Summary of the Decision of the California Supreme Court in
Alameda County Deputy Sheriff's Asso., et al., v. Alameda County Employees' Retirement Asso., et al.; Contra Costa County Deputy Sheriff's Asso., et al. v. Contra Costa County Employees' Retirement Asso., et al.; American Federation of State, County and Municipal Employees, et al., v. Merced County Employees' Retirement Asso., et al.; State of California, et al., Interveners and Appellants
July 30, 2020

Opinion by Chief Justice Cantil-Sakauye in which Justices Chin, Corrigan, Liu, Cuellar, Kruger and Groban concurred. Justice Cuellar filed a concurring opinion.

Executive Summary

In this case, the California Supreme Court upheld PEPRA as constitutional and affirmed the California Rule. Further, the Court rejected Plaintiffs' claims that they were entitled to pension benefits calculated without regard to PEPRA based on settlement agreements entered into prior to enactment of PEPRA or based on the doctrine of equitable estoppel.

Plaintiffs in this case contended that the employees of Alameda, Contra Costa and Merced Counties have a contractual right to receive pension benefits calculated without regard to PEPRA's changes to the definition of compensation earnable based on either (1) settlement agreements in effect when PEPRA was enacted or (2) application of the doctrine of equitable estoppel. Plaintiffs also contended that county employees who began their work prior to enactment of PEPRA have a constitutional right to receive pension benefits calculated according to the law as it existed prior to PEPRA.

The specific amendment enacted by PEPRA at issue in this case was the addition of subdivision (b) to CERL section 31461. Section 31461(a) defines compensation earnable, and new subdivision (b) specifies what is excluded from compensation earnable. Subdivision (b) excludes from compensation earnable any compensation determined by the retirement board to have been paid to enhance a member's retirement benefit[1], and any compensation for services rendered outside normal working hours[2]. In addition, compensation for the surrender of unused paid time off, such as vacation and sick leave, and payments made at termination of employment, can be included in compensation earnable only to the extent the leave time was "earned and payable" in any 12-month period during a final compensation year.[3]

The Court fairly quickly dispensed with Plaintiffs' first two challenges to PEPRA (see below) and then turned to the constitutional question.

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[1] Section 31461(b)(1) list three examples: cash compensation in lieu of a benefit normally provided in-kind ((b)(1)(A)); a one-time or ad hoc payment made to a member but not to his or her peers ((b)(1)(B)); and payments made solely due to the termination of the member's employment but received while the employee is still employed ((b)(1)(C)).
[2] Section 31461(b)(3). The court mentions on-call duty pay as an example of payments for additional services rendered outside of normal working hours.
[3] Section 31461(b)(2) and (4).

PEPRA Held Constitutional

The Court found the challenged provision of PEPRA, which amended the definition of compensation earnable, to be constitutional; and in doing so, the Court affirmed the California Rule as follows:

> A modification of the pension rights accorded to a public employee at the time he or she commenced public employment, or of pension rights made available subsequently during the course of his or her public career will be upheld against a contract clause challenge only if it satisfies the test established in *Allen I*[4]:
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> 'An 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. [Citations.] Such modifications must be reasonable . . . . 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.'

Applying the first component of the California Rule to PEPRA's exclusion of certain items of pay from compensation earnable, the Court concluded that PEPRA was a modification of the county employee's pension rights by changing the law of compensation earnable and thereby diminished county employees' pension rights without providing any comparable new advantages. However, in turning to the second component of the California Rule, the Court concluded that PEPRA's amendment of the CERL was enacted for the constitutionally permissible purpose of conforming pension benefits more closely to the theory underlying the definition of compensation earnable by closing loopholes and proscribing potential pension spiking. The Court stated that it had "no difficulty finding that the PEPRA amendment was enacted to maintain the integrity of the pension system and 'bear[s] some material relation to the theory of a pension system and its successful operation.'" The Legislature's primary purpose in enacting PEPRA was to narrow the CERL's broad and general definition of compensation earnable to prevent pension spiking, and accomplished this objective by adding new exclusions and limitations to the definition of compensation earnable in order to more closely align with the preexisting theory underlying the CERL determination of pension benefits. "A legislative intent to align the express language of a pension statute more closely with its intended manner of functioning directly relates to both the theory of a pension system and its successful operation."

Finally, the Court held that the California Rule does not require the Legislature to offset the disadvantages imposed by PEPRA with comparable new advantages where doing so would undermine, or would otherwise be inconsistent with, the constitutionally permissible purpose underlying the pension modification. The Court found that although PEPRA provided no new advantages to offset any impact of the exclusions from compensation earnable, providing such advantages would have undermined the constitutionally permissible purpose of PEPRA – which was to bring administrative practice respecting compensation earnable into closer alignment with the pension system's underlying theory by excluding income designed to artificially inflate a

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[4] *Allen v. City of Long Beach* (1955) 45 Cal.2d 128.

pension benefit and limiting the inclusion of other types of compensation that were reasonably viewed as inconsistent with the CERL's general approach to pensionable compensation. The Court stated:

> It would be anomalous, at best, to hold that the Constitution requires current employees to be provided an equivalent advantage to mitigate the effect of eliminating from compensation earnable payments that, in the view of the Legislature, are inconsistent with the theory underlying the pension system. Requiring comparable advantages would be wholly inconsistent with the Legislature's purpose by restoring in some form advantages that, in the view of the Legislature, should not have been available to county employees in the first place.
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> . . .
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> The Legislature must have the authority, discretion, and flexibility to address such problems without being required to, in effect, extend the life of the loopholes and the opportunities for abuse for the duration of the careers of current employees by providing comparable advantages.

Accordingly, the Court held PEPRA was constitutional without a comparable new benefit to the employees.

The Settlement Agreements Do Not Confer a Contractual Right to Pensions Inconsistent with the CERL as Amended by PEPRA

The Court also ruled that the settlement agreements that had been entered into between county employees and their retirement systems prior to the enactment of PEPRA did not confer a contractual right to the employees to a calculation of their pension benefits in a manner inconsistent with the terms of the PEPRA amendment. County retirement boards are required to implement the CERL as enacted by the Legislature, and the settlement agreements, which were silent on the issue, must be interpreted to permit the modification of board policies to accommodate statutory changes to the CERL. The county retirement boards were without authority to confer a contractual right to the Plaintiffs to a calculation of pension benefits in a manner inconsistent with the CERL, as amended by PEPRA.

Plaintiffs Failed to Prove Equitable Estoppel

With respect to the Plaintiffs' equitable estoppel claim the Court found that the Plaintiffs had failed to demonstrate the elements necessary for equitable estoppel because there was no evidence that the county boards made any representations regarding the continued enforceability of the terms of the settlement agreements in the event of inconsistent legislative changes to the controlling statutory provisions.