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

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 REPLY BRIEF ON THE MERITS

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INTRODUCTION

For many years, the unions and retirement boards involved in this litigation have used their post-*Ventura* settlement agreements as legal cover to engage in a wide array of impermissible and egregious pension-spiking practices. These practices inflated the final compensation on which an employee's pension is calculated by circumventing legal limits designed to promote uniformity and fairness. Examples of practices include adding vacation cashouts for which employees are only eligible after they retire; double- or triple-counting vacation hours accrued during an employee's final year of employment; "straddling" the "final compensation period" to enable the inclusion of annual leave cashouts from multiple calendar years; and letting employees volunteer for thousands of hours of additional standby shifts in their final year of work.

When the Legislature enacted AB 197 to end these abusive practices, the unions reflexively pointed to the settlement agreements to argue that AB 197 unconstitutionally impaired contractual rights. As their litigation has progressed, however, a major defect in the unions' strategy has emerged. The more closely the settlement agreements are scrutinized, the less clear it is that they actually require any of the prohibited practices, as the unions claim. For example, the CCCERA settlement agreement does not even apply to so-called "legacy" employees.[1] The retirement boards' "policies" and handbooks, meanwhile, often consist of no more than general principles or the most cursory summaries. And unsurprisingly,

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[1] Under the express terms of the agreement itself (which were never amended), no compensation earned after September 30, 1997 falls within the agreement's scope. (17 CT 4744.) Nor, in the words of CCCERA's legal counsel, is the agreement "binding as to any member who retired after September 30, 1997." (17 CT 4955; see also 17 CT 4957.) Impairment by AB 197—which applies only to employees who retire after January 1, 2013—is therefore impossible.

some of the most egregious practices were not put in writing, making it difficult for the unions to succeed in challenging AB 197 under the federal and state contract clauses.

Ultimately, the unions cannot meet their threshold burden of identifying valid promises actually impaired by AB 197. They desperately urge this Court to release them from their obligation "to show an explicit contractual agreement" (ACDSA Answer Br. 26) and to make out a clear case that AB 197 is unconstitutional (Unions' Answer Br. 35-36). This Court should decline. The ambiguities that the unions long exploited to cloak their spiking practices from the public now preclude any finding of impairment.

The unions also invoke a wide array of constitutional "rules" in their challenge to AB 197. These rules do not reflect this Court's precedent, however. They distort it. Review of this Court's jurisprudence shows that this Court has never held that an employee's vested pension rights are invariably violated when even a single term in a pension statute is modified on a purely prospective basis. This Court has never eliminated the threshold requirement that, for the contract clause to apply, a contractual impairment be substantial. This Court has never said that the only question that matters when reviewing the reasonableness of a pension modification is whether there are comparative new advantages. Nor has this Court ever held that no deference is owed the State when exercising its sovereign police power to promote the welfare of Californians.

Finally, the State urges this Court to reverse the lower court's injudicious and unprecedented estoppel decision. While the lower court and unions claim that the retirement boards misrepresented the law prior to AB 197, the issue of whether to enforce that prior law is not presented here. Rather, the issue is whether enforcement of AB 197 should be estopped. And as to that issue, it is dispositive that the retirement boards never misled

legacy employees as to any material fact related to AB 197. Statements made years before a statute's existence do not and cannot support later estopping the application of the statute, yet that is precisely the deeply flawed theory upon which the unions urge this Court to estop AB 197's application. In addition, the interests of public policy and justice could not more strongly disfavor estoppel here.

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

ARGUMENT

I. THE UNIONS FAILS TO ESTABLISH ANY VESTED RIGHT AFFECTED BY, LET ALONE IMPAIRED BY, AB 197

A. Payments Made Specifically to Enhance a Member's Benefit

Government Code section 31461, subdivision (b)(1),[2] was enacted to eliminate the practice of inflating pensions with irregular, ad hoc payments made to employees shortly before retirement specifically to enhance their pensions. For example, just a few days before retiring in 2008, one fire district chief secured a change to his contract that allowed him to retroactively cash out vacation leave that had previously been accrued only on a non-cashable basis. This change was made specifically so that he could inflate his pension with the resulting one-time cashout.[3]

The State previously explained how the Court of Appeal's mistaken interpretation of subdivision (b)(1) led it to find a likely impairment of

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

[3] Borenstein, Fire Board Aided Chief's Pension Spike (Aug. 6, 2009) East Bay Times <https://www.eastbaytimes.com/2009/08/06/daniel-borenstein-fire-board-aided-chiefs-pension-spike-2/> [as of August 22, 2018].

vested rights where none in fact exists. (State's Opening Br. 28-30.) Ignoring the Legislature's limited purpose of targeting practices like the one in the real-life example above, the lower court construed subdivision (b)(1) as potentially embracing "every item of compensation received by a CERL employee," even payments for special skills or payments pursuant to a MOU. (*Alameda County Deputy Sheriffs' Association v. Alameda County Employees' Retirement Assn.* (2018) 19 Cal.App.5th 61, 113.) As the State demonstrated, however, that construction cannot be reconciled with the Legislature's narrow aim or with other provisions in CERL, such as section 31529, subdivision (c), which make clear that payments for special skills or pursuant to a MOU do not fall within the scope of subdivision (b)(1). Properly understood, subdivision (b)(1) excludes a limited set of pay items which were never pensionable under CERL.

In their answer briefs, the unions offer no rebuttal of the State's statutory construction. Nonetheless, they insist that there was an impairment, citing a list of pay items in Alameda County that were excluded from pensionable compensation after January 1, 2013. This list includes payments such as "OneTime Payment" and "Employee of the Month (Zone 7)." (Unions' Answer Br. 23, citing 24 CT 7174.) However, evidence that ACERA tried to implement AB 197 is not the same as evidence that AB 197 has impaired a contractual obligation.

As a threshold matter, the unions do not identify which items were excluded solely under subdivision (b)(1), which were excluded under another provision, and which were *already* excluded before AB 197. For any items excluded solely under subdivision (b)(1), it is further unclear whether ACERA correctly followed subdivision (b)(1) in excluding them. In other litigation, the unions argued that a retirement board may only exclude items pursuant to subdivision (b)(1) after initiating the process set forth in section 31542. (See *Marin Assn. of Public Employees v. Marin*

County Employees' Retirement Association (2016) 2 Cal.App.5th 674, 691-692, review granted Nov. 22, 2016 (S237460).) Now they suggest that ACERA's categorical exclusions properly implemented subdivision (b)(1).

Even assuming that the exclusion of pay items pursuant to subdivision (b)(1) were proper, a more fundamental problem is that there is no indication of which, if any, of the items ACERA ever *promised* to include in pensionable compensation. The pay items were not a part of the ACERA settlement agreement. Nor was their pensionability promised in a MOU or contract. At most, ACERA had a *policy* of treating the items as pensionable. But a mere "practice or policy extended over a period of time does not translate into an implied contract right without clear legislative intent to create that right." (*Retired Employees Ass'n of Orange Cty., Inc. v. Cty. of Orange* (9th Cir. 2014) 742 F.3d 1137, 1142 [applying California law].) And because the unions fail to establish such intent, they cannot meet their threshold burden to demonstrate that subdivision (b)(1) impairs a contractual obligation.

Furthermore, the unions' basic assumption that, before AB 197, CERL permitted pensions to be based on payments specifically designed to enhance a member's pension is fundamentally flawed. The unions fail to respond to the State's argument that the idea of basing a public employee's pension on payments intended to spike the member's retirement benefit has always contradicted the fundamental theory of a pension system. (State's Opening Br. 31.) Rather, they only argue that *Ventura County Deputy Sheriffs' Assn. v. Board of Retirement* (1997) 16 Cal.4th 483 supposedly made *every single item* of compensation (except overtime) compensation earnable. (Unions' Answer Br. 41-42.) But *Ventura* did no such thing. (State's Opening Br. 32.) Moreover, *none* of the 20 CERL retirement boards understood *Ventura* in this way. (See, e.g., 23 CT 6717 [CCCERA's exclusion from pensionable compensation of payments

converted from in-kind benefits during the final compensation period].) The unions' argument that, before AB 197, payments made to enhance a member's pension were pensionable under CERL lacks merit.

Unable to show affirmatively that enhancement payments were pensionable before AB 197, the unions try to reach the same conclusion by pointing out that the Legislature paired subdivision (b)(1) with the new process set out in section 31542 to ferret out payments made to enhance a member's benefit. (Unions' Answer Br. 42.) This is a red herring. The Legislature created the section 31542 process to more effectively distinguish enhancement payments from other payments, and exclude them. Nothing in section 31542 suggests that payments made to enhance a member's benefit were pensionable before AB 197.

In sum, the unions do not identify any promise to legacy employees that was affected, let alone impaired, by subdivision (b)(1). Yet, even if they could identify such a promise, it would have been contrary to CERL and thus invalid. The unions cannot meet their burden of showing that subdivision (b)(1) impairs legacy employees' vested rights.

B. Leave Cashouts from Multiple Calendar Years, Straddled Across the Final Compensation Period

"Straddling" is a practice by which employees inflate their pensions with unused leave cashouts from multiple calendar years. (State's Opening Br. 34.) These cashouts from multiple calendar years are "straddled" across the final compensation period, enabling employees to *double* the amount of leave cashouts included in their pensionable compensation. (17 CT 4967, 4970.) Straddling was never permitted under CERL. But because some retirement boards nonetheless allowed the practice, subdivision (b)(2) was enacted to conclusively end it. Subdivision (b)(2) clarifies that employees may only include in their pensionable compensation cashouts equivalent to

the amount of leave both accrued and cashed out during each 12-month period of the final compensation period.

In their answer briefs, the unions do not defend straddling by name. They certainly never identify anywhere in a retirement board settlement agreement, policy, or handbook legacy employees are *promised* that they would be entitled to spike their pensions using straddling.[4] Instead, they defend straddling more elliptically, by claiming that prior law had no limits on leave cashouts and that subdivision (b)(2) should be interpreted in a way that continues to impose no limits. (Unions' Answer Br. 43-45.) In effect, however, the unions' position is that subdivision (b)(2) legalizes and protects straddling.[5]

This position is flawed for at least two reasons. First, it assumes that the Legislature has never been concerned about distortions "on the basis of accrued and unused leave." (*Salus v. San Diego County Employees Retirement Ass'n* (2004) 117 Cal.App.4th 734, 740.) In fact, as demonstrated by *Salus*, this concern is well-recognized. AB 197 is just the latest attempt by the Legislature to rein in pension spiking based on leave cashouts.

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[4] Indeed, ACDSA acknowledges that the State's interpretation of subdivision (b)(2) is *consistent* with what was promised in the ACERA settlement agreement. (ACDSA Answer Br. 32 [noting ACERA settlement agreement "does not call for the inclusion of leave cash outs in excess of the amount earnable in ACERA members' final compensation periods"].) At the same time, ACDSA does not deny that ACERA practices straddling, underscoring the need to determine whether subdivision (b)(2) obligates ACERA to immediately end its practice.

[5] The unions attempt to reframe the issue as whether the timing of leave accrual matters. (Unions' Answer Br. 43, 45-46.) This is another red herring. Under subdivision (b)(2), the issue is whether the cashout to be included in pensionable compensation reflects leave exceeding the amount of leave earned and cashable during the final compensation period. When exactly the leave was accrued is not relevant. (See State's Opening Br. 34-35.)

Second, the unions' position assumes that AB 197 does not have an anti-spiking purpose (or really any purpose at all), and was intended instead to *facilitate* spiking pensions using cashouts of leave in excess of the amount of leave that could be accrued during the final compensation period. But that view cannot be reconciled with extensive legislative history showing that AB 197 was designed to *stop* pension spiking. (State's Answer Br. 52-54). Indeed, the Legislature directly patterned subdivision (b)(2) on rules adopted by CCCERA to end straddling as to employees hired on or after January 1, 2011. (State's Opening Br. 36.) These rules were never challenged by the unions, but would be effectively nullified if this Court affirmed the lower court's ruling.

The unions also take issue with the State's argument that the operative qualifier in subdivision (b)(2)—"in an amount that exceeds that which may be earned and payable in each 12-month period during the final average period"—refers to leave *amounts*, as opposed to leave cashouts. (State's Opening Br. 35-36.) If the provision were truly intended to qualify leave "amounts," the unions argue, then the Legislature would have used the word "accrued" instead of "earned." (Unions' Answer Br. 46.) To be sure, replacing "earned" with "accrued" may have lessened the Court of Appeal's confusion. But the meaning of "earned" is clear enough in context, and mirrors the way that retirement boards themselves use the term in reference to amounts of leave. (See, e.g., 23 CT 6716 ["The value of accrued time, such as vacation, holiday, sick or administrative leave, that is both *earned* and sold back to the employer by the employee," italics added]); 23 CT 6770 ["vacation leave and/or sick leave paid as a lump sum shall be recognized as final compensation only to the extent that [the leave] is *earned* during the final compensation period," italics added].)

In sum, this Court should reject the lower court's interpretation of subdivision (b)(2). Straddling (which the lower court did not seem to

contemplate in it analysis) was never permitted under CERL. Nor were legacy employees promised that they would be able to inflate their pensions with straddling at the end of their careers. The unions fail to show that subdivision (b)(2)'s clarification of the law impairs any vested rights.

C. Payments for Services Rendered Outside Normal Working Hours

The unions make limited effort to situate their claim that subdivision (b)(3) impairs legacy employees' vested rights in promises allegedly made in the post-*Ventura* settlement agreements. Rather, they claim that in this case CERL previously demanded that standby and on-call pay be treated as pensionable. This claim lacks merit.

The unions concede that overtime pay has always been generally excluded from pensionable compensation, because it is not based on the "average number of days ordinarily worked by persons in the same grade or class." (Unions' Answer Br. 38.) Nonetheless, they insist that, before AB 197, CERL treated *other* types of payments for services rendered outside normal working hours—such as standing by on-call outside normal working hours—more favorably than actual work performed. But such favoritism toward compensation for merely *standing by* outside normal working hours, as opposed to compensation for *working* outside normal working hours, makes no sense. Moreover, the unions fail to identify any statutory language that would support distinguishing overtime pay from on-call and standby pay in this way. Indeed, they ignore that "the choice of the word 'days' rather than 'hours' or some other temporal measure" in former section 31461 "suggests reference to a standard work week (or month),"

excluding extra time outside of normal working hours. (*Ventura*, *supra*, 16 Cal.4th at p. 500, quotations omitted.)[6]

The unions' other arguments for why, before AB 197, CERL allegedly recognized a special "standby pay exception" are equally unpersuasive. They claim that "*Ventura* found that payments for being on call during meal periods were 'compensation earnable.'" (Unions' Answer Br. 38.) In fact, *Ventura* contains "no specific analysis . . . regarding on-call pay as a component of compensation earnable." (*Alameda County*, *supra*, 19 Cal.App.5th at p. 106.) And while *Ventura* determined that $60 biweekly payments for meal periods attached to mandatory, normally scheduled working hours were pensionable, that merely confirms the pensionability of pay for short on-call periods falling *within* employees' normally scheduled working hours. *Ventura* never held that pay for services rendered *outside* normal working hours was pensionable.

The unions also try to distinguish standby pay from overtime by claiming it is not paid at an overtime rate and, unlike overtime, does not cause the time basis for the "compensation earnable" calculation to exceed what is ordinarily worked by similarly situated employees. (Unions' Answer Br. 39.) Neither of these claims is true. Contrary to what the unions assert, standby pay *is* sometimes paid at an overtime rate. (E.g., 17 CT 4876 ["The employee on Stand-by Call receives nine hours extra overtime pay (at one and one-half times the basic pay) for the week on call. Pumping Station Operators receive eleven hours extra overtime pay for the week on call"].) And *precisely* like overtime, the inclusion of standby pay distorts the calculation of "compensation earnable" by making

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[6] This does not mean that hourly pay is categorically excluded from compensation earnable. Rather, the purpose of the language is to exclude pay divorced from the normal work schedule of similarly situated employees.

compensation earnable no longer based on "the average number of days ordinarily worked by" by similarly situated employees "and at the same rate of pay." (Former § 31461.)

Finally, the unions argue that subdivision (b)(3)'s importation of "outside normal working hours" terminology from the Public Employees' Retirement Law (PERL) shows that subdivision (b)(3) imported a new requirement into the law. (Unions' Answer Br. 39-40.) But the history of the limitation on payments for services rendered outside normal working hours in PERL shows that, when the language was added in 1993, it did not necessarily substantively alter PERL's definition of "compensation earnable." (See *Ventura, supra*, 16 Cal.4th at pp. 504-505.) Similarly here, the unions fail to show that subdivision (b)(3) substantively changed prior law, rather than clarifying it.

In sum, because subdivision (b)(3) was consistent with prior law and did not impair any prior promises to legacy employees, it did not impair any vested rights.

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 AB 197 altered the law, there was still no impairment because AB 197 only applies to compensation earned after its effective date. (State's Opening Br. 40-41.) Compensation for work performed before AB 197 came into effect is not affected. In light of AB 197's prospective scope, the State previously pointed out that the Court of Appeal's conclusion that the law impaired vested rights is puzzling. The lower court appeared to simply *assume* that legacy employees automatically acquired vested rights to the future pensionability of not-yet-earned pay items, such as standby pay that might be earned at the end of an employee's career. But this assumption was faulty. Absent the clear intent of the parties, such

a "right" is typically not recognized under contract clause analysis. (State's Opening Br. 43-45.)[7] And neither the retirement boards nor the Legislature evidenced any intent to establish such vested rights.

In their answer briefs, the unions dispute the State's conclusion, but offer no explanation for a right to the future pensionability of not-yet-earned pay items, immune from legislative modification. The post-*Ventura* settlement agreement, policies, and handbooks—which the unions otherwise claim as the source of vested rights at issue—directly conflict with the idea. The agreements, policies, and handbooks insist that when legacy employees reach their final compensation period, *CERL* will govern the calculation of their pension. (See, e.g., 23 CT 6769-6770 [mandating that the definitions of "compensation earnable" and "final compensation" used in the ACERA settlement agreement "be interpreted consistently with CERL"]; 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"]; 24 CT 7099 [stating that ACERA administers "the pension plan in accordance with the CERL"].) Courts have consistently interpreted such statements in a contract to mean that a party will "comply with existing *as well as future law*." (*Marina Plaza v. Cal. Coastal Zone Conservation Comm'n* (1977) 73 Cal.App.3d 311, 324, italics added; accord *Hermosa Beach Stop Oil Coalition v. City of Hermosa Beach*

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[7] The unions cite only two cases where they argue that a statute with a purely prospective scope, like AB 197, was held to be an unconstitutional impairment. (Unions' Answer Br. 51-52.) But neither case in fact involved a prospective-only statute. *Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 850, involved a statute that entirely divested a public employee of the pension he had been earning for nearly 20 years. *Legislature v. Eu* (1991) 54 Cal.3d 492, 531 involved an initiative that *terminated* the pension system as to additional benefits accruing for future services, causing some legislators to be entirely divested of the benefits they had already accrued, though were not yet eligible to receive.

(2001) 86 Cal.App.4th 534.) Thus, the retirement boards made it clear that legacy employees' pension calculations would be subject to future law, not immune from it.

Ultimately, the assumption underlying the unions' position seems to be that CERL establishes a vested right to the future pensionability of not-yet-earned pay items. But they identify nothing in CERL that shows "clearly and unequivocally" that the Legislature intended to create that kind of vested right. That absence of evidence of legislative intent matters. (*Retired Employees Assn. of Orange County, Inc. v. County of Orange* (2011) 52 Cal.4th 1171, 1185 ["to 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"].) CERL is a legal and regulatory framework for county retirement systems. Unlike PERL, parts of which may form a contract between the State and its employees, no part of CERL can be construed as an implied contract under which the Legislature makes promises regarding deferred compensation to county employees in exchange for their labor. As a result, absent an "unmistakable" indication that the Legislature intended to future legislators' hands, CERL does not independently confer any vested rights. (*Id.* at p. 1186, quoting *Claypool v. Wilson* (1992) 4 Cal.App.4th 646, 670.)[8] Nor, as ACDSA claims, has the Legislature ever relinquished its power to prospectively narrow the definition of compensation earnable. The Legislature has exercised its power repeatedly to modify the parameters of the definition of compensation earnable applying to active employees, including when it narrowed the definition by enacting section 31461.5. (State's Opening Br. 42.)

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[8] County employees of course acquire vested pension rights, but those rights are rooted in contracts among the employees, employers, and boards and must be consistent with CERL.

Yet, even in the case that CERL *were* held to directly confer vested pension rights, there would still be no impairment here. The cases cited by the unions hold that prospective modifications do not impair vested pension rights so long as the pension system is maintained and an employee can continue "to earn, through continued service, additional pension benefits in an amount *reasonably comparable* to those available when he or she first took office." (*Eu*, *supra*, 54 Cal.3d at p. 530, italics added.) Here, that standard is easily met because none of "the basic conditions" under which legacy employees earn a pension have changed. (*Packer v. Board of Retirement* (1950) 35 Cal.2d 212, 218.) Pensionable compensation still includes base salary, limited leave cashouts, and all premium and incentive 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. The unions fail to demonstrate that the pension benefits that legacy employees continue to earn through additional service are not "reasonably comparable" to those available before. (See also Part IV.A, *infra*.) Nor do they show that the Legislature's amendments to CERL were inconsistent with legacy employees' reasonable expectations.

III. THE COURT OF APPEAL'S TERMINAL PAY DECISION IS NOT PROPERLY BEFORE THIS COURT

Unlike the pay items excluded by subdivision (b)(1) and (b)(3), the Court of Appeal agreed with the State and Sanitary District that CERL always prohibited including in pensionable compensation leave cashouts payable only upon retirement. And because "terminal pay was never pensionable under CERL" (*Alameda County*, *supra*, 19 Cal.App.5th at p. 123), the court concluded that 1) the boards never had "the power to include terminal pay in compensation earnable as a matter of discretion (*id.*

at p. 125), and 2) legacy employees never had a vested right to the inclusion of leave cashouts payable only at retirement (see *id.* at pp. 102-105).

No party appealed these aspects of the Court of Appeal's decision in a petition for review in this Court or in an answer to one of the petitions. Yet, after declining to appeal and insisting that this Court should not grant review, the unions now opportunistically ask this Court to reverse the lower court's decision as to terminal pay. This Court should decline. Under this Court's rules and precedent, these issues are "not properly before" the Court. (*People v. Villa* (2009) 45 Cal.4th 1063, 1076; see Cal. Rules of Court, rule 8.516.) Moreover, the unions have provided no justification why this Court should bend the rules in their favor.

Should the Court nevertheless decide to reach the issues, it should affirm the lower court's conclusion for the reasons stated in the State's Answer Brief. The unions rely on a tortured reading of CERL and the case law to argue that including terminal pay in final compensation was consistent with CERL. However, as recognized by the Court of Appeal, as well as by the courts in *In re Retirement Cases* (2003) 110 Cal.App.4th 426 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. (*Alameda County*, *supra*, 19 Cal.App.5th at p. 103; *In re Retirement Cases*, *supra*, 100 Cal.App.4th at p. 475; *Salus*, *supra*, 117 Cal.App.4th at p. 740.) 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.[9]

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[9] Only ACERA and Merced CERA claimed to have a different understanding. In 2010, well before AB 197, CCCERA adopted a policy limiting the inclusion of cashouts at termination of unused leave to the amount of leave "that represents time both earned and cashable during the final compensation period." (23 CT 6716.) Though the policy only applied to those hired after 2010, it reflects CCCERA's understanding of what the pre-AB 197 law required.

The unions further argue 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.)

In sum, any promise to treat cashouts payable only upon termination as pensionable would have been contrary to CERL, and therefore invalid. (*Retired Employees*, *supra*, 52 Cal.4th at p. 1181.) That, in turn, is fatal to the unions' vested rights argument. (*Medina v. Board of Retirement* (2003) 112 Cal.App.4th 864, 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"].)

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

A. The Unions Fail to Show That AB 197's Exclusions Rise to the Level of Substantial Impairment

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 v. Board of Administration* (1983) 34 Cal.3d 114, 119 (*Allen II*).) A threshold issue is the severity of the alleged impairment, which in turn "measures the height of the hurdle the state legislation must clear." (*Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 830, quotations omitted.) Minimal alteration of contractual obligations like here does not trigger the contract

clause. (State's Opening Br. 47, citing *Allen II, supra*, 34 Cal.3d at p. 119.) The burden is on the unions to show that an impairment is significant. (See *RUI One Corp. v. City of Berkeley* (9th Cir. 2004) 371 F.3d 1137, 1147-1148 [indicating plaintiff has threshold burden to show law has operated as a substantial impairment].)

The unions fail to meet their burden. ACDSA's argument for why its burden is satisfied depends entirely on the alleged impairment of "rights" that clearly were never vested. Specifically, ACDSA asserts a substantial impairment because AB 197 excludes leave cashouts payable only upon retirement. (ACDSA Opening Br. 37; ACDSA Answer Br. 39 [alleging 15-percent reduction because of exclusion of leave cashouts at retirement]; *id.* at pp. 40-41 [alleging 50-percent reduction in pensionable vacation cashouts because of exclusion of leave cashouts at retirement].) As noted above, however, the lower court held that legacy employees never acquired a vested right to the inclusion of cashouts payable only upon retirement. ACDSA and the other unions then waived the issue by declining to appeal that aspect of the decision in a petition for review or in an answer to one of the petitions. As a result, ACDSA may not insist now that, contrary to the lower court's holding, there was a vested right to the inclusion of cashouts payable only upon retirement. There was no such vested right. And because only vested rights can be impaired, ACDSA's argument necessarily fails.

Meanwhile, the other unions make no attempt to demonstrate that AB 197's exclusions rise to the level of a substantial impairment. The unions baldly assert that "many employees" will lose "thousands of dollars per year," but cite no evidence in the record in support. (Unions' Answer Br.

51.)[10] They then attempt to reverse the burden by insisting that the State and Sanitary District have failed to show "that the impairment is *not* substantial." (*Ibid.*, italics added.) This argument, however, only concedes their inability to satisfy *their* threshold burden.

B. A Pension Modification May Be Reasonable Even Absent Comparative New Advantages

Were this Court to determine that AB 197's exclusions amounted to a substantial impairment of legacy employees' vested rights, the unions claim that the impairment would have been unconstitutional because the State failed to provide any new comparable advantages. According to the unions, once there is a determination that vested rights have been impaired, the only remaining question is whether the impairment was offset by comparable new advantages. If not, the impairment was per se unconstitutional and the analysis ends. The reasons for the impairment, and whether the State was exercising its police power (as opposed to pursuing its own self-interest), are completely irrelevant to the constitutional analysis.

As the Court of Appeal and other appellate panels have recognized, however, this approach misapprehends this Court's precedent by taking select quotations, stripping them of all context, and then canonizing them as inflexible, universal "rules." Consistent with general contract clause principles, the precedent of this Court and the U.S. Supreme Court alike has always required 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

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[10] This assertion is also implausible. That employees can no longer increase their pensions *prospectively* using ad hoc spiking enhancements or pay for standby shifts related to regular work assignments does not alter "the basic conditions" under which they can earn a pension, let alone reduce their annual pension by thousands of dollars.

["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 Co. of New York v. New Jersey* (1977) 431 U.S. 1, 25 [even a substantial impairment may not run afoul of the contract clause if "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. of Firefighters v. City of San Diego* (1983) 34 Cal.3d 292, 301.)

The absence of comparable new advantages, by contrast, is important, but not in itself invariably fatal, as the Court of Appeal and others have correctly noted. (*Alameda County*, *supra*, 19 Cal.App.5th at p. 120; see also *Hipsher v. Los Angeles Cty. Employees Ret. Ass'n* (2018) 234 Cal.Rptr.3d 564, 573; *Cal Fire Local 2881 v. California Public Employees' Retirement System* (2016) 7 Cal.App.5th 115, 131, review granted April 12, 2017 (S239958); *Marin*, *supra*, 2 Cal.App.5th at p. 699].) If the impairment is limited and does not meaningfully alter an employee's right to a "substantial or reasonable pension" (*Miller v. State of California* (1977) 18 Cal.3d 808, 816), or if it only operates prospectively and is reasonable and necessary to serve an important public purpose, it may be permissible under the contract clause.

The unions cite several Supreme Court cases in support of their proposed "California Rule." But none establishes the narrow, categorical rule they describe. As discussed in more detail in the State's Answer Brief, *Allen v. City of Long Beach* (1955) 45 Cal.2d 128 (*Allen I*), *Abbott v. City of Los Angeles* (1958) 50 Cal.2d 438, and *Betts v. Board of Administration* (1978) 21 Cal.3d 859 each involved the wholesale replacement of a "fluctuating" pension formula with a "fixed" pension formula, resulting in extraordinarily severe reductions in the pensions that employees were on

the cusp of receiving. These severe changes, were not materially related to the successful operation of the pension system, and there was no effort to apply the change on a prospective basis only. While the Court concluded that the absence of new advantages rendered the changes unconstitutional, it did so only because no compelling justification for the changes had been offered. (State's Answer Br. 48-50.) Consequently, these cases fail to support the unions' position that the absence of new advantages *alone* is fatal, regardless of the impairment's purpose.

Olson v. Cory (1980) 26 Cal.3d 532 posed a similar scenario, except involving retirees. The Legislature enacted a law limiting annual cost-of-living increases in judicial salaries, which had the effect of limiting cost-of-living adjustments for retired judges' pensions. (*Id.* at pp. 537, 540-541.) The State appeared as if it would benefit financially from these changes, but "offer[ed] no reason or justification for the state action." (*Id.* at pp. 539, 541.) It was *in the absence of any justification for the impairment* or comparable new advantages that this Court concluded the law was unconstitutional. (*Id.* at p. 541.)

The unions' claim that *Eu* affirmed the rule they propose here is also inaccurate. 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." The consequence of this termination were severe, including entirely divesting some legislators of the benefits they had already accrued, though were not yet eligible to receive, and jeopardizing the ability of current legislators to earn a substantial pension going forward. (*Id.* at pp. 530-531.) In the absence of any comparable new benefits, this Court concluded that these radical changes were unconstitutional. But nothing in the case suggests that

modest modifications with no impact on already accrued benefits—like the ones at issue here—are subject to the same test.

Finally, the unions place considerable weight on language in *Allen II* that, read in isolation, appears to mandate comparable new advantages. But the language noted is clearly "dicta" (*Hipsher*, *supra*, 234 Cal.Rptr.3d at p. 572), and the case ultimately does more to undermine the unions' position here than support it. In *Allen II*, a new law withheld from retired former legislators an unexpected windfall, modifying their vested pension rights. (*Supra*, 34 Cal.3d at p. 125.) Contrary to the unions' theory, however, this Court did not require 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 *Allen II*, 34 Cal.3d at pp. 123-125.)

In sum, 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*, *supra*, 7 Cal.App.5th at p. 131.) 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, to which the State was not party. The unions' proposed "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 v. Simmons* (1965) 379 U.S. 497, 508-509.)

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

The unions' argument that AB 197's exclusions were not reasonable turn entirely on whether this Court adopts a rule requiring comparative new advantages to offset any disadvantageous modification of a pension benefit. Thus, if the Court does not adopt such a rule, the unions make no argument that AB 197's exclusions were not reasonable and necessary to serve important public purposes.

Only ACDSA makes an argument that AB 197's exclusions were not justified. But its argument rests on two premises, neither of which is correct. ACDSA claims first that AB 197's exclusions impair the State's "own financial obligations," and thus trigger heightened scrutiny of the State's asserted justification. (ACDSA Answer Br. 44.) This is false. The challenged provisions of AB 197 impact the financial obligations of CERL retirement systems and county employers. They do not affect the State financially. The State is not a party to contracts between the retirement boards and their members. And while there are provisions of PEPRA that affect the State's financial obligations, none of them are part of AB 197 or at issue in this litigation. In sum, AB 197 is not an effort by the State to further its own self-interest. Instead, it represents the proper exercise of the State's police power. Consequently, the State's asserted justification is entitled to deference. (*RUI One Corp.*, *supra*, 371 F.3d at p. 1147 ["Unless the State itself is a contracting party, . . . courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure,'" quotations omitted].)

The other premise for ACDSA's argument is equally unfounded. AB 197's exclusions were *not* merely intended to save money. In its Answer Brief, the State explains the multiple problems motivating AB 197, and why AB 197's specific exclusions were needed to end abusive pension-

spiking practices 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. (State's Answer Br. 52-54.) Only professional cynics would dismiss these motivations as nothing more than an effort to save money.

V. THE UNIONS' THEORY OF ESTOPPEL IS DEEPLY FLAWED

A. None of the Requisite Elements for Equitable Estoppel Are Satisfied

Previously, the State pointed out that *none* of the requisite elements for estopping the application of AB 197 (and specifically subdivision (b)(4)) were satisfied. (State's Opening Br. 52.) The unions insist otherwise, but (like the lower court) never do a step-by-step analysis to support their claim. More fundamentally, their argument for estoppel is entirely premised on vague claims that the retirement boards "misrepresented" what was permitted *under the pre-AB 197 law.* Were the respondents seeking to apply the pre-AB 197 law to those who retired before January 1, 2013, such claims might at least in theory be relevant.[11] However, none of the respondents here are seeking to apply pre-AB 197 law to those who retired before 2013. In this litigation, they are simply trying to enforce AB 197 and only apply that law to pay items earned *after* the law's effective date of January 1, 2013.

To begin to satisfy the requisite elements for estopping the retirement boards from applying AB 197, the unions must make some threshold showing that the retirement boards misrepresented *AB 197* to legacy

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[11] At the same time, the unions continue to fail to demonstrate that the settlement agreements promised legacy employees anything in conflict with AB 197. The CCCERA settlement agreement did not make *any* promises to legacy employees. And, as discussed previously, the ACERA agreement does not contain the specific promises regarding terminal pay that are alleged by the unions. (State's Answer Br. 23-25.)

employees, that legacy employees were not aware of the "true state of facts" related to AB 197, and that employees relied upon the boards' misrepresentation of AB 197 to their detriment. But the unions nowhere attempt to make such a showing. There is no allegation in the record that the boards ever misled legacy employees as to any material fact related to AB 197. Nor is there any allegation that legacy employees were ignorant of the facts regarding AB 197, or relied upon representations related to AB 197 to their detriment. (To the contrary, the record shows that the retirement boards sought to faithfully implement AB 197 as soon as it was enacted and went to great lengths to keep employees informed.) And all of the undefined misrepresentations vaguely referenced by the unions were alleged to have taken place years before AB 197 came into existence. Thus, none of the alleged misrepresentations support a claim that the boards' enforcement of AB 197 contradicts a position that they previously took when AB 197 was not in existence.

The unions maintain that the retirement boards made "factual" representations years ago about the inclusion of terminal pay that, because of the later enactment of AB 197, turned out not to be true. (Unions' Answer Br. 63.)[12] This is incorrect. The boards neither purported to be omniscient nor ever told legacy members that the calculation of pensionable compensation would be unaffected by future laws, like AB 197. To the contrary, the boards repeatedly and consistently told legacy employees that their pensions are governed by CERL and would be calculated pursuant to CERL. (See, e.g., 23 CT 6769-6770 [mandating that

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[12] The unions' concession that the alleged misrepresentations were merely "factual," and "not legal in nature," directly undercuts the notion that the misrepresentations were "advice" about the law's effect offered to legacy employees in a confidential relationship. The unions' reliance on *Driscoll v. City of Los Angeles* (1967) 67 Cal.2d 297 is misplaced.

the definitions of "compensation earnable" and "final compensation" used in the ACERA agreement "be interpreted consistently with CERL"]; 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"].) Courts have consistently interpreted such statements in contracts to mean that a party will "comply with existing as well as future law." (*Marina Plaza*, *supra*, 73 Cal.App.3d at p. 324.) Thus, contrary to the unions' suggestion, legacy employees were told that they would be subject to laws that may change with time, not that they would be "immune" from future laws, like AB 197. (*RUI One Corp.*, *supra*, 371 F.3d at p. 1150.) The unions' asserted factual misrepresentation is based on a mischaracterization of the record.

Furthermore, even if retirement boards had mistakenly told employees that the calculation of their pensions would be unaffected by future laws (which they did not), such statements would not support equitable estoppel. Retirement boards *administer* the governing pension law established by the Legislature; they do not have authority to independently carve out exemptions to the law. If they did, a government entity could effectively immunize its employees (or members) from future law by simply telling them that any future legal changes would not apply to them. Under the unions' theory, if the Los Angeles City Police Department, for example, told its employees that they would be unaffected by any future legal changes to officer liability, then the department could be estopped from ever applying new laws to them related to officer liability. Such an unprincipled theory of estoppel would radically restrict the Legislature's powers on no constitutional basis.

B. The Retirement Boards' Authority to Settle Litigation Does Not Allow Them to Permanently Carve Out Employees from the Legislature's Authority

Even in the face of this Court's direction that estoppel many not be used to "contravene directly any statutory or constitutional limitations" (*Longshore v. County of Ventura* (1979) 25 Cal.3d 14, 28), the unions argue to the contrary. Yet, in none of the cases they rely on did a court compel a government agency to violate clear legislative prohibitions on a prospective basis, like the lower court did here in requiring the retirement boards to violate AB 197. Nor do the unions cite any case where a court blessed an agency's reliance on its "administrative" authority to settle litigation in a way that permanently carves out public employees from the Legislature's authority.

ACDSA does not dispute that the lower court's application of estoppel empowers retirement boards to usurp the Legislature's exclusive authority to define public pension benefits under CERL. Indeed, it claims that estoppel is necessary to avoid wasteful litigation. (ACDSA Answer B. 63.) Yet, even under that theory (which is wrong), estoppel should only apply with respect to the specific *issue of law* settled by the board. There is no basis for using estoppel to enable boards to permanently exempt employees from all future laws, as the lower court did here.

C. The Interests of Public Policy and Justice Strongly Favor Ending Abusive Pension-Spiking Practices and Applying the Same Rules to All Legacy Employees

The unions claim "justice and right" demands estopping the retirement boards from enforcing duly-enacted law and extending abusive pension-spiking practices for decades. (Unions' Answer B. 71.) In fact, the interests of public policy and justice could not more strongly favor ending unlawful practices that have long been ripping off taxpayers, unfairly benefitting some employees at the expense of others, and undermining the integrity of CERL systems.

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: August 22, 2018

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that the attached REPLY BRIEF ON THE MERITS uses a 13 point Times New Roman font and contains 7,998 words.

Dated: August 22, 2018

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/s/ Rei Onishi

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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 August 22, 2018, I served the State of California's REPLY 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 August 22, 2018, at Sacramento, California.

AD Ritchie

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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