, 38 Cal.2d at p. 398.)[11]

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[11] The Court of Appeal's recent decision in *Alameda County Deputy Sheriff's Association v. Alameda County Employees' Retirement Association* (Jan. 8, 2018, A141913) 19 Cal.App.5th 61 [2018 WL 317045] demonstrates the unworkability of petitioners' position. The court there, analyzing other provisions in PEPRA, concluded that no "corresponding advantages" had been provided, and therefore that any detrimental effects could only be justified on remand by "compelling evidence." (*Id.* at *31.) The court stated that the proper analysis compares the impact on "specific" pension plan members with whether, without the changes, the pension plan would have difficulty meeting its obligations. (*Ibid.*) It then cautioned the trial court, on remand, to consider whether "the fact that the modifications here at issue may be relatively modest looking at a system's pension costs as a whole may actually argue in favor of finding an impairment." (*Ibid.*) Yet, this turns the constitutional test on its head, transforming any "*modest*" modification into a *substantial* impairment, and requires corresponding

E. Petitioners Have Not Met Their Burden To Show A Constitutional Violation.

Finally, petitioners have not met their heavy burden to establish a contract clause violation. In a contract clause case, ambiguities regarding the claimant's asserted rights "should be resolved in favor of the public," and petitioners therefore have the burden to "make out a clear case, free from all reasonable ambiguity," which places petitioners' asserted rights "fully and fairly within the protection" of the contract clause. (*Floyd v. Blanding* (1879) 54 Cal. 41, 43; see, e.g., *Deputy Sheriffs' Ass'n of San Diego County v. County of San Diego* (2015) 233 Cal.App.4th 573, 578 [same].)

Petitioners' arguments fall well short of that standard. The unexercised offer to sell airtime credits did not create a binding contract on the State, was operating contrary to the Legislature's intent and costing the State additional unfunded pension liabilities, and was not material to the theory of a pension system. Petitioners' failure to make a clear case that the Legislature intended that its airtime credit offer created a vested pension right, that its repeal was a substantial impairment of their pension rights, or that the repeal did not serve a reasonable and legitimate public policy is fatal to their attack on the constitutionality of the statute.

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advantages that neutralize the financial benefits of modest changes to reduce the unfunded liabilities.

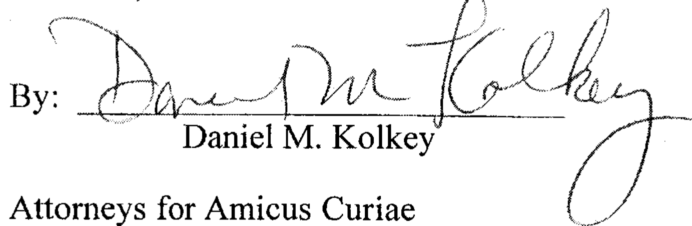
VII. CONCLUSION

For all of the foregoing reasons, PRI respectfully requests that the Court affirm the judgments below.

Dated: February 21, 2018

Respectfully submitted,

GIBSON, DUNN & CRUTCHER LLP



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CERTIFICATE OF WORD COUNT

In accordance with rule 8.520(c) of the California Rules of Court, the undersigned hereby certifies that this Brief of Amicus Curiae Pacific Research Institute in Support of Intervener and Respondent State of California contains 10,223 words, as determined by the word processing system used to prepare this brief, excluding the cover information, the tables, the signature block, and this certificate, according to the word count generated by the computer program used to produce this document.

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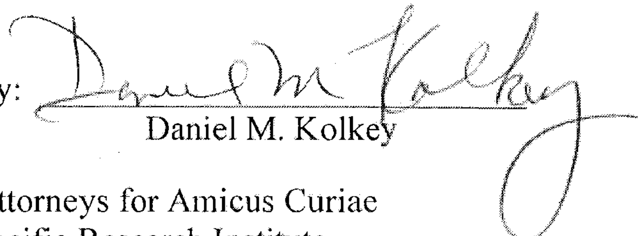

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PROOF OF SERVICE

I, Ariella Boeck, declare as follows:

I am employed in the County of San Francisco, State of California; I am over the age of eighteen years and am not a party to this action; my business address is 555 Mission Street, Suite 3000, San Francisco, California 94105-0921 in said County and State. On February 21, 2018, I served the within:

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☑ **BY MAIL:** I placed a true copy in a sealed envelope addressed as indicated on the attached service list for collection and mailing at my business location, on the date mentioned above, following our ordinary business practices. I am readily familiar with this business's practice for collecting and processing correspondence for mailing with the United States Postal Service. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the U.S. Postal Service in a sealed envelope with postage fully prepaid. I am aware that on motion of the party served, service is presumed invalid if the postal cancellation date or postage meter date on the envelope is more than one day after the date of deposit for mailing contained in the proof of service.

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