Case No. S239958

IN THE SUPREME COURT OF CALIFORNIA

CAL FIRE LOCAL 2881,

Petitioners and Appellants,

v.

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CALPERS),

Defendant and Respondent,

and

THE STATE OF CALIFORNIA

Intervenor and Respondent.

After a Decision by the Court of Appeal
First Appellate District, Case No. A142793
Alameda County Superior Court, Case No. RG12661622
The Honorable Evelio Martin Grillo, Presiding Judge

APPLICATION TO FILE *AMICI CURIAE* BRIEF AND *AMICI CURIAE* BRIEF OF HOWARD JARVIS TAXPAYERS ASSOCIATION AND VENTURA COUNTY TAXPAYERS ASSOCIATION IN SUPPORT OF RESPONDENTS

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APPLICATION FOR LEAVE TO FILE *AMICI CURIAE* BRIEF

Pursuant to California Rules of Court, rule 8.520(f), Howard Jarvis Taxpayers Association ("HJTA") and Ventura County Taxpayers Association ("VCTA") request leave to file the attached *amici curiae* brief in support of Respondents California Public Employees' Retirement System (CalPERS) and the State of California.[1]

HJTA is a nonprofit public benefit corporation comprised of over 200,000 California taxpayers dedicated to the protection of Proposition 13 and the advancement of taxpayers' rights, including the right to limited taxation, the right to vote on tax increases, and the right of economical, equitable and efficient use of taxpayer dollars.

VCTA is a non-partisan, nonprofit organization that advocates for the rights of Ventura County taxpayers. It promotes the wise use of public funds, opposes waste, advises public officials regarding issues of concern to taxpayers, and recommends positions that will best serve the taxpayers' interests.

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[1] No party or counsel for any party authored this brief, participated in its drafting, or made any monetary contributions intended to fund the preparation or submission of the proposed brief. Thomas Layton, a private citizen and California taxpayer, made a monetary contribution intended to partially fund the preparation of the proposed brief. *Amici* certify that no other person or entity other than *amici* and their counsel authored or made any monetary contribution intended to fund the preparation or submission of the brief. Cal. Rules of Court, rule 8.520(f)(4).

Amici are interested in this case because it raises an important issue affecting California taxpayers. The Union's conception of the so-called "California Rule" threatens fundamental constitutional protections of California citizens. If the Court were to affirm the Union's version of the rule it would squelch reform efforts and doom state and local budgets. The proposed brief will assist the Court by addressing the constitutional infirmities of the Union's position, the incongruence of treating stand-alone pension statutes as part of a "contract" in the context of collective bargaining, and the ramifications of the rule on state and local government.

Respectfully submitted,

Dated: February 21, 2018

Benbrook Law Group, PC

By: /s/ Bradley A. Benbrook
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AMICI CURIAE BRIEF

INTRODUCTION AND SUMMARY OF ARGUMENT

Under the Union's conception of the so-called "California Rule," no pension benefit provided to public employees through a statute can ever be withdrawn without replacement of a "comparable" benefit. In other words, the Union posits a *constitutional right* that a public pension can only get better and never worse over the course of one's employment. And furthermore, under this rule it is the obligation of the judiciary to tell the Legislature that it is barred from engaging in any pension reform, even if the Legislature determines that the non-public employee citizens are unfairly suffering as a result of prior legislatures' mistakes.

Not surprisingly, a rule as extreme as the Union posits has a dubious heritage. As the Governor points out, the Union's version of the rule doesn't exist, and we summarize further below the rickety foundation on which the supposed rule is built.

Amici emphasize in this brief that the Union's version of the rule would imperil fundamental constitutional principles designed to protect the freedom and well-being of the mere citizens who pay for these pensions. Namely, the supposed rule undermines basic notions of state sovereignty and representative government: In essence, the rule assumes that powerful political players can obtain legislative victories to enrich

themselves that can never be reformed. Judicial promotion of such a regime would further raise serious separation of powers concerns.

We also highlight the incongruence of treating stand-alone pension statutes as a "contract" or "part" of a contract (as claimed here) given the prevalence of collective bargaining agreements that already cover pension rights. Since, as the Union concedes, basic contract rules apply to any assertion that a statute creates contract rights, those basic principles torpedo any claim that Government Code § 20909's "air time" provisions created a contract.

Finally, we emphasize the policy consequences of turning a blind eye to reform efforts. As State and local budgets have to spend more money paying for rich pension benefits, private-sector citizens pay ever-higher taxes and fees while also getting *fewer* services and crumbling infrastructure. In the meantime, their fellow citizens who are fortunate enough to retire from public service in their 50s are starting a second career—or double-dipping while still working for the state as a "consultant."

It is urgent that the Court clarify once and for all that the supposed "California Rule" does not exist.

BACKGROUND ON THE "CALIFORNIA RULE"

In a 2012 law review article, Professor Amy B. Monahan demonstrates that the entire "California Rule" doctrine can be traced to a single sentence in this Court's decision a century ago in *O'Dea v. Cook*, 176 Cal. 659 (1917), where a widow sued the city of San Francisco over its modification of death benefits provided to police officers' families. *See* Amy B. Monahan, *Statutes as Contracts? The "California Rule" and Its Impact on Public Pension Reform*, 97 Iowa L. Rev. 1029, 1051–53 (2012).

Before *O'Dea*, this Court had held that public employee benefits were subject to change at the state's discretion—in 1885, it proclaimed that "it is well settled that salaried public offices, created by the legislature, are not held by contract or grant. The legislature has full control over them, unless restricted by the constitution, and may abolish them altogether, or impose upon them new duties, or reduce their salaries." *Miller v. Kister*, 68 Cal. 142, 144 (1885). Four years later, in *Pennie v. Reis*, this Court again emphasized that "[a] public officer . . . has no contract by which he can have or hold either his office or his salary against the legislative will." 80 Cal. 266, 269 (1889).[2]

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[2] *Pennie* was affirmed by the U.S. Supreme Court, which held a similar line: the state's provision of pension benefits "was subject to change or revocation at any time, at the will of the legislature" and "[t]here was no contract on the part of the state that its disposition should

This Court began to change course three decades later in *O'Dea*, when it observed that "where . . . services are rendered under . . . a pension statute, 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." 176 Cal. at 661–62 (emphasis added).

O'Dea's dictum that pension provisions "in a sense" become "part of the contract of employment" lay dormant for nearly twenty years, until an appellate court relied on *O'Dea* to resuscitate a widow's claim that was time-barred under Los Angeles' municipal pension regulations. *Dryden v. Bd. of Pension Comm'rs*, 51 P. 2d 177 (Cal. Ct. App. 1935). In the course of its analysis, the Court of Appeal observed (dicta, again) that "pension provisions of the city charter" "are an indispensable part of [a public employee's] contract, and that the right to a pension becomes a vested one upon acceptance of employment by an applicant." *Id.* at 178 (citing *O'Dea*). That decision, standing alone, wouldn't have been a big deal, but this Court granted a further hearing in the case and adopted the Court of Appeal's opinion wholesale. *Dryden v. Bd. of Pension Comm'rs*, 6 Cal. 2d 575, 579 (1936). As Professor Monahan put it, "[a]s a result, that unfortunate bit of dictum ended up becoming the dictum of the California

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always continue as originally provided." *Pennie v. Reis*, 132 U.S. 464, 471, (1889).

Supreme Court, which profoundly impacted the future development of the law in this area." Monahan, *supra*, 97 Iowa L. Rev. at 1054.

After *O'Dea* and *Dryden*, the idea that pension provisions were an "indispensable" part of a public employment contract gained traction—yet the pension could be modified. In *Kern v. City of Long Beach*, 29 Cal. 2d 848 (1947), this Court held that a public employee "may acquire a vested contractual right to a pension" that "is not rigidly fixed." *Id.* at 855. So while "an employee does not have a right to any fixed or definite benefits," he is assured "a substantial or reasonable pension." *Id.* at 855. (Notably, in *Kern* the City of Long Beach was attempting to jettison its pension obligations altogether. *See* Section I(B) below.) In *Wallace v. City of Fresno*, 42 Cal. 2d 180 (1954), the Court explained that, under *Kern*, a public pension system is entitled to "make reasonable modifications and changes before the pension becomes payable and that until that time the employee does not have a right to any fixed or definite benefits but only to a substantial or reasonable pension." *Id.* at 183.

The Court built on *Wallace*'s "reasonable modification" standard the following year in *Allen v. City of Long Beach*, 45 Cal. 2d 128 (1955). While the *Allen* court recognized that "[a]n employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with

changing conditions and at the same time maintain the integrity of the system," *id.* at 131, it added a new twist that has occupied much of the parties' briefing: "To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages."[3] *Id.* This set the foundation for the competing conceptions of the "California Rule" that are now before the Court.

While the rule posited by the Union—no changes ever, even prospectively, for future service—sounds implausible on its face, it is all the more so given the government's ability to alter every other aspect of public employment compensation. For example:

- Ordinary compensation and other employee benefits can be

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[3] The "comparable new advantages" requirement was more or less invented out of whole cloth. The *Allen* Court cited *Wallace* and *Packer v. Bd. of Retirement*, 35 Cal. 2d 212 (1950), but neither case provides sturdy support for that proposition. *Wallace* simply observed that, in *Packer*, the "[pension] modification eliminated a benefit for an employee's widow but made other changes which were advantageous to the employee." 42 Cal. 2d at 185. And in *Packer*, while the Court compared a modified plan with the original plan (and observed that the revised plan "embraced both advantages and disadvantages"), it did not purport to set in stone a balancing requirement. 35 Cal. 2d at 214, 218–19. *See* Monahan, *supra*, 97 Iowa L. Rev. at 1060 n.195 (discussing *Packer* and the "comparable new advantages" requirement).

changed prospectively.[4]

- Tenure rules can be changed.[5]

- Terms of civil service can be changed at any time.[6]

Professor Sasha Volokh has explained how this imbalance, where pension benefits are privileged over salary and other employment benefits, yields a disguised form of deficit spending:

> [G]overnments, free from ERISA regulations that govern private employers, find it easier to promise generous pensions and then underfund them, leaving future generations to pick up the bill. Underfunded public employee pensions are thus a form of deficit spending. [¶] . . . [T]he fact that pensions are protected actually makes it easier for governments to credibly promise generous pensions to their employees, knowing that (outside of a cataclysmic event like municipal bankruptcy) later generations won't be able to undo the terms.

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[4] *See, e.g.*, *Butterworth v. Boyd*, 12 Cal. 2d 140, 150 (1938) ("It is well settled that public employees have no vested right in any particular measure of compensation or benefits, and that these may be modified or reduced by the proper statutory authority.")

[5] *Miller v. State of California*, 18 Cal. 3d 808, 814 (1977) (based on "long and well settled principles," "the power of the Legislature to reduce the tenure of plaintiff's civil service position and thereby to shorten his state service, by changing the mandatory retirement age was not and could not be limited by any contractual obligation.").

[6] *Miller*, 18 Cal. 3d at 814 ("Nor is any vested contractual right conferred on the public employee because he occupies a civil service position since it is equally well settled that '[t]he terms and conditions of civil service employment are fixed by statute and not by contract.'" (quoting *Boren v. State Personnel Bd.*, 37 Cal. 2d 634, 641 (1951)); *see also Hinchliffe v. City of San Diego*, 165 Cal. App. 3d 722, 725 (1985) ("The public employee . . . can have no vested contractual right in the *terms* of his or her employment, such terms being subject to change by the proper statutory authority.").

Alexander Volokh, *Overprotecting Public Employee Pensions: The Contract Clause and the California Rule* 17 (Reason Foundation 2014). Here, of course, the State cannot file for bankruptcy protection, so there is no doomsday relief option.

Perhaps the most surprising thing about the Union's conception of the California Rule is that it has been taken seriously for so long. But limiting principles always apply to constitutional rules, and this case is an excellent opportunity to re-affirm those principles.

The Governor's brief does a masterful job in explaining why the outlier view of the California Rule does not exist. We write separately to stress, in a little more detail, the constitutional infirmities and policy ramifications of the Union's position.

ARGUMENT

I. The Union's Version Of The "California Rule" Would Undermine Important Structural Constitutional Principles.

A. The Legislature's Role As The Policy-Making Body On Behalf Of All Citizens Is Generally Incompatible With The Notion Of Unalterable, Legislation-Based "Contracts."

When a plaintiff asserts a contract clause violation arising from a legislature's modification of a prior enactment, California courts follow the federal courts in imposing a heavy burden at the outset. This Court unanimously reaffirmed in *Retired Emps. Ass'n of Orange Cnty., Inc. v.*

Cnty. of Orange, 52 Cal. 4th 1171 (2011), that courts must *presume* statutes do not form a contract unless the intention to create one is "clearly and unequivocally expressed." *Id.* at 1185–86 (citing *Nat'l R.R. Passenger Corp. v. A.T. & S.F.R. Co.*, 470 U.S. 451 (1985)). In *National R.R. Passenger*, Justice Thurgood Marshall explained on behalf of a unanimous Court that this deeply entrenched presumption arises from the fundamental nature of legislative role:

> For many decades, this Court has maintained that absent some clear indication that the legislature intends to bind itself contractually, the presumption is that "a law is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise." This well-established presumption is grounded in the elementary proposition that the principal function of a legislature is not to make contracts, but to make laws that establish the policy of the state. Policies, unlike contracts, are inherently subject to revision and repeal, and 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. Indeed, "'[t]he continued existence of a government would be of no great value, if by implications and presumptions, it was disarmed of the powers necessary to accomplish the ends of its creation.'"

National R.R. Passenger, 470 U.S. at 455–56 (citations omitted).

Likewise, in *Taylor v. Bd. of Educ.*, 31 Cal. App. 2d 734 (1939), a case on which this Court relied in *Retired Employees*, 52 Cal. 4th at 1186, the court rejected a claim that the legislature could not revise teacher-tenure statutes:

> In our opinion, the sovereign power vested in the Legislature to enact laws for the betterment of common schools is one which cannot be bartered away. The exercise of such power at one time does not mean that future Legislatures may not, in the light of experience, declare a different policy. If such is not the law, there is no hope for progress, and future legislators, in determining educational policies concerning the tenure of teachers, must follow in trodden paths.

Taylor, 31 Cal. App. 2d at 746 (quoting *Campbell v. Aldrich*, 79 P. 2d 257 (Or. 1938)).

Indeed, much to the frustration of many elected officials, their policies can be undone: "It is the general rule that one legislative body cannot limit or restrict its own power or that of subsequent Legislatures and that the act of one Legislature does not bind its successors." *Ex parte Collie*, 38 Cal. 2d 396, 398 (1952).

This rule is fundamental to preserving representative democracy. "[T]hat one legislature cannot abridge the powers of a succeeding legislature" and "one legislature is competent to repeal any act which a former legislature was competent to pass" is a foundational principle that "can never be controverted." *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 135 (1810). Put simply, a statute is "alterable when the legislature shall please to alter it." *Marbury v. Madison*, 1 Cranch 137, 177 (1803). *See Newton v. Comm'rs*, 100 U.S. 548, 559 (1880) (in cases involving "public interests" and "public laws," "there can be . . . no irrepealable law"). Were it

otherwise, powerful political interests could sneak through "vested" contract rights in legislation that does not "clearly and unequivocally" create such rights, thereby diminishing accountability and opportunities for reform in the interest of the general population.

Moreover, if courts were *not* bound to presume that the legislature is preserving its fundamental authority to adjust policy for the benefit of the citizens at large, but rather could freely pick the statutes that create vested contract rights among beneficiaries—and thereby limit the legislature's authority—that would raise grave separation of powers concerns. Monahan, *supra*, 97 Iowa L. Rev. at 1076 ("Courts that bind legislatures, absent clear indication that a legislature intended to bind itself in perpetuity, are infringing on legislative power.").

B. Even When Vested Contract Rights Are Created By Statute, Reasonable Exercise Of The "Reserved" Sovereign Power Does Not Violate The Contract Clause.

In the rare case when a legislative enactment *does* create vested contract rights, courts grant legislators leeway to continue acting in the interest of the citizenry at large.

In *Allen v. Bd. of Admin.*, 34 Cal. 3d 114 (1983) ("*Allen II*"), this Court relied heavily on the general principles set out in *City of El Paso v. Simmons*, 379 U.S. 497 (1965), and *Home Building & Loan Ass'n v.*

Blaisdell, 290 U.S. 398 (1934), and stressed that "[t]he reservation of the essential attributes of continuing governmental power is also read into contracts as a postulate of the legal order. The contract clause and the principle of continuing governmental power are construed in harmony . . . ." *Allen II*, 34 Cal. 3d at 120 (citations omitted). In short, "[t]he State has the 'sovereign right . . . to protect the . . . general welfare of the people.'" *City of El Paso*, 379 U.S. at 508 (quoting *East New York Savings Bank v. Hahn*, 326 U.S. 230, 232–33 (1945)).

To be sure, this reserve power is limited. The Contract Clause prevents the State from reneging on its deals such that a contracting party loses all benefit of the contract. *See, e.g.*, *U.S. Trust Co. of New York v. New Jersey*, 431 U.S. 1, 22 (1977) (while "[t]he States must possess broad power to adopt general regulatory measures without being concerned that private contracts will be impaired, or even destroyed," "private contracts are not subject to unlimited modification under the police power.").

But that is not at issue here. It is critical to remember that the Union claims only that the rights created by Government Code § 20909 were "*part* of the contemplated compensation for [employees'] services and so in a sense a *part* of the contract of employment." AOB at 24 (quoting *O'Dea*, 176 Cal. at 661–62) (emphasis added). The Union cannot dispute

that its members still retain a reasonable—indeed a very generous—pension.

The Union relies heavily on *Kern*, which illustrates these principles. In that case, the city amended its charter to repeal employees' rights to any pension. When a 20-year employee sought his retirement (and pointed out that he had paid into the system along the way), the city tried to fall back on its reserve powers to modify pensions. This Court's resolution of the issue demonstrates why this is an easy case:

> The rul[e] permitting modification of pensions is a necessary one since pension systems must be kept flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system and carry out its beneficent policy. The permissible scope of changes in the provisions need not be considered here, because the respondent city, with a minor exception, has repealed all pension provisions.
>
> Thus . . . an employee may acquire a vested contractual right to a pension but that this right is not rigidly fixed by the specific terms of the legislation in effect during any particular period in which he serves. The statutory language is subject to the *implied qualification* that the governing body may make modifications and changes in the system. The employee does not have a right to any fixed or definite benefits, but only to a *substantial or reasonable* pension. There is no inconsistency therefore in holding that he has a vested right to a pension but that the amount, terms and conditions of the benefits may be altered.

Kern, 29 Cal. 2d at 854. Here, by contrast, a controversial "part" of the supposed pension system was removed, and a far-more-than-reasonable pension remains intact for every one of the Union's members.

The ability to permissibly modify contracts also depends on a finding that the modification is "necessary to serve an important public purpose." *U.S. Trust Co.*, 431 U.S. at 25. The Governor's brief chronicles the many reasons why the reforms in the PERL were urgently needed, and we highlight in Section III below the risks associated with maintaining the one-way pension ratchet required by the Union's conception of the "California Rule."

We focus here on the importance of deferring to the Legislature's judgment, at least when it comes to acting for the benefit of the citizens as a whole rather than the benefit of a favored minority, *see* below. The Union spends page after page mocking the notion that budgetary concerns are "external" to the proper analysis here, AOB at 37–44, and even suggests that a finding of CalPERS' *insolvency* is required to show a modification is "necessary." *Id.* at 41. In essence, the Union argues for heightened constitutional scrutiny of pension modifications—a modern-day version of *Lochner*ism for public employees.

But the United States Supreme Court has rejected the notion that courts are the proper arbiters of the legislature's policy determinations:

"Once we are in this domain of the reserve power of a State we must respect the 'wide discretion on the part of the legislature in determining what is and what is not necessary.'" *City of El Paso,* 379 U.S. at 508–09.

C. That Politically-Dominant Public Employee Unions Regularly Obtain Supposed Legislative Pension Contracts Strongly Increases These Constitutional Concerns.

Recognizing the State's retained power to govern by enacting reforms—and the judiciary's power to enforce structural constitutional limits—is all the more urgent when, as here, the purported legislative "contract" was obtained by a politically powerful group, rather than through traditional public-contract bargaining. Indeed, the United States Supreme Court has stressed that "the scope of the State's reserved power depends on the nature of the contractual relationship with which the challenged law conflicts." *U.S. Trust*, 431 U.S. at 22–23. And "[i]t is the motive, the policy, the object that must characterize the legislative act, to affect it with the imputation of violating the obligation of contracts." *City of El Paso*, 379 U.S. at 509 (citation omitted).

In the normal public contract setting, of course, a representative of the government sits across the table from a private party and attempts to negotiate the best deal possible for the State. Indeed, California law imposes many restrictions aimed at ensuring that the financial interests

of the State are protected. *See, e.g.*, Pub. Contract Code § 10180 (State Contract Act generally requires the award of contracts to the "lowest responsible bidder"); *Domar Electric, Inc. v. City of Los Angeles*, 9 Cal. 4th 161, 173 (1994) (setting forth purpose of the state's competitive bidding process, citing Pub. Contract Code § 100).

The terms on which the State obtains public employment are a different matter. In the collective bargaining process, public employee unions sit across the table from government agents appointed by the politicians that the Union helped elect. The FPPC has documented that public employee unions are the single most powerful political block in California in terms of political donations. In 2010, the California Fair Political Practices Commission measured all campaign and lobbying reports from 2000-2009 and identified the 15 largest political spenders, whose collective political expenditures totaled $1 billion. Cal. Fair Political Practices Comm'n, *Big Money Talks: California's Billion Dollar Club* at 11 (March 2010). The top two contributors were public employee unions (the California Teachers Association and the California State Council of Service Employees (SEIU)), who collectively spent $319 million. *Id.*

Others have documented the public employee unions' rise to political dominance in the State. *See, e.g.*, Steven Greenhut, *Plunder! How*

Public Employee Unions are Raiding Treasuries, Controlling Our Lives and Bankrupting the Nation (2009); Steven Malanga, *The Beholden State: How public-sector unions broke California* (City Journal Spring 2010); Daniel DiSalvo, *Government Against Itself* 98–113 (Oxford Univ. Press 2015).

Indeed, several public employee unions pushed the airtime bill through the Legislature, claiming that the benefit would be "cost neutral to employers." S. Rules Comm., Sept. 12, 2003 Senate Floor Analysis, Assem. Bill 719 (2003-2004 Reg. Sess.), at 3. The bill passed over the opposition of the State Department of Finance, which objected to taking the benefit out of the collective bargaining process: "It is inappropriate to set in statute employee benefits that are subject to negotiation through the collective bargaining process. To the extent this type of benefit is negotiated through collective bargaining, appropriate legislation to conform to those negotiations should then be sought, but not before the negotiations have begun." *Id.* at 4.

Normally a major political contributor proceeds with caution when they try to collect benefits from legislators they helped elect. It is a backwards theory indeed that would afford *constitutionally-protected* "contract" status to a piece of legislation conferring a benefit to that contributor. At a minimum, these political realities are appropriately

considered when an interest group claims that the government is constitutionally constrained from modifying legislation, no matter how much the rest of society is burdened or harmed by it.

While confirming that the Union's conception of the "California Rule" is wrong surely requires no bold reshaping of the law, judicial intervention to clarify this field is appropriate to prevent the government from malfunctioning. As Professor Ely wrote, when "the ins are choking off the channels of political change to ensure that they will stay in and the outs will stay out," judicial engagement is justified to "keep the machinery of democratic government running as it should." John Hart Ely, Democracy and Distrust: A Theory of Judicial Review 76, 103 (1980). And so it is here. This Court's guidance is unfortunately necessary to confirm that the Legislature and local governments have the authority to engage in pension reform.

II. General Contract Principles Should Make The "Heavy" Presumption Against Finding A Contract Insurmountable In Most Cases, And Certainly When A Separate Collective Bargaining Agreement Already Governs Pensions.

In *Retired Employees*, this Court confirmed that general contract principles apply to claims that a statute or ordinance creates a contract. 52 Cal. 4th at 1179 ("All contracts, whether public or private, are to be interpreted by the same rules unless otherwise provided by the Civil

Code.") (citing Civ. Code § 1635, and *M.F. Kemper Const. Co. v. City of Los Angeles*, 37 Cal. 2d 696, 704 (1951) ("California cases uniformly refuse to apply special rules of law simply because a governmental body is a party to a contract.")). Indeed, general contract principles demonstrate the incongruence of treating an isolated statute setting out an *additional* pension benefit as a "contract" between the State and a public employee when, as here, a separate collective bargaining agreement (CBA) already governs pensions.

At the time Government Code 20909 was enacted in 2003, plaintiff CalFire Local 2881 had negotiated a CBA with the State that began as follows: "This agreement . . . has as its purpose the promotion of harmonious labor relations between the State and the CDF Firefighters . . . and, the establishment of rates of pay, hours of work, and other conditions of employment." Agreement between State of California and CDF Firefighters covering Bargaining Unit 8 Firefighter, Effective July 2, 2001 through June 30, 2006.[7] Of particular import here, pages 87 through 96 of this CBA set out, in excruciating detail, the pension terms available to covered workers.

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[7] CDF's 2001 collective bargaining agreement is available online at https://www.dol.gov/olms/regs/compliance/cba/pdf/cbrp0380.pdf.

A contract involves consideration flowing in both directions between the parties, and the search for a contract out of legislation is no different. "In California law, a legislative intent to grant contractual rights can be implied from a statute if it contains an unambiguous element of exchange of consideration by a private party for consideration offered by the state." *Retired Employees*, 52 Cal. 4th at 1186 (quoting *Cal. Teachers Ass'n v. Cory*, 155 Cal. App. 3d 494 505 (1984)). What additional consideration does an already-employed public servant provide to make their *continued* employment a "contract?" (The Governor correctly points out that, if the payment for airtime is considered the consideration, the statute is properly considered an offer to contract that can be withdrawn, rather a contract that is "accepted" by employment. *See* Answering Br. of California at 42–55.)

Likewise, CBAs have limited duration. The publicly-available CBAs negotiated by plaintiffs here generally last four or five years.[8] If the theory is that a stand-alone statute adds to the overall compensation package offered to a public employee as "part" of the contract, why does the CBA expire and the statute live on in perpetuity?

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[8] The current CBA and supporting documents, along with historical agreements, are available on the California Department of Human Resources' website at http://www.calhr.ca.gov/labor-relations/Pages/Unit-08-Firefighters.aspx.

Moreover, when a CBA contains an integration clause confirming that the written agreement is the "entire" agreement and that it may only be amended by a separate writing, even Houdini couldn't turn a stand-alone statute into "part" of the CBA. And so it is here:

> Integration and Amendment
>
> 10. This agreement constitutes the entire agreement between the parties pertaining to the subject matter hereof and supersedes all prior agreements and understanding of the parties in connection herewith.
>
> 11. Any amendment hereof must be in writing and signed by each party.

Id. at 131.[9] Given this language, it is impossible under general contract theories for a separately-enacted statute to supplement the CBA.

Finally, at a more general level, it is worth noting that collective bargaining for public employees is a relatively new phenomenon.[10] It was

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[9] "When the parties to a written contract have agreed to it as an 'integration'—a complete and final embodiment of the terms of an agreement—parol evidence cannot be used to add to or vary its terms." *Masterson v. Sine*, 68 Cal. 2d 222, 225 (1968). *See* Code Civ. Proc. § 1856(a).

[10] Through the 1950s, "many states forbade government workers from joining unions, and when they could join unions, union rights were highly restricted." Daniel DiSalvo, Government Against Itself 40 (Oxford Univ. Press 2015). "The dominant understanding, regardless of political viewpoint—from labor leaders to conservative Republicans—was that collective bargaining would interfere with the sovereignty of government by delegating a piece of policymaking authority to union representatives in collective bargaining negotiations." *Id.* State employees were not given collective bargaining rights in California until 1978, when the State

certainly not the norm when *O'Dea* and *Allen I* were decided. Yet as the power of public employee unions has exploded, a large portion of state workers are now covered by CBAs: Of California's 2.5 million public employees, approximately 1.4 million are members of a public employee union. Unionstats.com, *Union Membership, Coverage, Density and Employment by State*, 2017, online at http://unionstats.gsu.edu/State_U_2017.htm.

III. As Taxpayers Are Forced To Foot The Bill For Increased Pension Obligations, They Are Receiving Fewer Traditional Government Services. The Court Must Preserve Opportunity For Reform.

The very term "California Rule" implies that California is somehow different when it comes to Contract Clause principles, not to mention principles of demography, economics, and simple mathematics. Indeed, under the Union's conception of the California Rule, "external" budgetary concerns about how pensions will be paid have nothing to do with the case—the implication being there will always be enough money, because this is California. But that is wrong.

For several years now, State and local budgets have shown the strain associated with pension obligations that have grown under the

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Employer-Employee Relations Act (SEERA) took effect. *See Pac. Legal Found. v. Brown*, 29 Cal. 3d 168, 175–77 (1981).

mistaken assumption that they can never be modified. California taxpayers are suffering the brunt of this. They are already paying a number of fees and taxes (and receiving fewer services) in light of the growing gap between pension promises and pension funding. If the current pension system cannot be changed, taxation levels will continue to rise or more essential government service simply won't be provided.

As pension obligations increase, government bodies have been forced to cut back on traditional, essential services in order to shift financial resources to cover the cost of public employees. In this way, pension costs are said to "crowd out" government services. "[L]arge and growing contributions to public employee defined benefit plans are diverting revenues away from other priorities. In economic jargon, public pension expenditures are crowding out expenditures on public goods and services and creating pressure to raise taxes in order to fund government employees' retirement." Wayne Winegarden, *California's Pension Crowd-Out, California's defined benefit public pension plans are unaffordable and over-burden current and future taxpayers* 15–16 (Pac. Research Inst. Jan. 2016). *See also*, *e.g.*, Mark Bucher, *Big pensions drive proposed tax increases on California ballots*, Sacramento Bee (Oct. 25, 2014) ("Big pension obligations mean fewer tax dollars for services like safety and

infrastructure, driving away taxpayers and increasing pension burdens further.").

A recent study by Stanford Professor (and former California State Assemblymember) Joe Nation concluded that "[p]ension costs have crowded out and will likely to continue to crowd out resources needed for public assistance, welfare, recreation and libraries, health, public works, other social services, and in some cases, public safety." Joe Nation, *Pension Math: Public Pension Spending and Service Crowd Out in California, 2003-2030*, Stanford Inst. for Econ. Pol'y Research (SIEPR) Working Paper No. 17-023 (Oct. 2, 2017), at iii (Preface). Put simply, "rising pension costs are making it harder to provide services traditionally considered part of government's core mission." *Id.* at 1.

In his study, Nation explains how the steady increase of pension expenditures as a share of California's operating budget over the last two decades has required the State to shift billions of dollars from traditional government services to cover pension obligations. For example, "the pension expenditure share of the state's operating budget increased from 2.1% in 2002-03 to 4.9% in 2008-09; it is estimated at 7.1% in 2017-18," and Nation estimates that pension expenditures will exceed 10% of the state budget by 2030. *Id.* at 13–14. "This increasing share, despite an expanding budget, has shifted $6.0 billion in 2017-18 from other state

expenditures to pensions." *Id.* at 13. After preparing case studies of three counties, six cities, and other governmental entities, Nation concluded:

> [A]s employer pension expenditures have increased, governments have reduced social, welfare and educational services, as well as "softer" services, including libraries, recreation, and community services. In some cases, governments have reduced total salaries paid, which likely includes salary and personnel reductions. While these shifts in budget priorities appear relatively small in some cases, they are substantial since many state and local expenditures are mandated, protected by statute, or reflect essential services (*e.g.*, Proposition 98, debt service, public safety, etc.), leaving limited maneuvering room to adjust in response to increased pension costs. Moreover, employer pension contributions are projected to roughly double between 2017 and 2030, resulting in the further crowd out of traditional government services.

Id. at 84. *See also* Winegarden, *supra*, at 115 ("[T]otal state run pension contributions in California in 2013 were $11.3 billion. Between 2003 and 2013, these contributions grew 9.8 percent per year, which is more than double the growth in total state tax revenues over the same time period (4.5 percent). The result, by definition, is that the public pension system requires a growing share of total California tax revenues leaving less money available for all other priorities."). California's pension system thus "places an unprecedented burden of meeting the current public employees' retirement promises on California's taxpayers either in the form of higher taxes, fewer public goods and services provided to citizens (*i.e.*, crowding-

out), or a combination of both." Winegarden, *supra*, at 14.[11] As Steven Greenhut put it, "at the end of the day, there are three things to expect as debt loads become unsustainable: cuts in government services, massive tax increases and pension-obligation bonds, or some combination of all three." Greenhut, *supra*, at 72.

The crowd-out effect demonstrates that it is essential for state and local governments to have the flexibility to reform and restructure long-term pension obligations to meet present-day needs. But the effect of unchecked pension obligations is not just a problem for today—they pose a disastrous threat to the next generation of Californians.

"Underfunding public pensions is in substance, if not in form, an example of deficit spending in which current taxpayers enjoy the benefits of government services while pushing off some of the costs to future taxpayers. It is a double whammy for those future taxpayers—they will not only be required to pay for the consumption of prior generations, but will also receive reduced government services as state and local governments allocate funds to pensions and health care for retired

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[11] *See also* Eric Boehm, Opinion, *Pension debt will force cuts to government services*, L.A. Daily News (Oct. 17, 2017) ("The state's pension costs have climbed by 423 percent since 2003. By comparison, spending on higher education, something that is typically viewed as being on an unsustainable fiscal course as annual cost increases strain schools and students, have climbed by 'just' 47 percent over the same period of time.").

workers rather than services for current taxpayers." Jack M. Beerman, *The Public Pension Crisis*, 70 Wash. & Lee L. Rev. 3, 7 (2013); *see also* Volokh, *supra*, at 16 (recognizing that the protection of pension benefits burdens taxpayers, and "may result in trimming various state government services (*e.g.*, police, fire, garbage collection, DMV, schools).").

There should be no illusion that California is exempt from the laws of economics or that there will always be enough "rich people" to pay for millions of government retirees' pensions. Multiple high-profile municipal funding crises and bankruptcies have resulted from prior governments' decisions to grant pensions at levels that future taxpayers were unwilling (and unable) to support. Former San Jose Mayor Chuck Reed sounded this alarm, arguing that California's "$400 billion in retirement debt is driving massive cost increases, which in turn are driving cuts in services and tax increases. Without reform, California faces a future of higher taxes and fewer services." Chuck Reed, *California Faces Higher Taxes, Fewer Services Without Pension Reform*, Cal. State Treasurer *Intersections*, vol. 2, no. 4 (Apr. 11, 2016).

Mayor Reed is talking from experience. Over the last decade, San Jose faced a budgetary crisis brought on in large part by the city's growing pension obligation, which caused it to reduce essential services. As the New York Times explained in 2013, "San Jose now spends one-fifth of its

$1.1 billion general fund on pensions and retiree health care, and the amount keeps rising. To free up the money, services have been cut, libraries and community centers closed, the number of city workers trimmed, salaries reduced, and new facilities left unused for lack of staff. From potholes to home burglaries, the city's problems are growing." Rick Lyman & Mary Williams Walsh, *Struggling, San Jose Tests a Way to Cut Benefits*, N.Y. Times (Sept. 23, 2013). In 2012, Reed drafted a plan to reform current and future government retirement benefits, and the voters approved the plan ("Measure B") with a 70 percent majority. *Id.* The city's plan has since been mired in litigation brought by public employee union representatives seeking to invalidate the measure and restore their benefits. *See* Ali Budner, *A Case Study on Pension Reform: San Jose's Grand Compromise*, Capital Public Radio (Jan. 1, 2017); Ramona Giwargis, *San Jose: Measure F promises to end pension battle—but will it?*, San Jose Mercury News (Oct. 2, 2016).

San Diego faced a similar dilemma. *See, e.g.*, Matthew T. Hall, *Shortfall in pension fund at $2.7 billion*, San Diego Union-Tribune (Nov. 12, 2008). And like San Jose, San Diego voters overwhelming approved a ballot measure (65.8%–34.2%) aimed at reforming pension obligations to reduce municipal debt. Craig Gustafson, *Pension reform scores big with voters*, San Diego Union-Tribune (June 5, 2012); Michael Cooper & Mary

Williams Walsh, *San Diego and San Jose Lead Way in Pension Cuts*, N.Y. Times (June 6, 2012). But that plan, too, has stalled in the courts. Marc Joffe, Opinion, *California Supreme Court case on San Diego pension reforms will impact cities and counties across state*, Orange County Register (Aug. 4, 2017).[12]

Stockton's public pension obligations were at the forefront of its bankruptcy, and the resolution of that case only reinforces the tradeoff between pension obligations and public services. Ultimately, the city was forced to compromise essential services, while pensions remained intact—and the city passed on the cost of its unfunded pension liability through an unprecedented municipal sales-tax hike. *See* Marc Lifsher & Melody Petersen, *Stockton bankruptcy ruling preserves city pensions*, L.A. Times (Oct. 30, 2014) (explaining that "Stockton's [bankruptcy] plan slashes city spending, cuts salaries and eliminates jobs—but preserves worker pensions," and that "[o]verly large pensions approved by city officials for employees are among the reasons that Stockton found it could no longer pay its bills"); Mary Williams Walsh, *$1.6 Million Bill Tests Tiny Town and 'Bulletproof' Public Pensions*, N.Y. Times (Oct. 9, 2016) ("Stockton chose to stay with Calpers and keep its existing pension plans, cutting

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[12] San Diego's pension reform proposition is headed to this Court on two unrelated questions. *Boling v. Pub. Empm't Relations Bd. (City of San*

other obligations and pushing through the biggest sales tax increase allowed by law.").

Rising pension obligations in Richmond likewise forced the city to make a choice between covering pensions and maintaining traditional services. The city's "relentless growth in pension costs" put the city at risk of bankruptcy: "Payments for employee pensions, pension-related debt and retiree health care have climbed from $25 million to $44 million in the last five years, outpacing all other expenses. [¶] By 2021, retirement expenses could exceed $70 million—41 percent of the city's general fund." Judy Lin, *Cutting jobs, street repairs, library books to keep up with pension costs*, L.A. Times (Feb. 6, 2017); Karina Ioffee, *Moody's downgrades Richmond, cites pension debt, increased spending*, San Jose Mercury News (May 29, 2015). Once again, the citizens have been left holding the bag. With pension and retirement costs skyrocketing, Richmond has cut jobs, trimmed city services, reduced city-sponsored programs serving K-12 students and seniors, eliminated some waste disposal programs, cut back on library books, increased the sales tax, and attempted to increase property taxes.[13] Lin, *supra*, *Cutting jobs, street repairs, library books to*

Diego), Case No. S242034.

[13] *See also* Ashley Gross, *Richmond Makes Cuts To Services As Pension Costs For Public-Sector Workers Mount*, Capital Public Radio (Feb. 6, 2017) (quoting Richmond Mayor Tom Butt explaining: "We've

keep up with pension costs. All of this, and it still may not be enough to keep the city out of bankruptcy. Riley McDermid, *City of Richmond named as high-risk candidate for bankruptcy, despite cutbacks*, S.F. Business Times (Feb. 17, 2017).

The time has come to clarify that the Union's conception of the "California Rule" is wrong. The State and its municipalities desperately need to engage in further pension reform without the cloud of uncertainty, not to mention the cost of litigation, arising from the pervasive misconception of the law.

CONCLUSION

For the foregoing reasons and those stated by Respondents, this Court should affirm the decision of the Court of Appeal.

Respectfully submitted,

Dated: February 21, 2018

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neglected filling positions in departments like the library and recreation. I think the fire department's kind of down to the bone. If we cut anybody else in there, we're going to have to start closing fire stations."); *id.* ("Butt says one big reason is that costs for employees' retirement benefits keep climbing. The city's finance director said in an email that over the next five years, Richmond's pension costs are projected to jump almost 40 percent.").

CERTIFICATE OF COMPLIANCE

I certify that the attached brief uses a 13-point Century Schoolbook font and contains 7,178 words as counted by the Microsoft Word® software program used to prepare this brief.

Respectfully submitted,

Dated: February 21, 2018

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