SUPREME COURT
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Case No. S247095

# IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

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*ALAMEDA COUNTY DEPUTY SHERIFF'S 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;*

*SERVICE EMPLOYEES INTERNATIONAL UNION, LOCAL 1021, et al.,*
*Interveners;*

*BUILDING TRADES COUNCIL OF ALAMEDA COUNTY et al.,*
*Interveners and Appellants.*

After an Order by the Court of Appeal, First Appellate District,
Case No. A141913, Contra Costa County Superior Ct. Case No. MSN12-1870
(Coordinated with Alameda Superior Ct. Case No. RG12658890
and Merced Superior Ct. Case No. CV003073)

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## PETITIONERS' OPENING BRIEF ON THE MERITS

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DAVID P. MASTAGNI, ESQ., SBN 57721
DAVID E. MASTAGNI, ESQ., SBN 204244
ISAAC S. STEVENS, ESQ., SBN 251245
**MASTAGNI HOLSTEDT, APC**
1912 I Street, Sacramento, CA 95811
Telephone: (916) 446-4692 / Facsimile: (916) 447-4614
Attorneys for Petitioners and Appellants,
ALAMEDA COUNTY DEPUTY SHERIFFS' ASSOCIATION, JON RUDOLPH, ROCKY MEDEIROS, JAMES NELSON, and DARLENE HORNSBY

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I

## ISSUE PRESENTED

Does the Contracts Clause of the California Constitution require that any modification to public employees' pension benefits resulting in a disadvantage to the employees be accompanied by an offsetting new advantage?

II

## SUMMARY OF THE ARGUMENT

The framework for analyzing whether changes to vested pension rights are constitutional is simple: the Court must look at whether the change results in a detriment to employees and, if it does, must then determine whether the change is reasonable and necessary for an important public purpose. Saving money is not an important public purpose. In determining whether a modification is reasonable, this Court has said any detrimental change must be material to the theory of a pension *and* offset by a corresponding new advantage. This framework, often referred to as the California Rule, prevents the State from changing employees' vested pension benefits to save money to use elsewhere – any change must be essentially cost neutral to survive constitutional scrutiny.

The appellate court failed to recognize the Petitioners' vested right to have terminal pay and other pay items included in their pension calculations pursuant to a court-approved settlement and the representations ACERA

made to its members. The court found a vested right to a pension using a definition of compensation earnable that did not require the retirement board to determine whether pay items included were paid to enhance retirement benefits. Then the appellate court said the State could impair that right without providing any corresponding new advantage. Specifically, the appellate court stated, "much of *Marin's* vested rights analysis – including its rejection of an absolute need for comparable new advantages when pension rights are eliminated or reduced – is not controversial, and we do not disagree with it." (*Alameda County Deputy Sheriffs' Association v. Alameda County Employees Retirement Association* (2018) 19 Cal.App.5th 61, 121 ("*ACDSA*."))

This third attempt by the First Appellate Court to erode the California Rule breaks with decades of this Court's vested rights jurisprudence.[1] (*Marin Association of Public Employees v. Marin County Employees' Retirement System* (2016) 2 Cal.App.5th 674 ("*MAPE*"); *Cal Fire Local 2881 v. California Public Employees' Retirement System* (2016) 7 Cal.App.5th 115 ("*CalFire*.")) By removing the corresponding new advantage requirement, the appellate court invites the State to impair vested rights to divert money to politically favored spending priorities. Tellingly,

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1 The First Appellate District recently issued a fourth decision involving judicial pensions which cited approvingly to *MAPE* and *Cal Fire*. (*McGlynn v. State* (2018) 21 Cal.App.5th 548, 551 FN 3.)

Governor Brown admitted this fundamental change in California's vested rights doctrine meant that, during the next recession, the government would "have the option of considering pension cutbacks for the first time in a long time."[2]

The appellate court suggested broader reductions in pension benefits could be permissible if predicated on a fear of system collapse. The appellate court erred in narrowly focusing its reasonableness analysis on the funding status of each pension system, instead of the employer's overall financial condition, despite the fact that the pension is the employer's obligation. More fundamentally, the court's consideration of the need to save pension costs ignored Ninth Circuit and California precedent under the U.S. and California Constitutions that cost savings do not justify impairing financial obligations. Preserving the California Rule is consistent with longstanding Contracts Clause jurisprudence holding public agencies cannot eliminate or reduce their financial obligations without invoking the power of the Bankruptcy Court in a Chapter 9 bankruptcy proceeding.

This Court should reverse the appellate court's decision in this case and affirm to the lower courts that it meant "must" when it held any modification to public employees' vested pension rights "resulting in

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2 Pensions will be 'on the chopping block' in next recession, Jerry Brown says, Sacramento Bee, January 12, 2018 (http://www.sacbee.com/news/politics-government/the-state-worker/article194434479.html)

disadvantage to employees, *must* be accompanied by comparable new advantages." (*Allen v. Board of Administration* (1983) 34 Cal.3d 114, 120.) ("*Allen II*") (Emphasis added.)

## III

## FACTUAL AND PROCEDURAL BACKGROUND

### A. PETITIONERS' PENSION BENEFITS

Petitioner ACDSA is the employee organization representing deputy sheriffs in the County of Alameda. Petitioners Rudolph, Medeiros, Nelson, and Hornsby are, or were, employees of the County of Alameda and represented by the ACDSA in employee relations. The County of Alameda maintains an employee retirement plan under the County Employees' Retirement Law ("CERL") administered by the Alameda County Employees' Retirement Association ("ACERA.")

Petitioners' retirement benefits are a combination of a retirement annuity based on their accumulated contributions, supplemented by a pension established with county contributions sufficient to equal a specified fraction of their "final compensation." (*Ventura County Deputy Sheriffs' Assn v. Board of Retirement* (1997) 16 Cal.4th 483, 490 ("*Ventura*.") To calculate an employee's retirement amount, ACERA must determine whether items paid to the employee are "compensation" under Government Code section 31460 and "compensation earnable" pursuant to Government Code section 31461.

Government Code section 31460 defines "compensation" as "the remuneration paid in cash out of county or district funds, plus any amount deducted from a member's wages for participation in a deferred compensation plan . . . but does not include the monetary value of board, lodging, fuel, laundry, or other advantages furnished to a member." Government Code section 31461 defines "compensation earnable" and, as discussed below, was modified significantly by the Public Employees' Pension Reform Act ("PEPRA.")

For years, ACERA included in employees' compensation earnable standby pay, call-back pay, and cash received for cashing out sick leave and vacation hours. It did so pursuant to a settlement agreement between ACERA, employee organizations, and the County of Alameda, executed after the *Ventura* case. The cost of including these pay items in employees' pension benefits was included in ACERA's actuarial assumptions, and factored into the contribution rates ACERA charged employees and their employers. As such, ACERA's members have *paid* for the benefit of having these pay items included in their pensions.

This changed when PEPRA was enacted. ACERA announced, effective January 1, 2013, it would no longer include these pay items in compensation earnable. This change reduced employees' pension benefits. The affected employees received no new offsetting advantages in return for these reductions.

## B. PEPRA REDEFINED "COMPENSATION EARNABLE"

PEPRA became effective January 1, 2013, drastically changing the laws governing public employees' pension benefits. This suit challenges PEPRA's changes to Government Code section 31461, which provides the definition of "compensation earnable" used to calculate employees' pension benefits.

Before PEPRA's enactment, Government Code section 31461 defined "compensation earnable" as "the average compensation as determined by the board for the period under consideration upon the basis of the average number of days ordinarily worked by persons in the same grade or class of positions during the period, and at the same rate of pay. (Govt. Code § 31461(a).) "The computation for any absence shall be based on the compensation of the position held by the member at the beginning of the absence." (*Id.*) "Compensation, as defined in section 31460, that has been deferred shall be deemed 'compensation earnable' when earned, rather than when paid." (*Id.*)

PEPRA moved the old definition of compensation earnable to its own subsection, then added a subsection (b) to Government Code section 31461, excluding various forms of pay from "compensation earnable." Government Code section 31461(b) provides:

> (1) Any compensation determined by the board to have been paid to enhance a member's

retirement benefit under that system. That compensation may include:

(A) Compensation that had been previously provided in kind to the member by the employer or paid directly by the employer to a third party other than the retirement system for the benefit of the member, and which was converted to and received by the member in the form of a cash-payment in the final average salary period.

(B) Any one-time or ad hoc payment made to a member, but not to all similarly situated members in the member's grade or class.

(C) Any payment that is made solely due to the termination of the member's employment, but is received by the member while employed, except those payments that do not exceed what is earned and playable in each 12-month period during the final average salary period regardless of when reported or paid.

(2) Payments for unused vacation, annual leave, personal leave, sick leave, or compensatory time off, however denominated, whether paid in a lump sum or otherwise, in an amount that exceeds that which may be earned and payable in each 12-month period during the final average salary period, regardless of when reported or paid.

(3) Payments for additional services rendered outside of normal working hours, whether paid in a lump sum or otherwise.

(4) Payments made at the termination of employment, except those payments that do not exceed what is earned and payable in each 12-month period during the final average salary period, regardless of when reported or paid.

## C. IMPLEMENTING PEPRA REDUCED PENSION BENEFITS

Under the auspices of implementing PEPRA, ACERA excluded certain previously included pay items from Petitioners' "compensation earnable." These exclusions applied to new and legacy members alike. Specifically, ACERA announced it would exclude on-call and call-back pay, pay for performance benefits, vacation and sick leave sold back at retirement, and various other payments. (Minutes of the January 17, 2013 Meeting of the ACERA Board of Retirement, p. 6 (42 CT 012336.)) These changes significantly reduced employees' pension benefits. (*See* Miles Declaration in Support of Appellants' Motion for Stay of Appeal filed May 29, 2014, ¶ 5 ($1,000/month reduction); Medeiros Declaration in Support of Appellants' Motion for Stay of Appeal filed May 29, 2014, ¶ 14 ($850/month reduction.))

In implementing PEPRA, ACERA declared it would no longer include a large portion of members' vacation cash outs in their pension benefits. (*See* ACERA Members: How Does the New CA Pension Law Affect You?, p.1; 24 CT 007168.) Instead, ACERA announced compensation earnable would only include vacation employees sold back while still employed. (24 CT 007168.)

ACERA also declared sick leave cash outs would no longer be included in Safety members' final compensation. (24 CT 007169.) As a

result, Safety members in ACERA were no longer entitled to include 13 or 39 days of sick leave cash out in their final compensation.

Finally, ACERA announced that many other forms of pay that were previously included in final compensation would no longer count towards members' pension benefits. These forms of pay included: 232 (On-call Duty); 284 (Emergency Response); 316 (Water Quality Analyst Cert); 369 (Pay for Performance); 403 (Election Poll Worker); 405 (Emergency Call Coverage); 452 (Canine Care); 715 (Recruit Bonus); 716 (OneTime Payment); 829 (CWW ERU 24hr Shift OnCall Cov.); 830 (Member, Planning Commission); 912 (Members, LAFC); 913 (Member, Assessment Appeals Board); 914 (Member, Retirement Board); 915 (Member, Board of Equalization); 917 (Member, Board of Dir-Flood Control); CAO (Comp Time Payoff (Alt Wrk Sch); EOM (Employee of the Month (Zone 7); ERR (Emergency Response); 150 (Converted 5D DSA In-Lieu Payoff); ICO (In-lieu Payoff - Court (Expire)); IDO (DSA In-Lieu Payoff (Expire)); INO (In-lieu Payoff (Non Expiring)); IPO (Payoff in Lieu Balance); S00 (Share the Savings $100); S50 (Share the Savings $50); S75 (Share the Savings $75); SBY (Standby); SLC (Sick Leave - Cash Out 20%); SNP (Short Notice Cov. Pay-Zone 7); SS2 (Shift Standby - Shift 2); SS3 (Shift Standby - Shift 3); SS6 (Shift Standby - Shift 6); SS8 (Shift Standby - Shift 8); SSA (Shift Standby - Shift A); SSY (Shift Standby - Shift Y); SSZ (Shift Standby - Shift Z); TSR (Call Back); TRW (Call Back); VMC (Vacation Maximum

Cashout); VPO (Vacation Payoff). (*See* County of Alameda: Pay Codes Not Compensation Earnable After January 1, 2013 (24 CT 007174; 37 CT 11017-11025.)

## D. PROCEDURAL HISTORY

Petitioners filed this action in the Superior Court for the County of Alameda in December 2012, as a petition for mandamus relief requiring ACERA to continue including the disputed pay items in legacy employees' pension calculations. The petition alleged PEPRA impaired Petitioners' vested pension benefits. It sought relief on constitutional and promissory estoppel grounds.

The matter was later consolidated with similar challenges filed in Merced and Contra Costa County, and heard by Judge Flinn in the Contra Costa Superior Court.

### 1. Trial Court Proceedings and Judgment

The trial court separated the litigation into phases. Phase One was limited to purely legal issues focused on whether pay items expressly excluded from compensation earnable by PEPRA were includable under prior CERL law and whether, if not, legacy members could nonetheless obtain a vested right to have such compensation included.

The trial court issued its decision on May 12, 2014. Along with its decision, the trial court issued judgments specific to each retirement system, and ordered the issuance of related writs of mandate. The court's judgments

denied Petitioners' request to have PEPRA deemed an unconstitutional impairment of the vested rights of legacy members.

The trial court's decision in the case first addressed the "timing issue" – whether compensation had to be earned *and* payable in the final compensation period before PEPRA amended Government Code section 31461. The court determined that cash-outs of leave that were not earned during the final compensation period could not be included in compensation earnable, even before PEPRA was enacted. The court further determined that terminal pay could not be included in compensation earnable, because it was not payable during the final compensation period – only at retirement.

Next, the court addressed whether PEPRA's exclusion of "payments for additional services rendered outside of normal working hours, whether paid in lump sum or otherwise" required ACERA to exclude on-call and call-back pay. On this issue, the court directed ACERA to continue including the pay in legacy members' compensation earnable, "in those limited circumstances where the pay category was previously included and the amount to be included was both earned and required of the employee during his or her final compensation period."

The trial court denied Petitioners' estoppel claims, ruling that promissory estoppel was unavailable on the facts presented.

Finally, the court addressed whether PEPRA changed the definition of compensation earnable by excluding "any compensation determined by the board to have been paid to enhance a member's retirement benefit." The court denied Petitioners' request for relief, ruling in essence any danger of this new exclusion affecting them was pure speculation.

### 2. The *MAPE* and *CalFire* Decisions

While this case was on appeal, the First District Court of Appeal issued rulings in *MAPE* and *CalFire*. Like this case, *MAPE* addressed PEPRA's changes to the definition of "compensation earnable" used to calculate pension benefits. *CalFire* dealt with PEPRA's elimination of "air time."

In *MAPE*, the appellate court ruled PEPRA did not unconstitutionally impair employees' pension benefits because it left a "reasonable" benefit intact. (*MAPE*, *supra*, 2 Cal.App.5th at p. 707.) In reaching this conclusion, the court opined that a detrimental change to pension benefits need not be accompanied by a comparable new advantage to be deemed constitutional. (*Id.*, at p. 698.)

The *MAPE* court held this Court misconstrued its own precedent in *Allen II, supra,* 34 Cal.3d 114, which stated that, to survive constitutional scrutiny, any modification "must be accompanied by comparable new advantages." According to the *MAPE* court, the 1983 *Allen II* decision's use of the word "must" simply misstated this Court's prior rulings. (*MAPE*,

*supra*, 2 Cal.App.5th at p. 698.) The *MAPE* court opined it did "not believe the word 'must' was intended to be given the literal and inflexible meaning" the *MAPE* plaintiffs attributed to it.

As discussed herein, this ruling breaks from decades of precedent requiring any changes to be offset by comparable new advantages. The Court granted review in *MAPE*, and deferred further action pending the decision in this case. (*Marin Assn. Of Public Employees v. Marin County Employees' Retirement Association* (2016) 210 Cal.Rptr. 3d 15.)

The appellate court then issued its decision in *CalFire*, which challenged PEPRA's elimination of the option to purchase "airtime" service credit. Despite finding no vested right to purchase airtime, the court gratuitously affirmed *MAPE* by holding the state was not required to provide a comparable new advantage to offset the loss of airtime even if it was a vested right. (*CalFire, supra*, 7 Cal.App.5th 115, 130-31.) The court reiterated *MAPE*'s assertion that this Court did not mean detrimental changes to pension rights *must* be offset by new advantages. This Court granted review in the *CalFire* case on April 12, 2017. (*CalFire Local 2881 v. California Public Employees' Retirement System* (2017) 216 Cal.Rptr.3d 119.)

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### 3. The Court of Appeal Holds Pension Reductions Need Not Be Offset by New Advantages to Survive Scrutiny

Petitioners timely appealed the decision in this case, as did the Respondents and Intervenors. The matter was argued in December 2017, and the court issued its ruling on January 8, 2018.

The appellate court affirmed in part and reversed in part the trial court's ruling, and remanded the matter for further proceedings. Among other things, the appellate court affirmed the trial court's ruling that terminal pay was not pensionable before PEPRA's enactment, and thus PEPRA did not change how terminal pay was treated with respect to calculating pension benefits. (*ACDSA*, *supra,* 19 Cal.App.5th at pp. 102-103.)

The appellate court found PEPRA impaired employees' vested rights by adding a new requirement that compensation earnable cannot include pay to employees for the purposes of enhancing their retirement benefit. (*Id.*, at p. 110.) This impaired employees' vested right to a pension based on the pre-PEPRA definition of compensation earnable that contained no such requirement. Additionally, the appellate court correctly reversed the trial court's ruling denying Petitioners' estoppel claims, finding the Petitioners were entitled to pension benefits that included the pay items at issue because they relied on representations from their employer and ACERA. (*Id.*, at pp. 128-129.)

IV

## LEGAL ARGUMENTS

Petitioners have a vested right to pension benefits based on the compensation earnable they were promised would be included. This means the Petitioners are entitled to pensions based on compensation earnable that included the value of leave cash outs and the other disputed pay items at issue in this case. The appellate court erred in finding no vested right to the inclusion of terminal pay and the other disputed pay items. Vested pension rights are deferred compensation, and cannot be destroyed without impairing a contractual obligation. The appellate court compounded its error by failing to follow this Court's precedent and creating a framework to impair vested rights to obtain financial savings – contravening the Contracts Clause of the U.S. and California Constitutions.

The Contracts Clause exists to protect beneficiaries of States' long-term financial obligations against changes in political opinions and policy goals by successive legislatures. When the federal Constitution was adopted, "the widespread distress following the revolutionary period and the plight of debtors had called forth in the States an ignoble array of legislative schemes for the defeat of creditors and the invasion of contractual obligations. Legislative interferences had been so numerous and extreme that the confidence essential to prosperous trade had been

undermined and the utter destruction of credit was threatened." (*Home Bldg. & Loan Ass'n v. Blaisdell* (1934) 290 U.S. 398, 427-28 (concurring opinion of Justice Olson.)) As a result, the Contracts Clause was necessary as "an additional fence[] against the dangers ... [of] sudden changes and legislative interferences, in cases affecting personal rights, [which] become jobs in the hands of enterprising and influential speculators, and snares to the more-industrious and less informed part of the community." (The Federalist, No. 44, at 1 (Madison).) Thus, from an early period, "the general purpose of the Clause was clear: to encourage trade and credit by promoting confidence in the stability of contractual obligations." (*U.S. Trust Co. v. New Jersey* (1977) 431 U.S. 1, 15.)

Chief Justice Marshall described the Contracts Clause, along with its sister clauses banning bills of attainder and ex post facto laws, as a "bill of rights for the people of each state." (*Fletcher v. Peck* (1810) 10 U.S. 87, 138.) These rights exist to protect Americans from legislatures changing the rules after the fact and "shield [Americans] and their property from the effects of those sudden and strong passions to which men are exposed." (*Id.*) Thus, that Court concluded, a state may not pass a law to interfere with a contract, just as it may not use a bill of attainder or ex post facto law to accomplish the same goal. (*Id.*, 10 U.S. at pp. 138-139.)

In a similar vein, this Court described the Contracts Clause as foundational to the "peculiar glory of our Constitution." (*Robinson v.*

*Magee* (1858) 9 Cal. 81, 83.) In *Robinson*, Justice Burnett explained that, under our Constitution, "Whatever, the State, therefore, binds itself to do, or not to do, must be observed." (*Id.*, 9 Cal. at p. 83.) He observed that this Clause is part of what distinguishes our Constitution from that of "Great Britain, [which] merely distributes and classifies, but does not limit the powers of government..." (*Id.*) This Court concluded, "The power to impose conditions, after the contract is once complete and perfect, is nothing but the power to impair its obligation, and this the Constitution has prohibited." (*Id.*, 9 Cal. at pp. 84–85.)

The concerns and principles underlying the federal and California Contracts Clauses are as relevant now as they were in the eighteenth and nineteenth centuries. Shifting political opinions and policy goals can make it seem attractive to raid pre-existing, long-term financial obligations. Indeed, "A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contracts Clause would provide no protection at all." (*California Teachers Assn. v. Cory* (1984) 155 Cal.App.3d 494, 511.)

The Contracts Clauses of the U.S. and California Constitutions prohibit the enactment of legislation that impairs contracts. In determining whether a law violates the Contracts Clause, the Court must consider: (1)

whether the law impairs a contractual obligation; (2) whether the impairment is substantial; and (3) whether the impairment is reasonable and necessary to serve a legitimate public purpose. (*University of Hawai'i Professional Assembly v. Cayetano* (9th Cir. 1999) 183 F.3d 1096, 1104-1107.) Further, the impairment must be temporary with interest running to be reasonable. (*Olson v. Cory* (1980) 27 Cal.3d 532, 539.) "*United States Trust* places the justification for an impairment of a contractual funding obligation under the light of strict scrutiny" and requires the state to establish a compelling state interest.(*California Teachers Assn. v. Cory* (1984) 155 Cal.App.3d 494, 511 (emphasis added) ; *see also*, *Bd. of Admin. v. Wilson* (1997) 52 Cal.App.4th 1109, 1155-56.)

## A. PENSION BENEFITS ARE DEFERRED COMPENSATION

Pension benefits are deferred compensation. (*Thorning v. Hollister School Dist.* (1992) 11 Cal.App.4th 1598, 1606-7.) Public employees obtain a vested contractual right to earn retirement benefits upon accepting employment. (*Betts v. Board of Administration* (1978) 21 Cal.3d 859, 864; *Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 853; *Miller v. State of California* (1977) 18 Cal.3d 808, 817; *Carman v. Alvord* (1982) 31 Cal.3d 318, 325.) They are entitled to continue earning additional retirement benefits through continued service under the terms originally promised by the employer. (*See Legislature v. Eu* (1991) 54 Cal.3d 492, 530; *Pasadena Police Officers Assn. v. City of Pasadena* (1983) 147 Cal.App.3d 695.)

Public employees also have a vested right to any additional retirement benefits established during their employment. (*County of Orange v. Assn. of Orange County Deputy Sheriffs* (2011) 192 Cal.App.4th 21, 41-42.)

Pension benefits are constitutionally protected because they are an inducement to employment and considered deferred compensation, granted in exchange for employees' continued service. (*See, e.g. In re Marriage of Brown* (1976) 15 Cal.3d 838, 845 ("Since pension benefits represent a form of deferred compensation for services rendered, the employee's right to such benefits is a contractual right, derived from the terms of the employment contract."); *Miller v. State of California* (1977) 18 Cal.3d 808, 814 ("Pension rights . . . are deferred compensation earned immediately upon the performance of services for a public employer and cannot be destroyed without impairing a contractual obligation."); *Lyon v. Flourny* (1969) 271 Cal.App.2d 774, 781 (both state and federal Contracts Clauses protect public pension benefits.))

Although pension benefits are a type of contractual obligation under the Contracts Clause, there is no need to show an explicit contractual agreement for the constitutional protection to apply. Rather, so long as the particular pension benefits have been properly instituted and formally adopted, employees gain a vested right to them. This flows from the idea that pension benefits are offered as deferred compensation, and prospective employees accept the offer by virtue of commencing, or continuing in,

employment. (*See*, *e*.g. *Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 851-52 (upon performing work "the pension provisions become a part of the contemplated compensation for those services and so in a sense a part of the contract of employment itself."); *Dryden v. Bd. of Pension Commissioners* (1936) 6 Cal.2d 575, 579 (pension provisions were an "integral portion" of the employee's contemplated compensation.))

## B. PLAINTIFFS HAVE A VESTED RIGHT TO PENSION BENEFITS INCLUDING THE DISPUTED PAY ITEMS

For years, ACERA included terminal pay, standby, and the other disputed pay items in the compensation earnable used to calculate employees' pension benefits. Nothing in the CERL prohibited ACERA from including these pay items from members' compensation earnable. Further, the inclusion of these pay items was approved by a court as part of a settlement agreement. ACERA advised employees these pay items would be included in their pension benefits in its publication. Indeed, ACERA members *paid* to have these pay items included in their benefits – their inclusion was factored into the actuarial assumptions used to calculate their contribution rates. Accordingly, ACERA members had a vested right to receive pension benefits based on a definition of compensation earnable that included the disputed pay items.

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### 1. ACERA Had Discretion to Include Pay Items in Compensation Earnable Regardless of Whether They Were Required by Statute

ACERA had the right to include the disputed pay items in members' pension calculations, and used that authority to do so. The appellate court erred in holding no vested pension rights were created in vacation and sick leave pay outs because the contract was inconsistent with the governing pension statutes. (*ACDSA*, *supra,* 19 Cal.App.5th at p. 105.) The issue here is not whether the CERL *required* all retirement associations to include the disputed pay items. Rather, the issue is whether ACERA *could* include them. The legislative history shows ACERA had such authority.

Throughout the years, the Legislature has amended the Public Employees' Retirement Law to specifically exclude pay items from pension calculations, but declined to enact similar changes to the CERL. This indicates the Legislature did not intend to limit 37 Act retirement systems' power to include pay items in employees' pension calculations.

In 1990, the Legislature added Government Code section 31460.1, which excluded employer payments from flexible benefits programs, if the board of supervisors adopted the law. (Stats. 1990, ch. 142, § 1, p. 1191.) However, the Legislature later repealed that provision, after coming to believe the statute was being misinterpreted as requiring retirement boards to exclude these payments unless the board of supervisors resolved otherwise. (Stats. 1993, ch. 45, § 1, p. 158.)

This legislative history evidences the Legislature's understanding that CERL retirement systems were providing pension benefits based on compensation earnable that included forms of compensation not expressly required under the CERL. There would be no need to prohibit the inclusion of flexible benefit payments if they were not required or permitted to be included, so it must be concluded that at that time the Legislature intended to permit their inclusion. (*E.g. Howard Jarvis Taxpayers' Assn. v. Board of Supervisors of Los Angeles County* (1996) 41 Cal.App.4th 1363, 1373 (finding retirement board had the authority to include flexible benefit payments as "compensation earnable.")) This shows that, even before PEPRA's enactment, the Legislature meant to allow the inclusion of these types of payments in pension benefits and permit retirement boards to make determinations about what to include, contrary to the argument that CERL has always prohibited retirement associations from including them.

Likewise, in 1993, the Legislature enacted Government Code section 31461.1, which excluded certain payments from compensation earnable for Los Angeles County employees, if the county board of supervisors so decided. (Govt. Code § 31461.1; Stats. 1993, ch. 396, § 4, p. 2239.) In particular, the statute excluded "cafeteria or flexible benefit plan contributions, transportation allowances, [and] security allowances." (Govt. Code § 31461.1(b.)) The exclusion, if adopted by the board of supervisors, would apply only to members entering the system after the resolution's

enactment. (Govt. Code § 31461.1(c.)) The Legislature could have extended these restrictions to other counties, but it chose not to. Likewise, it could have made these prohibitions more expansive, prohibiting the inclusion of leave cash outs not earned during the final compensation period, or otherwise limiting the inclusion of leave cash outs (for members entering retirement systems after the statute's effective date.) It did not. This shows the Legislature did not intend to limit the CERL or retirement boards' authority in this fashion.

In fact, in Government Code section 31461.45, the Legislature sets forth a list of all the pay codes that are to be considered compensation earnable for Los Angeles County. Notably, section 31461.45 includes leave cash outs as pensionable, without any articulated limit on how much leave might be cashed out or when the leave must be accrued. Again, if the Legislature wanted to, it could have easily specified what could or could not be included as compensation earnable for other counties as it did for Los Angeles County, or stated accrued leave cash outs must be limited to what is earned and payable. The fact that the Legislature did not include such express restrictions on the retirement boards' discretion shows it did not intend to restrict that discretion and, as discussed *infra*, this intent is also apparent when the CERL is compared to the PERL. (*Reidy v. City and County of San Francisco* (2004) 123 Cal.App.4th 580, 592; *Estate of McDill* (1974) 14 Cal.3d 831, 837-38 ("The failure of the Legislature to

change the law in a particular respect when the subject is generally before it and changes in other respects are made is indicative of an intent to leave the law as it stands in the aspects not amended."))

### 2. ACERA Executed a Court-Approved Settlement Agreement to Include the Disputed Pay Items in Compensation Earnable

ACERA agreed to include the disputed pay items in members' compensation earnable in a court-approved settlement of post-*Ventura* litigation. Given the Retirement Board's authority to administer the retirement system, and its obligation to act as a fiduciary of the system for employee members, it was entirely appropriate for ACERA's Board to settle on these terms. The explicit promises in the settlement agreement are enforceable, and support a finding that Petitioners had a vested right to have the disputed pay items included in their pension calculations.

The ACERA *Ventura* settlement is an express contract, providing benefits to employees hired and working under its terms. The agreement, which was court-approved, says compensation earnable will include "leave paid as salary or in lieu of paid leave and pay for hours ordinarily worked by the employee in the employee's permanent work assignment, mandated by the County or applicable Memorandum of Understanding." (23 CT 006770.)

With respect to final compensation, the settlement agreement provides that "vacation leave and/or sick leave paid as a lump sum shall be

recognized as final compensation only to the extent that it is earned during the final compensation period and, in the case of a three-year final compensation period, shall be the annual average of the leave earned." (23 CT 006770.) It does not require members to cash out that leave in service, instead of at retirement. The preamble of the agreement makes the elements of exchange and consideration explicit, providing that the parties agree they are "specifically seeking clarification of the issues of vacation accrual and contributions by members in exchange for increased benefits." (23 CT 006771.) The agreement – and accompanying resolutions by the Board of Supervisors – provided that "leave paid as salary or lump sum(s) in lieu of paid leave" would be "compensation earnable," and such cash outs would be considered "final compensation," up to the amount of leave earnable in the final compensation period, even if paid as a lump sum at retirement. (28 CT 008095-96, 008099-8100, 008108.)

It is undisputed that ACERA's practice, authorized under its *Ventura* settlement and concomitant formal Board of Retirement resolutions, was to include vacation cash outs as "compensation earnable" up to the amount that could be accrued by the member during the final compensation period, even if employees could cash out the vacation only at retirement. That is, ACERA included as compensation earnable up to the amount that the member could accrue during his or her final compensation period, even if employees could cash out the vacation only at retirement. Likewise, safety

employees previously could include as compensation earnable and final compensation a limited amount of sick leave cashed out at retirement, and all employees could include as pensionable pay compensation for being on call and various other payments described previously. Similarly, the agreement states that incentive pay for special duties will be included as compensation earnable. (28 CT 008096, 008099, 008108.)

As a result, the compensation policies arising from the post-*Ventura* settlement agreement – consistently applied to all employees for over a decade – required ACERA to include limited amounts of leave cash outs, terminal payments, on-call payments and other items of compensation now excluded under AB 197.

The ACERA *Ventura* settlement gave rise to vested contractual rights. (*E.g., Weddington Productions, Inc. v. Flick* (1998) 60 Cal.App.4th 793, 810 (settlement agreements are contractual obligations.)) Contracts involving public entities are constitutionally protected against impairment. (*See Sonoma County Organization of Public Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 314 (finding vested rights in union contract were impaired by state legislation); *Retired Employees Assn. of Orange County, Inc. v. County of Orange* (2011) 52 Cal.4th 1171, 1182.)

The ACERA *Ventura* settlement is a final, court-approved settlement. The State cannot now challenge the validity of that agreement. Indeed, permitting such an attack would "undermine the validity of the

legitimate authority of the judiciary." (*Ferguson v. Lieff, Cabraser, & Bernstein* (2003) 30 Cal.4th 1037, 1054.)

### 3. ACERA Consistently Promised Members Pension Benefits That Included the Disputed Pay Items

ACERA repeatedly promised its members that vacation cash outs and other pay items would be included in the compensation earnable used to calculate their pensions. For example, ACERA's Members Handbook advised members they could include vacation cash outs in the compensation used to calculate their benefits. "If you accrue vacation at a rate of five weeks per year, you can sell/cashout up to 15 weeks of vacation during the consecutive 36-month period leading to retirement (5 weeks x 3). This value can be included in your final average salary calculation." (24 CT 007070; *see also* 24 CT 007151 (stating "your final average salary can also include eligible vacation accruals in the form of cash outs at retirement."))

Indeed, the handbook even encouraged members to use vacation accruals to get the most out of their retirement benefits, stating "you may use some vacation accruals to increase your retirement benefit." (24 CT 007139.)

ACERA's communications to its members confirm the existence of a vested right. Communications directed at those who will rely on them are another way to show the existence of implied contractual rights. (*Kashmiri v. Regents of University of California* (2007) 156 Cal.App.4th 809, 828-33

(University's promise on website and in catalogues not to raise certain fees held to be an implied contract.)) As more recently noted, the conduct of providing a benefit, coupled with assurances that those benefits may be relied upon, gives rise to an enforceable implied or quasi-contact. (*Requa v. Regents of the University of California* (2012) 213 Cal.App.4th 213, 226-28 (implied contract for retiree medical benefits may arise from history of the provision of such benefits.))

### 4. ACERA Collected Contributions to Fund Pension Benefits that Included the Disputed Pay Items

ACERA's contribution rates are based on the amount of money projected to be needed to fund employees' future retirement benefits. (Gov. Code § 31453.5; 24 CT 007106.) Including the disputed pay items in the compensation used to calculate retirees' benefits obviously raised the retirement benefits for the employees who received them, thus increasing the normal cost for those benefits, thereby increasing the contribution rates charged to employees and employers.

The terms of ACERA's *Ventura* settlement had an actuarial cost, to which members contributed over the years. As indicated by ACERA's actuarial estimates from 1999, as a result of the agreement, the "employer contributions were adjusted to reflected estimated annual sellor of vacation." (23 CT 006799.) Employee rates were also adjusted, with the actuaries noting early on that "[a]djustments to member basic rates may

result if terminal pay is reflected in the salary scales used to derive basic rates." (23 CT 006799.)

For over a decade, ACERA members' contribution rates reflected the cost of the increased terminal pay, including leave cashouts. (23 CT 006854; 24 CT 006865 (calculating terminal pay assumptions as a percentage of retirement costs.)) As a result, the additional cost of the *Ventura* benefit was incorporated into the contribution rates paid by the members. (24 CT 005894; 25 CT 007652; 28 CT 008099 ("it is recommended that the Board determine the method and timing of any retroactive employee contributions if any and that the collection of employee contributions on future compensation shall be implemented as soon as possible.") The employees' contributions to ACERA are significant. For example, in 2008 alone, members contributed $75.6 million (compared to employer contributions of $129.7 million.)[3] (25 CT 007462.)

The fact that ACERA assessed employers and employees for the value of their pension benefit attributable to these items of compensation establishes the pay items were a contemplated part of the "pension

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[3] Employer contributions are not a gift, even though they are not included in the compensation earnable used to calculate pension benefits. They are earned by the member and included in the vested right to a retirement as an inducement to employment and considered "deferred compensation." (*Kern*, *supra*, 29 Cal.2d at p. 848.) Thus, the disparity between "employer" and "employee" contributions is irrelevant in this analysis – all the contributions represent employees' compensation, notwithstanding the fact the employer pays this employee compensation directly to the retirement fund.

contract," and indicates an exchange of consideration associated with a vested contractual requirement. (*Pasadena Police Officers' Assn v. Pasadena* (1983) 147 Cal.App.3d 695, 707 ("by so agreeing, the retirees gave consideration for the city's promise to pay a fully adjustable pension."); Civil Code § 1605 ("Any benefit conferred, or agreed to be conferred, upon the promisor, by any other person, to which the promisor is not lawfully entitled, or any prejudice suffered, or agreed to be suffered, by such person other than such as he is at the time of consent lawfully bound to suffer, as an inducement to the promisor, is a good consideration for a promise."))

## C. PEPRA SUBSTANTIALLY IMPAIRED PETITIONERS' VESTED PENSION RIGHTS

PEPRA substantially impaired ACERA members' vested pension rights. The pre-PEPRA inclusion of accrual cash outs substantially differed from the post-PEPRA inclusion of cash outs. Before PEPRA's enactment, ACERA included cash outs up to the amount of leave an employee could earn during his or her final compensation period, regardless of whether the employee could cash out the leave during employment. PEPRA reduced the amount of includable cash outs to the amount of leave the employee cashed out during the regular course of employment during their final compensation period.

Excluding various pay items from compensation earnable

substantially reduced the level of compensation used to calculate members' pension benefits. This redefined the level of each member's pension annuity, which is calculated as a percentage of final compensation, multiplied by the member's years of service to the County. Before PEPRA's enactment, ACERA included forms of pay like standby pay in compensation earnable. PEPRA required ACERA to exclude those pay items from members' pension calculations. (*See* 37 CT 0011017-28 ("Pay Codes Compensation Earnable or Not Compensation Earnable After January 1, 2013," excluding Weekend Standby, On-Call Duty, and several other pay codes from compensation earnable because they supposedly represented compensation for work "outside normal working hours.")

Another impact of PEPRA related to payments of in lieu in-kind benefits, meaning pay offered as an incentive to forgo fringe benefits otherwise offered by the employer, or payments for benefits received in-kind but later received in cash. Before PEPRA, ACERA treated such benefits as pensionable compensation. (*See* 8 RT 548:2-7.) After PEPRA, such payments were excluded.

Excluding these pay items as compensation earnable reduced members' retirement benefits by hundreds of dollars a month. It is undisputable that such reductions are a substantial impairment.

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## D. THE IMPAIRMENT WAS NOT REASONABLE OR NECESSARY

Pension benefits are an "element of compensation" and a "vested contractual right" that cannot be removed "without impairing a contractual obligation of the employing public entity." (*Betts, supra,* 21 Cal.3d at pp. 863-64.) Once vested, the employer can only make reasonable modifications to the pension benefits. (*Maffei v. Sacramento County Employees' Retirement System* (2002) 103 Cal.App.4th 993, 999-1000.)

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 a disadvantage to employees must be accompanied by comparable new advantages. (*Allen II, supra,* 34 Cal.2d at p. 131; *Betts, supra*, 21 Cal.3d at p. 864; *Maffei, supra*, 103 Cal.App.4th at pp. 999-1000.) This is the California Rule, which this Court and lower courts have affirmed throughout the decades since the Court's decision in *Allen v. City of Long Beach* (1955) 45 Cal.2d 128 ("*Allen I*"). (*See Legislature v. Eu* (1991) 54 Cal.3d 492; *Protect Our Benefits v. City and County of San Francisco* (2015) 235 Cal.App.4th 619.)

While courts have oscillated between saying a detrimental change "must" or "should" be offset by new advantages, the cases applying the California Rule (with the exception of the First Appellate District's

opinions here, in *MAPE,* and in *CalFire*) have used the terms interchangeably to indicate a legal obligation to offset pension reductions with new advantages. For example, in *Abbot v. City of Los Angeles* (1958) 50 Cal.2d 438, 452-53, this Court said any disadvantage "should" be offset by comparable new advantages, then opined "the validity of attempted changes" to employees' pension rights depended on the advantage or disadvantage imposed on the employees. (*Id.*)

Likewise, in *Betts v. Board of Administration* (1978) 21 Cal.3d 859, this Court invalidated a statutory amendment that withdrew pension benefits promised during employment because no new comparable advantages offset the detriment the petitioner suffered. (*Id.,* at pp. 867-68.)

This Court again invalidated a detrimental change to pension rights in *Olson v. Cory* (1980) 27 Cal.3d 532, "since no new comparable or offsetting benefit appeared in the modified plan." (*Id.*, at p. 541.)

Indeed, in *Allen v. Board of Administration* (1983) 34 Cal.3d 114, the Court emphasized that "disadvantage to employees, *must* be accompanied by comparable new advantages." (*Id.*, at p.120.)

Likewise, in *Legislature v. Eu* (1991) 54 Cal.3d 492, 533, this Court affirmed its position that vested benefits cannot be detrimentally changed without a new advantage. At issue in that case was the State's attempt to change legislators' pension benefits. According to the Court in *Eu*, once the State created a retirement plan for its legislators, it could not thereafter

abandon the plan for incumbent/re-elected legislators "without providing them comparable new benefits." (*Ibid.*)

Over the last sixty years, the lower courts have followed the California Rule, requiring pension impairments to be offset by new advantages. (*See Board of Administration v. Wilson* (1997) 52 Cal.App.4th 1109, 1137 (disadvantage to employees "must" be accompanied by comparable new advantages); *Frank v. Board of Administration* (1976) 56 Cal.App.3d 236; *Lyon v. Flourny* (1969) 261 Cal.App.2d 774.) Indeed, the First District appellate court itself acknowledged in *Protect Our Benefits, supra*, at pp. 628-29, that any modification resulting in a disadvantage to employees "must be accompanied by comparable new advantages."

### 1. Impairing Pension Benefits to Save Money is Per Se Unreasonable

The *ACDSA* decision is the latest in a string of cases from the First District seeking to turn public employees' deferred compensation into a new source of revenue for other spending priorities. While the *ACDSA* case may represent a less extreme version of *MAPE* and *CalFire*, it leads to the same result – governments taking retirees' money and spending in other, politically determined ways. The government's desire to spend its funds differently does not override the California Rule.

This Court and the U.S. Supreme Court have repeatedly said saving money is not an important public purpose justifying the impairment of

vested rights. Saving money is not a valid purpose justifying contract impairment. (*U.S. Trust Co. v. New Jersey* (1977) 431 U.S. 1.) "A governmental entity can always find a use for extra money, especially when taxes do not have to be raised." (*Valdes v. Corey* (1983) 139 Cal.App.3d 773, 789-90.) The California Rule prevents the use of pension cuts as a tool for debt relief, because any savings must be allocated to the benefit of the pensioners in the form of a new advantage.

This case, *MAPE*, and *CalFire* ignore this requirement entirely, asserting a pension cut can be reasonable, even if the State takes the savings instead of giving them back to the pensioners whose work paid for their benefits.

*MAPE* cavalierly upheld a pension detriment with no offsetting advantage. While the appellate court in this case criticized *MAPE*'s reasonableness scrutiny, it bolstered *MAPE*'s dilution of the California Rule. After defending a net diminution as "non-controversial," the appellate court attempted to excuse *MAPE*'s lack of scrutiny due to the "procedural nature" of the case. (*ACDSA, supra,* 19 Cal.App.5th at p. 831.)

In upholding PEPRA's changes to pension benefits, the *MAPE* court effectively reversed *Allen I* and its progeny. The appellate court tried parsing the language of *Allen I* to nullify its holding that changes to pensions resulting in a disadvantage must be offset by comparable new advantages. The appellate court hinged its argument on the fact that the

*Allen I* Court said "changes in a pension plan which result in disadvantage to employees *should* be accompanied by comparable new advantages." (*MAPE*, *supra*, 2 Cal.App.5th at p. 697, *citing Allen I, supra,* 45 Cal.2d at p. 131.) According to the appellate court, the *Allen I* Court's use of the word "should" meant the Court did not intend to require detrimental changes to be offset by comparable advantages.

The *MAPE* court's interpretation of *Allen I* conflicts with this Court's subsequent interpretation of the same case. In 1983, this Court cited *Allen I* as requiring detrimental changes to be offset by corresponding advantages to be sustained as reasonable. (*Allen II, supra*, 34 Cal.3d at p. 120.) In that case, this Court cited *Allen I* in support of its assertion that a modification resulting in a disadvantage to employees "*must* be accompanied by comparable new advantages." (*Id.*) The appellate court erred by presuming this Court didn't mean what it said in *Allen II*. Likewise, the appellate court disregarded this Court's ruling in *Legislature v. Eu*, *supra*, which held the State could not change legislators' pension plan without providing comparable new benefits. (*Legislature v. Eu* (1991) 54 Cal.3d 492, 533.)

The appellate court in this case largely adopted the *MAPE* court's position about the need for offsetting new advantages, going a step further to say it was "not controversial." (*ACDSA, supra*, 19 Cal.App.5th at p. 121.) To be sure, the appellate court disagreed with *MAPE's* focus on whether a

reduction leaves a "reasonable" pension benefit intact, acknowledging that the "reasonable pension" is one subject only to reasonable modifications. (*Id.,* at p. 122.) Nevertheless, it affirmed that an offsetting new advantage was not absolutely required for a detrimental change to public employees' pension benefits to survive constitutional scrutiny. (*Id.*, at p. 121.) In so doing, the court further eroded this Court's precedent and eviscerated the California Rule.

**2. The Impairment's Reasonableness Does Not Turn on Potential Savings**

The State cannot just issue findings of a "compelling state interest in resurrecting the actuarial viability of public retirement systems and avoiding the draconian consequences that will occur if public pension liabilities remain underfunded" to justify impairing employees' vested rights, as the First District recently suggested in *McGlynn v. State* (2018) 21 Cal.App.5th 548, 565.. While properly recognizing the analysis must consider each pension system individually, the *ACDSA* court's holding that "difficulty meeting its pension obligations" could be a legitimate public purpose for allowing a public entity to impair financial terms is error.

In this case, as in *MAPE*, the appellate court misguidedly focused its scrutiny on the "financial stability of the specific CERL system" and its difficulty meeting pension obligations, rather than the financial condition of the employer responsible for funding those obligations. (*ACDSA, supra*, 19

Cal.App.5th at p. 123.) Specifically, the court stated 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. However, the employer owes the obligation to provide a County-funded pension benefit, not the individual CERL systems, which merely administer and service the pensions. (*In re City of Stockton, California* (Bankr. E.D. Cal. 2015) 526 B.R. 35, 60, aff'd in part, dismissed in part (B.A.P. 9th Cir. 2015) 542 B.R. 261.) "In the absence of a clear and unequivocal declaration in the pension provisions that benefits are payable only to the extent of available funds from specified contributions, the liability to pay promised pension benefits is a general obligation of the city." (*Bellus v. City of Eureka* (1968) 69 Cal.2d 336, 348-352; *see also Carman v. Alvord* (1982) 31 Cal.3d at pp. 318, 332-333.)

Thus, the appellate court should have based its reasonableness analysis on the justification – if any – for impairing financial terms of the County of Alameda's contractual obligations, not just reducing pension costs generally. As a threshold matter, a state-wide proscription reducing all 37 Act counties' financial obligations is ill-suited to survive strict scrutiny, given the varied financial conditions of the public employers who must contribute to the CERL systems.

The appellate court merely redirected *MAPE's* misguided Contracts Clause analysis from focusing on the reasonableness of the post-impairment

pension benefit to the reasonableness and necessity of the savings realized by the impairment. This analysis suffers the same defect; financial savings are never legitimate or reasonable grounds for impairment of contract. "A State cannot refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote the public good rather than the private welfare of its creditors." (*U.S. Trust Co. v. New Jersey* (1977) 431 U.S. 1, 27.) "If a state could reduce its financial obligations whenever it wanted to spend money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all." (*University of Hawai'i Professional Assembly v. Cayetano* (9th Cir. 1999) 183 F.3d 1096.) Moreover, "in the last thirty-five years, no Ninth Circuit or Supreme Court case has found a statute or ordinance necessary when the law in question altered a financial term of an agreement to which a state entity was a party." (*Southern California Gas v. City of Santa Ana* (C.D. Cal. 2002) 202 F.Supp.2d 1129, 1139.)

In *Sonoma County Organization of Public Employees v. County of Sonoma*, 23 Cal.3d 296, 302, 152 Cal.Rptr. 903 (1979), this Court invalidated legislation that "impair[ed] the obligation of contracts in violation of article 1, section 10, of the United States Constitution and article 1, section 9, of the California Constitution." *Sonoma* held a statute prohibiting payment of contractual cost of living increases due under local public employees' labor contracts unconstitutionally impaired their

contractual rights, even though the statute was enacted in response to the fiscal crisis following the enactment of Proposition 13. (*Id.*, at pp. 313-317.)

Further, the constricted consideration of only the CERL system's funding does not account for the fact that the system's funding level is a product of the employer's contributions and discretionary actuarial assumptions (e.g. the discount rate employed, the length of the amortization period, mortality rates.) The post-recession growth of the unfunded liability was caused in significant part by rapid and unexpected changes in actuarial assumptions. For example, CalPERS estimates its three year reduction of the discount rate alone will increase the normal cost as a percentage of payroll by 1 to 5 percent and a 30 to 40 percent increase in their current unfunded accrued liability payments.[4]

The court's reasonableness analysis fails to account for the employing agency's burden to *demonstrate* its impairments were a reasonable and necessary response in light of less drastic measures because "impairing the obligations of its own contracts" is not "on par with other policy alternatives." (*See Sonoma, supra*, 23 Cal.3d at p. 308; *U.S. Trust Co., supra*, 431 U.S. at pp. 30-31; see also *Opinion of the Justices (Furlough)* (1992) 135 N.H. 625, 635-636 ("The contract clause, if it is to

[4](*See* CalPERS to Lower Discount Rate to Seven Percent Over the Next Three Years (https://www.calpers.ca.gov/page/newsroom/calpers-news/2016/calpers-lower-discount-rate))

mean anything, must prohibit the State from dishonoring its existing contractual obligations when other policy alternatives are available."))

Moreover, this tunneled analysis ignores the myriad of non-impairing alternative measures available to realize equivalent savings. The government can always cut discretionary expenditures or raise revenues, and it can reduce pension payments directly without impairing vested rights. Future pension obligations can be reduced by paying off or down unfunded actuarial liabilities with reserves or one-time revenues. Reciprocity rules could be modified to prevent unexpected unfunded actuarial liabilities associated with job changes. Employers can reduce staffing levels or negotiate concessionary terms in labor contracts that have significant ancillary reductions in pension liabilities. (*In re City of Stockton, California* (B.A.P. 9th Cir. 2015) 542 B.R. 261, 279 (*holding* the plan of adjustment had a substantial indirect impact on pensions because "employee compensation on which pension benefits were calculated had been reduced", "reductions in numbers of City employees", and pension benefits for new City employees had been reduced in the labor contracts.))

In addition to violating the Contracts Clause, PEPRA's impairment of pension benefits improperly seeks to supplant Chapter 9 of the Bankruptcy Code as the appropriate mechanism by which a local government may impair financial terms of its contracts, under the supervision of a federal bankruptcy judge. "While the Contracts Clause is a

key navigational star in the firmament of our Constitution and economic universe, it is subject to being eclipsed by the Bankruptcy Clause." (*In re City of Stockton*, Cal. (Bankr. E.D. Cal. 2012) 478 B.R. 8, 15.) "For a plan of adjustment to be confirmed as to a class of claims that has not accepted the plan, it must be "fair and equitable" and "not discriminate unfairly." (11 U.S.C. § 1129(b)(1.)) Bankruptcy laws exist to allow municipalities to do that which they cannot do outside of bankruptcy: impair contracts to save money. "While a state cannot make a law impairing the obligation of contract, Congress can do so. The goal of the Bankruptcy Code is adjusting the debtor-creditor relationship." (*In re City of Stockton, Cal.* (Bankr. E.D. Cal. 2012) 478 B.R. 8, 16.) If resurrecting the "financial stability of the specific CERL system" or the overall financial condition of a County justified unilateral impairment of financial terms of their contracts, governments would have no reason to petition for bankruptcy – they could simply afford themselves contract modifications without judicial oversight or the hassle of treating all creditors equally. Moreover, there is no meaningful limiting principal to the *MAPE* or *ACDSA* standard. For example, under these standards the government could impair a municipal bond funding a stadium because the stadium failed to produce sufficient revenue to service the bond when it had money elsewhere. The Court should affirm the longstanding principle that a government's desire to save money does not justify impairing its financial obligations.

## E. EVEN IF SAVING MONEY WAS A VALID JUSTIFICATION, THE FAILURE TO CONSIDER WHETHER ACERA WAS FACING FINANCIAL DIFFICULTIES RENDERS THE IMPAIRMENT UNREASONABLE

The State cannot credibly claim its statewide changes to the definition of compensation earnable were reasonable and necessary for an important public purpose. PEPRA changed the definition of compensation earnable for *all* 1937 Act retirement associations – regardless of whether they were facing financial difficulties. Thus, even if the State could impair pensions as a cost-saving measure, it cannot show its impairment of the Petitioners' pensions was reasonable and necessary.

A fundamental flaw in the appellate court's reasoning appears in the second sentence of its Opinion. According to the court, the Governor was "faced with a statewide crisis involving the significant underfunding of public pension systems" when he signed PEPRA into law. (Opinion, p. 1.) The error arises from the appellate court's failure to acknowledge that 1937 Act retirement systems – like ACERA – are not statewide organizations, or controlled by the State.

1937 Act retirement systems, including ACERA, are independent of each other, administering pension benefits solely for employees of the County or other local entity they serve. (*See* Govt. Code § 31520.) Their funding levels and general financial conditions vary as well.

PEPRA is not tailored to address any financial concerns ACERA

may have. There is no evidence the Legislature considered whether ACERA had any financial concerns. Indeed, while the State discussed supposed "spiking" in Alameda County in its petition for review, it cited no evidence showing ACERA is underfunded as a result of "spiking," or that changing the definition of compensation earnable was necessary to address any financial issue. In fact ACERA's funding level was above 70% when PEPRA was enacted. Thus, the State cannot claim its decision to redefine compensation earnable was "reasonable and necessary" to save money – even if saving money was a valid justification for impairing ACERA members' pensions.

## F. BECAUSE PEPRA PERMANENTLY IMPAIRED VESTED RIGHTS, IT IS PER SE UNCONSTITUTIONAL

Finally, PEPRA's changes to the definition of compensation earnable were *per se* unreasonable because they were not temporary in nature. As this Court noted in *Olson v. Cory, supra,* 27 Cal.3d at p. 539, to survive constitutional scrutiny, an impairment must be temporary, with interest running during the temporary deferment. (*Id., citing Sonoma County Organization of Public Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 305-06.)

PEPRA permanently changed the definition of compensation earnable. Nothing in the law called for the eventual restoration of the old definition, or required the retirement systems to pay interest to their

members while the new definition remained in place. Accordingly, the change violated the Contracts Clause.

## VI

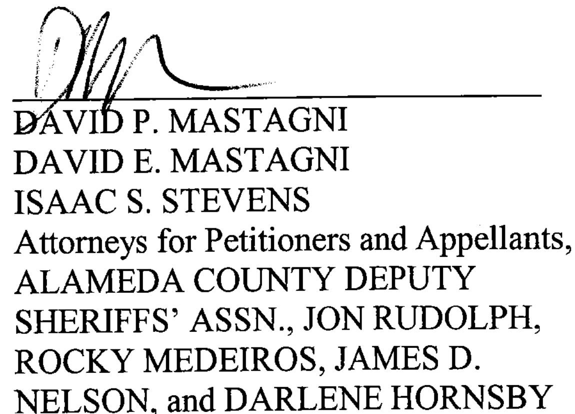
## CONCLUSION

PEPRA substantially impaired ACERA members' vested pension rights. It was not reasonable and necessary for an important public purpose, because it reduced vested pension rights without providing an offsetting new advantage. Petitioners respectfully ask this Court to reverse the appellate court's finding that ACERA's members did not have a vested right to have leave pay outs in their pension benefits, and vacate the portions of the decision removing the "comparable new advantage" requirement from the constitutional analysis of pension modifications, and remand the matter back to the trial court for further proceedings.

Respectfully Submitted:

Dated: May 4, 2018

**MASTAGNI HOLSTEDT, APC**



DAVID P. MASTAGNI
DAVID E. MASTAGNI
ISAAC S. STEVENS
Attorneys for Petitioners and Appellants,
ALAMEDA COUNTY DEPUTY SHERIFFS' ASSN., JON RUDOLPH, ROCKY MEDEIROS, JAMES D. NELSON, and DARLENE HORNSBY

## CERTIFICATE OF WORD COUNT

Pursuant to Rule 8.204(c)(1) of the California Rules of Court, I certify that this brief consists of 11,396 words, as counted by the computer program used to generate the document.

Respectfully Submitted:

Dated: May 4, 2018

**MASTAGNI HOLSTEDT, APC**

DAVID P. MASTAGNI
DAVID E. MASTAGNI
ISAAC S. STEVENS
Attorneys for Petitioners and Appellants,
ALAMEDA COUNTY DEPUTY SHERIFFS' ASSN., JON RUDOLPH, ROCKY MEDEIROS, JAMES D. NELSON, and DARLENE HORNSBY

## PROOF OF SERVICE

SHORT TITLE OF CASE: *ACDSA, et al. v. ACERA, et al.*
SUPREME COURT CASE NO.: S247095
COURT OF APPEAL CASE NO.: A141913

I am employed in the County of Sacramento, State of California. I am over the age of eighteen years and not a party to the above-entitled action. My business address is 1912 I Street, Sacramento, California 95811-3151. On the date below, I served the following document(s):

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| Clerk of the Superior Court<br>Merced County Superior Court<br>2260 N Street<br>Merced, CA 95340-3744 | Clerk of the Superior Court<br>Alameda County Superior Court<br>René C. Davidson Courthouse<br>1225 Fallon Street<br>Oakland, California 94612 |

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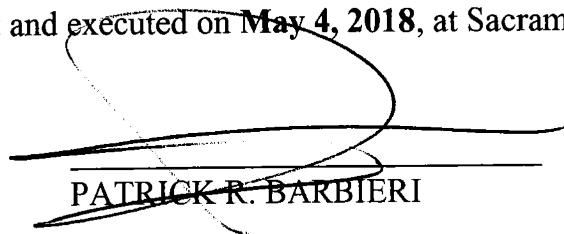
I declare under penalty of perjury, under the laws of the state of California, that the foregoing is true and correct and executed on **May 4, 2018**, at Sacramento, California.



PATRICK R. BARBIERI

| SERVICE LIST | |
|---|---|
| **Party** | **Attorney** |
| Alameda County Deputy Sheriff's Association, Jon Rudolph, James D. Nelson, Darlene Hornsby, Robert Brock, Rocky Medeiros : Plaintiffs and Appellants | David E. Mastagni<br>Isaac Sean Stevens<br>Mastagni Holstedt, APC<br>1912 I Street<br>Sacramento, CA 95811<br>davidm@mastagni.com<br>istevens@mastagni.com |
| Alameda County Employees' Retirement Assn. and Bd. of the Alameda County Employees Retirement Assn. : Defendant and Respondent | Harvey Lewis Leiderman<br>Reed Smith<br>101 Second Street - Suite 1800<br>San Francisco, CA 94105-3659<br>hleiderman@reedsmith.com<br><br>Robert Lee Gaumer<br>Alameda City Employees' Retirement Association<br>475 14th Street, Suite 1000<br>Oakland, CA 94612-1916<br>rgaumer@acera.org |
| Service Employees International Union, Local 1021, Amy Dooha, Building Trades Council of Alameda County, Mike Harteau : Interveners and Appellants | Anne I. Yen<br>Weinberg, Roger & Rosenfeld<br>1001 Marina Village Parkway - Suite 200<br>Alameda, CA 94501-1091<br>ayen@unioncounsel.net |
| Alameda County Management Employees' Association, Kurt Von Savoye, International Federation of Professional and Technical Engineers, Local 21 : Interveners and Appellants | Arthur Wei-Wei Liou<br>Leonard Carder<br>1330 Broadway - Suite 1450<br>Oakland, CA 94612<br>aliou@leonardcarder.com |
| Teamsters Local 856, Hasani Tabari, Daniel Lister : Interveners and Appellants | Katwyn T. DeLaRosa<br>Bennett & Sharpe, Inc.<br>2444 Main Street, Suite 110<br>Fresno, CA 93721<br>ktdelarosa@bennettsharpe.com<br><br>Robert Bonsall<br>Beeson Tayer & Bodine<br>483 Ninth Street, Suite 200<br>Oakland, CA 94607<br>rbonsall@beesontayer.com |

| | |
|---|---|
| Contra Costa County Deputy Sheriff's Association, Ken Westermann, Sean Fawell : Plaintiff and Appellant | Rockne Anthony Lucia<br>Timothy Keith Talbot<br>Rains Lucia Stern St. Phalle & Silver PC<br>2300 Contra Costa Blvd., Suite 500<br>Pleasant Hill, CA 94523<br>rlucia@rlslawyers.com<br>ttalbot@rlslawyers.com |
| United Professional Fire Fighters of Contra Costa County, Local 1230 : Plaintiff and Appellant | W. David Holsberry<br>McCracken, Stemerman & Holsberry, LLP<br>595 Market Street, Suite 800<br>San Francisco, CA 94105<br>wdh@dcbsf.com |
| Physicians' and Dentists' Organization of Contra Costa : Intervener and Appellant | William Ira Corman<br>Bogatin Corman & Gold<br>1330 Broadway, Suite 1203<br>Oakland, CA 94612<br>wcorman@bcgattorneys.com |
| Contra Costa County Employees' Retirement Association, Board of Retirement of the Contra Costa County Employees' Retirement Association : Defendants and Respondents | Harvey Lewis Leiderman<br>Reed Smith<br>101 Second Street - Suite 1800<br>San Francisco, CA 94105-3659<br>hleiderman@reedsmith.com |
| International Association of Fire Fighters Local 3546, Michael Mohun, David Atkins, Contra Costa County Deputy District Attorneys Association, Paul Graves, Gary Koppel : Interveners and Appellants | Christopher E. Platten<br>Wylie, McBride, Platten & Renner<br>2125 Canoas Garden Avenue - Suite 120<br>San Jose, CA 95125<br>cplatten@wmprlaw.com |
| Probation Peace Officers Association of Contra Costa County : Intervener and Appellant | Paul Quentin Goyette<br>Goyette & Associates<br>2366 Gold Meadow Way - Suite 200<br>Gold River, CA 95670<br>goyettep@goyette-assoc.com<br><br>Rockne Anthony Lucia<br>Rains, Lucia & Wilinson<br>2300 Contra Costa Blvd., Suite 230<br>Pleasant Hill, CA 94523<br>rlucia@rlslawyers.com |
| Service Employees International Union, Local 1021, Peter Barta : Interveners and Appellants | Vincent A. Harrington, Jr.<br>Weinberg Roger & Rosenfeld<br>1001 Marina Village Parkway - Suite 200<br>Alameda, CA 94501-1091 |

| | |
|---|---|
| | vharrington@unioncounsel.net |
| Public Employees Union, Local No. 1, International Federation of Professional and Technical Engineers, Local 21, David M. Rolley, Peter J. Ellis, Susan Guest : Interveners and Appellants | Arthur Wei-Wei Liou<br>Leonard Carder<br>1330 Broadway - Suite 1450<br>Oakland, CA 94612<br>aliou@leonardcarder.com |
| Locals 512 and 2700 of the American Federation of State, County and Municipal Employees AFL-CIO : Intervener and Appellant | Robert Bonsall<br>Beeson Tayer & Bodine<br>483 Ninth Street, Suite 200<br>Oakland, CA 94607<br>rbonsall@beesontayer.com |
| United Chief Officers Association : Intervener and Appellant | Robert James Bezemek<br>1611 Telegraph Avenue - Suite 936<br>Oakland, CA 94612<br>rjbezemek@bezemeklaw.com |
| Alameda County Medical Center : Interested Entity/Party<br>Wright Lassiter, III, CEO<br>Alameda County Medical Center,<br>1411 East 31st St.<br>Oakland, CA 94602<br>wlassiter@acmedctr.com | Pro Per |
| First 5, Alameda County Children & Families Commission : Intervener and Appellant<br>Mark Friedman, CEO First 5<br>1115 Atlantic Avenue<br>Alameda, CA 94501<br>mark.friedman@first5ecc.org | Pro Per |
| Housing Authority of County of Alameda : Intervener and Appellant | Brian Edward Washington<br>Office of County Counsel<br>1221 Oak Street - Suite 450<br>Oakland, CA 94612-4296<br>brian.washington@acgov.org |
| Livermore Area Recreation and Park District : Intervener and Appellant | Rod A. Attebery<br>Neumiller & Beardslee<br>509 West Weber Avenue, 5th Floor<br>P. O. Box 20<br>Stockton, CA 95201-3020<br>rattebery@neumiller.com |
| Alameda County Office of Education : Intervener and Appellant | Pro Per |

| | |
|---|---|
| Sheila Jordan, Superintendent of Schools<br>313 W. Winton Avenue<br>Hayward, CA 94544<br>sjordan@acoe.org | |
| Superior Court of California : Intervener and Appellant<br>Patricia Sweeten, Court Executive Officer<br>1225 Fallon Stret, Room 209<br>Oakland, CA 94612<br>psweeten@alameda.courts.ca.gov | Pro Per |
| County of Alameda : Intervener and Appellant | Andrea Lynne Weddle<br>Office of the County Counsel Alameda County<br>1221 Oak Street, Suite 450<br>Oakland, CA 94612<br>andrea.weddle@acgov.org |
| State of California, Dominic Ciotola : Interveners, Appellants and Respondents | Anthony Paul O'Brien<br>Office of the Attorney General<br>1300 "I" Street - Suite 125<br>Sacramento, CA 95814<br>anthony.obrien@doj.ca.gov<br><br>Rei R. Onishi<br>Office of Governor Edmund G. Brown Jr.<br>State Capitol, Suite 1173<br>Sacramento, CA 95814<br>rei.onishi@gov.ca.gov |
| Rodeo-Hercules Fire Protection District : Intervener and Appellant | Richard Delmendo PioRoda<br>Meyers, Nave, Riback, Silver & Wilson<br>555 12th Street, Suite 1500<br>Oakland, CA 94607<br>rpioroda@meyersnave.com |
| Bethel Island Municipal Improvement District : Intervener and Appellant | David Jeffry Larsen<br>Law Office of David J. Larsen<br>5179 Lone Tree Way<br>Antioch, CA 94531<br>dlarsen@dlarsenlaw.com |
| Contra Costa County, Contra Costa County Fire Protection District, Housing Authority of the County of Contra Costa, In-Home Supportive Services Public Authority, Contra Costa Local Agency Formation Commission, Children and Families First Commission : | Thomas Lawrence Geiger<br>Contra Costa County Counsel<br>651 Pine Street, 9th Floor<br>Martinez, CA 94553-1229<br>thomas.geiger@cc.cccounty.us |

| | |
|---|---|
| Intervener and Appellant | |
| Central Contra Costa Sanitary District : Real Party in Interest and Respondent | Linda M. Ross<br>Renne Public Law Group<br>350 Sansome Street, Suite 300<br>San Francisco, CA 94104<br>lross@publiclawgroup.com<br><br>Kenton Alm<br>Meyers, Nave, Riback, Silver & Wilson<br>555 12th Street, Suite 1500<br>Oakland, CA 94607<br>kalm@meyersnave.com |
| Superior Court of California County of Contra Costa : Intervener and Appellant | Lyle R. Nishimi<br>Judicial Council of California<br>455 Golden Gate Avenue<br>San Francisco, CA 94102<br>lyle.nishimi@jud.ca.gov |
| Attorneys for East Contra Costa County Fire Protection District : Intervener and Appellant | Diane Marie Hanson<br>Hanson Bridgett LLP<br>425 Market Street, 26th Floor<br>San Francisco, CA 94105<br>domalley@hansonbridgett.com |
| Byron, Brentwood, Knightsen Union Cemetery District : Intervener and Appellant<br>Barbara Fee<br>P.O. Box 551<br>Brentwood, CA 94513<br>ucemetery@yahoo.com | Pro Per |
| Rodeo Sanitary District : Intervener and Appellant | Carl P. Nelson<br>Bold, Polisner, Maddow, Nelson & Judson, PC<br>500 Ygnacio Valley Road, Suite 325<br>Walnut Creek, CA 94596-3840<br>cpanelson@bpmnj.com |
| San Ramon Valley Fire Protection District : Intervener and Appellant<br>Robert Leete<br>1500 Bollinger Canyon Road<br>San Ramon, CA 94583 | William Dale Ross<br>400 Lambert Ave.<br>Palo Alto, CA 94306-2219<br>wross@lawross.com |
| Contra Costa Mosquito & Vector Control District : Intervener and Appellant<br>Craig Downs | Martin Thomas Snyder<br>Snyder, Cornelius & Hunter<br>399 Taylor Blvd., Suite 102<br>Pleasant Hill, CA 94523 |

| | |
|---|---|
| 155 Mason Circle<br>Concord, CA 94520 | mtsnyder@schlawfirm.net |
| Moraga/Orinda Fire Protection District : Intervener and Appellant<br>Sue Casey<br>33 Orinda Way<br>Orinda, CA 94563<br>scasey@mofd.org | Pro Per |
| American Federation of State, County and Municipal Employees Local 2703, AFL-CIO, Jeffrey Miller, Sandra Gonzalez-Diaz, Merced County Sheriff's Assoc., an Affiliate of International Brotherhood of Teamsters, Local 856: Plaintiffs , Appellants and Respondents | Barry Jay Bennett<br>Katwyn T. DeLaRosa<br>Bennett, Sharpe, Delarosa, Bennett & Licalsi<br>2444 Main Street, Suite 150<br>Fresno, CA 93721<br>ktdelarosa@bennettsharpe.com |
| Merced County Employees' Retirement Association, Board of Retirement of the Merced County Employees' Retirement Association : Defendant and Respondent | Ashley K. Dunning<br>Nossaman LLP<br>50 California Street 34th Floor<br>San Francisco, CA 94111<br>adunning@nossaman.com |