

# Cal Fire Local 2881 v. California Public Employees' Retirement System



## Background

The contracts clauses of the California and United States constitutions prohibit the impairment of contracts. For decades, California courts have interpreted promised pension benefits to constitute “vested” contractual rights. Thus, California courts have held that promised pension benefits cannot be modified without violating the Constitution, except in limited circumstances — namely, only if the modifications are necessary to maintain the integrity of the pension system, and if they are “reasonable.” According to most California courts, modifications are not reasonable unless resulting disadvantages to employees are offset by comparable new advantages. This concept is now commonly referred to as the “California rule” of vested pension benefits.

In 2016, a three-judge panel of the California Court of Appeal for the First Appellate District departed from the California rule and upheld a pension benefit modification made pursuant to the California Public Employees’ Pension Reform Act of 2013 (PEPRA) even though the modification was made without an offsetting comparable new advantage. Specifically, the court upheld PEPRA’s elimination of the option for employees to purchase up to five years of service credit — “airtime” — to increase the amount of service factored into their pension at retirement. The California Supreme Court granted review.

## The Court of Appeal Opinion

### *The Airtime Benefit was not a Vested Contract Right*

In upholding the constitutionality of PEPRA’s elimination of airtime, the court first analyzed whether the airtime benefit was a vested contract right for those employees who were eligible to purchase airtime before it was eliminated. The court concluded that the airtime benefit was not vested, because nothing in the text of the statute or its legislative history unambiguously demonstrated a legislative intent to create a vested right. In other words, the Legislature had not promised not to eliminate or modify the benefit.

### *The Elimination of Airtime was Reasonable Although No Comparable New Benefit was Provided*

The court further concluded that even if the airtime benefit was a vested right, it was not unconstitutional for the Legislature to eliminate it. The court rejected the concept that the constitutionality of the modification was dependent on providing a new, offsetting comparable benefit. In concluding the modification was reasonable, the court noted that:

1. the employees were given a window within which to purchase airtime before it was eliminated, and
2. the employees personally paid for airtime, so this was not a case where a benefit was provided in exchange for work performance and then taken away.

## California Supreme Court Proceedings

The California Supreme Court granted review of the case on April 12, 2017. Briefing was completed by the parties on January 22, 2018, leaving 30 days within which interested non-parties were permitted to file amicus — or friend-of-the-court — briefs. The League of California Cities® was one of several interested non-parties to file an amicus brief.

### *Party Briefing*

This case was initiated by Cal Fire Local 2881 on behalf of itself and its members (professional firefighters employed by the State). Cal Fire Local 2881 sued CalPERS to compel it to continue to offer the airtime benefit to employees employed prior to PEPRA, even though PEPRA had eliminated the benefit. The State intervened in the case to defend the constitutionality of PEPRA. Throughout the trial and appellate court proceedings, the case was handled by the Attorney General’s office on behalf of the State. Once the Supreme Court granted review, the Governor’s office took over.

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## Governor's Arguments

The Governor's brief begins by explaining the origins of airtime and the flaws that emerged after the Legislature authorized its purchase. It also underscores the severity of the public pension crisis in California. It then makes the following arguments:

- » A law creates a vested contract right only where the Legislature clearly and unequivocally intends to create a contract, and no contract can be implied from the statute that authorized airtime.
- » Although pension benefits may become vested contract rights where they are "deferred compensation" for time already worked, the airtime benefit was merely a potential benefit enhancement, not deferred compensation.
- » Even assuming the airtime benefit was a vested contract right, it was lawful to modify it because:
  - The modification was minimal, not substantial. Those who never purchased airtime saw no changes whatsoever to their expected pension once the airtime benefit was eliminated.
  - And even if the modification was substantial, it was "reasonable and necessary to serve an important public purpose." This means to
    1. Restore the severed link between pension benefits and public service,
    2. Eliminate a known cause of premature retirements, and
    3. Eliminate an inherently unworkable and fiscally unsustainable scheme.
  - It is not necessary that every modification include an offsetting comparable advantage; rather, this is just one factor for the court to consider when deciding whether a modification is reasonable.

## The League's Arguments

The League's amicus brief, drafted by Jonathan Holtzman and Linda Ross of Renne Public Law Group®, extensively discusses the current fiscal hardships that cities are facing due to the unsustainable rise in pensions costs. It also makes the following arguments:

- » For a pension or retirement benefit to become a vested contract right, there must be unmistakable evidence that the legislative body intended to create a private contractual or vested right.
- » Even contractually-vested pension or other retirement benefits can be modified without providing a comparable new advantage, so long as the modifications are reasonable.
- » Modifications that are made to prospective benefits (i.e. to benefits attached to time not yet worked as opposed to time already worked) are reasonable so long as they bear a "material relation to the theory of a pension system and its successful operation" and leave employees with a "substantial and reasonable" pension. By contrast, benefits already earned by employees through completed service, and benefits paid to retirees, are subject to a higher standard of review if the legislative body seeks to modify them.
- » An economic emergency is not required in order to modify prospective benefits.

## Next Steps

The timeline for when the Supreme Court will issue a decision in this case will depend on when it sets oral argument. The Rules of Court do not impose any timeline under which the Court must set an oral argument, but once oral argument is held and the Court takes the case under submission, it has 90 days within which to issue an opinion.