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SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF CONTRA COSTA

CONTRA COSTA COUNTY DEPUTY SHERIFFS' ASSOCIATION, et al.

Petitioners,

v.

CONTRA COSTA COUNTY EMPLOYEES' RETIREMENT ASSOCIATION, et al.,

Respondents.

AND RELATED PETITIONS IN INTERVENTION AND CONSOLIDATED ACTIONS TRANSFERRED FROM OTHER COURTS

Case No. MSN12-1870

PETITIONERS' PHASE ONE OPENING BRIEF

Date:	October 31, 2013
Time:	9:00am
Dept.:	6
Judge:	Hon. David B. Flinn
Compl. Filed:	Nov. 27, 2012
Trial Date:	None

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I. INTRODUCTION

With the enactment of Assembly Bills 197 and 340, the Legislature has imposed sweeping new changes to the field of public employee pensions. For employees who are members of retirement systems under the County Employees Retirement Law of 1937 ("CERL"), Government Code sections 31450 *et seq.*, A.B. 197 and the similar provisions of A.B. 340 significantly limit what employee compensation may be considered "compensation earnable" for purposes of computing an employees' final retirement benefit. Whereas Government Code section 31461, which sets forth the primary definition of "compensation earnable," had remained essentially unchanged since its enactment in 1937, A.B. 197 has vastly altered the law to exclude multiple categories of compensation from CERL pension formulas.[1] The result is a dramatic reduction in employees' pension benefits, confounding their reasonable expectations and, more crucially, impairing their vested pension rights.

But despite the unprecedented and significant nature of these amendments, the State of California contends that these are no changes at all. The State claims that these revisions were already a part of CERL, and that the retirement boards of the Contra Costa County, Alameda County, and Merced County Employees' Retirement Associations (the "Retirement Boards") exceeded their authority by including the payments at issue here as compensation earnable. Thus, the State necessarily recognizes the vested nature of the pension rights at issue here, but seeks to circumvent the constitutional protection of such vested benefits by making an untenable argument: that the Retirement Boards were never authorized to provide the benefits in the first place.

Contrary to the State's position, it is well within the Retirement Boards' discretion to consider the disputed payments compensation earnable and to include them in pension calculations. As explained by *Guelfi v. Marin County Employees' Retirement Assn.* (1983) 145

[1] Government Code section 31461 was amended by both A.B. 340 and A.B. 197, although the amendments enacted by A.B. 197 duplicate and supersede the amendments by A.B. 340. (See Stats. 2012, ch. 296, § 28 [A.B. 340]; Stats. 2012, ch. 297, § 2 [A.B. 197].) For convenience, "A.B. 197" is used throughout to refer to the amendments made to § 31461 by both bills, and unless otherwise noted, references to Government Code section 31461 are to the unamended version that existed before the passage of A.B. 197 and A.B. 340.

Cal.App.3d 297, 305, and other cases, CERL retirement boards are vested "with authority to determine, according to the guiding language [of CERL], which elements of compensation constitute 'compensation earnable' for purposes of inclusion or exclusion from the calculation of 'final compensation.'" This includes the authority to consider payments "compensation earnable" and include them in pension calculations even if CERL does not require it. (*Id.* at p. 307, fn. 6.)

Further, given the California Supreme Court's decision in *Ventura County Deputy Sheriffs' Assn. v. Board of Retirement of Ventura County Employees' Retirement Assn.* (1997) 16 Cal.4th 483 ("*Ventura*"), CERL retirement boards are required to include in pension calculations many of the payments disputed here. *Ventura* clarified for the first time that under CERL any compensation paid in cash, with the exception of overtime, is considered compensation earnable even if not earned by all employees in the same grade or class. (*Id.* at p. 487.) On the one hand, this means that many of the payments now excluded by A.B. 197 were previously required to be included. On the other hand, as a result of *Ventura*, each of the Retirement Boards here settled lawsuits arising out of that case and specifically agreed to include several disputed pay items in pension calculations. In doing so, the Retirement Boards acted within the scope of their authority, but they also established contractual obligations that the Legislature cannot simply undo now.

Thus, as the union petitioners and intervenors (together, the "Petitioners") here show, for each of the five disputed categories of inclusions, the Retirement Boards did not exceed their authority by including them in retirement calculations.[2] This includes payments such as lump-sum payouts for vacation and sick leave, including those made at termination of employment, on-call or standby pay, and payments received in lieu of health insurance or other in-kind benefits. Only with the passage of A.B. 197 have the Retirement Boards' powers been limited, but there is no mistaking that these are limitations that have never before applied to CERL retirement

[2] Even now, under A.B. 197, the Retirement Boards would not exceed their authority by including (1) compensation provided as cash payments rather than in kind, (2) one-time or ad hoc payments not received by all similarly situated employees in the same grade or class, or (3) payments made solely due to termination but received while still employed, so long as the Retirement Boards have not determined that these particular payments were made to enhance a member's retirement benefits. (Gov. Code, § 31461, subd. (b)(1), as amended by Stats. 2012, ch. 297, § 2 [A.B. 197].)

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systems, and their application to legacy members, those hired before January 1, 2013, is contrary to the established constitutional protection of vested pension rights.

II. FACTUAL SHOWING

The facts in each of the three consolidated cases are largely undisputed. In fact, in the Contra Costa County litigation, the parties previously agreed to a Joint Statement of Stipulated Facts, which was filed with the court on February 19, 2013 (the "CCCERA Joint Statement," filed in Contra Costa Superior Court Case No. MSN12-1870). Nevertheless, to establish the context for the court's Phase One briefing, Petitioners submit that they could show the following facts at any future hearing or trial. Given that the central question here is whether the Retirement Boards exceeded their authority, it is particularly important to understand that each of the three retirement systems reached binding settlement agreements in post-*Ventura* litigation which established much of the parties' basic understanding of what would be included as compensation earnable.

A. THE RETIREMENT SYSTEMS

The three retirement systems—the Contra Costa County Employees' Retirement Association ("CCCERA"), Alameda County Employees' Retirement Association ("ACERA"), and Merced County Employees' Retirement Association ("MCERA")—that are parties to the consolidated litigation are organized under CERL and are the retirement systems for their respective counties. They are each independent public agencies, responsible for administering multi-employer, defined benefit public employee retirement systems, under which multiple retirement benefit formulas are provided. Under the California Constitution, article XVI, section 17, the Retirement Boards are fiduciaries, and they hold their assets in trust for the exclusive benefit of the retirement systems' members and beneficiaries. Between them, the systems have several billion dollars in assets.

Each is funded through actuarially determined contributions from both participating employers and participating employees—"members" in the language of Government Code sections 31470 and 31470.1.[3] The State of California makes no contributions to any of the

[3] Members are divided into two main groups of employees, based on their job classifications:

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retirement systems, and it is not a participating employer in any of them. Nor does the State play any role in administering the retirement systems, a task vested solely in the Retirement Boards.

Under CERL, a member's retirement benefits are generally based on (1) the applicable statutory benefit formula, (2) the member's age at retirement, (3) the member's years of credited service, and (4) the member's "final compensation." (See, e.g., Gov. Code, §§ 31664, 31664.1, 31664.2 [pension formulas for safety members, calculated based on "final compensation"], 31676.01-31676.19 [pension formulas for non-safety members].)

Final compensation is the "average annual compensation earnable by a member during any year elected by a member at or before the time he files an application for retirement, or, if he fails to elect, during the year immediately preceding his retirement." (Gov. Code, § 31462.1; *Ventura*, *supra*, 16 Cal.4th at p. 491.) Depending on the particular pension plan, this final compensation period may also be three years instead of one. (Gov. Code, § 31462.)

For example, ACERA has four tiers. For Tier 1 and 3 employees, the final compensation period is one year, whereas for Tier 2 and 4 employees, the final compensation period is three years. For an ACERA member in safety Tier 1, the maximum age factor is 3% per year of service. Thus, a member of safety Tier 1 retiring at age 50 with 30 years of service credit would receive 90% of his average monthly compensation during his final compensation period.

B. A.B. 340 AND A.B. 197

As is evident from the definition, final compensation depends on what is considered "compensation earnable," and the Retirement Boards' power to decide what constitutes compensation earnable is the crux of the Phase One briefing.

Under the prior Government Code section 31461, compensation earnable is:

> 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. The computation for any absence shall be based on the compensation of the position held by the member at the beginning of the absence. Compensation, as defined in Section 31460, that has been deferred shall be deemed "compensation earnable" when earned, rather than when paid.

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general and safety. Safety members work in active law enforcement, fire fighting, or similar positions that have been designated "safety" positions. Employees in all other positions are considered "general" members.

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(See former Gov. Code, § 31461, added by Stats. 1947, ch. 424, § 1, p. 1264, and amended by Stats. 1993, ch. 396, § 3 and Stats. 1995, ch. 558, § 1.)

In August 2012, the California Legislature passed A.B. 340, a comprehensive pension reform act that included amendments to CERL. Signed into law in September 2012, the legislation became effective on January 1, 2013. After A.B. 340 was enacted, the Legislature passed, and the Governor signed, A.B. 197, which also went into effect on January 1, 2013. A.B. 197's provisions amended CERL section 31461, superseding similar changes made by A.B. 340.

A.B. 197 added to the definition of compensation earnable several new restrictions on what could be included under this category:

> (b) "Compensation earnable" does not include, in any case, the following:
>
> (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 previously been 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 payments 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 payable 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.

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> (c) The terms of subdivision (b) are intended to be consistent with and not in conflict with the holdings in *Salus v. San Diego County Employees Retirement Association* (2004) 117 Cal.App.4th 734 and *In re Retirement Cases* (2003) 110 Cal.App.4th 426.

(Gov. Code, § 31461, subds. (b), (c), as amended by Stats. 2012, ch. 297, § 2 [A.B. 197].) This is a significant departure from the prior section 31461, and it resulted in drastic changes to the Retirement Boards' policies, as explained here.

C. CONTRA COSTA COUNTY

During the mid-1990s, disputes arose in Contra Costa County and in other CERL counties over which elements of employee compensation CERL required retirement boards to include as "compensation earnable" and "final compensation" when computing employee pensions. In August 1997, the California Supreme Court issued its opinion in *Ventura*, holding that "items of 'compensation' paid in cash, even if not earned by all employees in the same grade or class, must be included in the 'compensation earnable' and 'final compensation' on which an employee's pension is based." (*Supra*, 16 Cal.4th at p. 487.)

CCCERA's final compensation policy at that time was not in compliance with *Ventura*. Retirees filed two lawsuits in Contra Costa County Superior Court against CCCERA seeking to compel compliance with *Ventura*. These cases were *Paulson v. Contra Costa County Employees' Retirement Association* (Contra Costa County Superior Court No. C-96-02939) and *Walden v. Contra Costa County Employees' Retirement Association* (Contra Costa County Superior Court No. C-97-03953), which were consolidated and collectively referred to as "*Paulson*."

Ultimately, CCCERA, the County of Contra Costa, all other participating employers and the retiree class settled the *Paulson* litigation.[4] In so doing, all parties agreed on a county- and employer-wide list of pay items, with determinations as to whether the items were included or excluded in the calculation of final compensation pursuant to *Ventura* (the "*Paulson* Settlement").

[4] The participating employers in CCCERA are the Bethel Island Municipal Improvement District; the Byron, Brentwood, Knightsen Union Cemetery District; the Central Contra Costa Sanitary District; the Contra Costa Housing Authority; the Contra Costa Mosquito and Vector Control District; the County of Contra Costa; First 5 – Children & Families Commission; the In-Home Support Services Authority in Contra Costa; the Rodeo Sanitary District; the Superior Court of Contra Costa County; the Contra Costa Fire Protection District; the East Contra Costa Fire Protection District; the Moraga-Orinda Fire Protection District; the Rodeo-Hercules Fire Protection District; and the San Ramon Valley Fire Protection District.

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A copy of the pay items and their includability is attached as Exhibit B to the CCCERA Joint Statement. The includability of certain pay items under *Ventura*, including annual vacation cash out, terminal pay, on-call pay, call-back pay, shift differentials and hazard pay was confirmed in a legal opinion by the Board's outside fiduciary counsel, which is attached as Exhibit D to the CCCERA Joint Statement. The *Paulson* Settlement was ultimately approved following a hearing before Judge Trembath in October 1999. The Court's Order re: Final Approval of Settlement and Notice of Entry of Order and the *Paulson* Settlement is attached as Exhibit A to the CCCERA Joint Statement.

While the *Paulson* litigation was pending, the CCCERA Retirement Board also formally resolved to include the same pay items for calculating the retirement benefits for all active CCCERA members. In so doing, the Board was guided by *Irby v. Board of Retirement of the Contra Costa Employees' Retirement Assn.* (Sept. 25, 1995, A068135) (nonpub. opn.) which held that the Board could not selectively include items of compensation for one employee group and not for others who met the same criteria. (Request for Judicial Notice ("RJN") Exh. AA.)[5] In January 1998, CCCERA adopted and issued its policy for "Determining Which Pay Items Are 'Compensation' For Retirement Purposes" ("CCCERA Final Compensation Policy") which is attached as Exhibit C to the CCCERA Joint Statement. Again, prior to arriving at its decision, the Retirement Board received advice from its fiduciary counsel, which is attached as Exhibit D to the CCCERA Joint Statement. The CCCERA Final Compensation Policy reiterated that "all cash payments given as remuneration for services rendered or for special skills or qualifications" are included in compensation. With respect to the annual "cash out" and lump-sum payments at termination (also known as "terminal pay") the policy stated:

> **4. Remuneration paid in cash for time earned is considered "final compensation" and is limited by the following:**
>
> a. Annual "cash-out"
> The value of accrued time, such as vacation, holiday or sick leave, that is sold back to the employer by the employee each year under a "cash-out" agreement, is includible in compensation earnable.

[5] This unpublished opinion is presented pursuant to California Rule of Court 8.1115(b)(1), as it has a collateral estoppel effect and because it explains the factual background of this case in Contra Costa County. (See *Conrad v. Ball Corp.* (1994) 24 Cal. App.4th 439, 443, fn.2.)

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b. Lump sum at termination

Only the portion of accrued time (such as vacation, holiday or sick leave) that is paid in the form of a lump sum at termination, and that represents time earned during the final compensation period is includible in compensation.

The CCCERA Final Compensation Policy has remained unchanged and unmodified as to all employees who became members prior to January 1, 2011 and was applied by CCCERA and the Retirement Board to those members until the Retirement Board voted, in the wake of A.B. 197's passage, to make the changes to that policy which are the subject matter of this litigation.

Beginning with the first valuation after *Paulson*, the actuarially established contribution rates for both employers and employees have included the projected cost of funding retirement benefits that include terminal pay (such as for unused accruals of vacation, personal holiday, sick leave or holiday compensatory time off) and other elements of compensation, in addition to regular salary. Employers have been required to pay for a portion of the projected cost of these benefits in their normal cost,[6] unfunded actuarial accrued liability ("UAAL"), and cost-of-living ("COLA") contributions. Employees have been required to pay for a portion of the projected cost of these benefits in their normal cost and COLA contributions. An analysis of these respective amounts, as calculated by CCCERA's actuary and as presented publicly to the CCCERA Retirement Board on or about April 13, 2011 are attached as Exhibit O to the CCCERA Joint Statement.

After the CCCERA Final Compensation Policy was adopted in 1998, CCCERA, the County and employers who participate in CCCERA repeatedly communicated and committed to CCCERA members that payouts for vacation and sick leave, terminal pay, and other payments, including on-call pay, call-back pay, shift differentials, and hazard pay, would be included in the calculation of their final compensation. CCCERA and the participating employers encouraged CCCERA members to plan their retirement with the assurance that these pay items would be included in the determination of their pension benefits. Some examples of these promises are attached as exhibits to the CCCERA Joint Statement. (See, e.g., CCCERA Joint Statement, Exhs. N [Board Member Cullen's Memorandum to "all safety members and employers"], M [newsletter

[6] In simple terms, the "normal cost" is the cost of funding the member's retirement benefit.

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to all members], Q [retirement benefit handbooks], R [benefit statement information], S [CCCERA's brochure for safety members: "Do the Math: Estimate Your Retirement Benefit"].) CCCERA also presented seminars and gave individual consultations consistent with these commitments.

The value and associated costs of these promised benefits have also have been a factor in determining the wage and benefit packages offered to CCCERA members by their employers through the collective bargaining process, and in some instances has led to employees' acceptance of lower wages or other benefits.

Individual participants received and relied on CCCERA's communications and the promises therein when planning their retirement and calculating their future retirement benefits. Participants have delayed retirement and have foregone other employment opportunities to remain with Contra Costa County or other participating employers based on these communications and promises. (See, e.g., Declarations of Theodore Anderson, James Bickert, Sean Fawell, Doug Powell, Ken Westermann, Troy White, Christopher Allen, Lisa Beaty, Mark Gloistein, David Perkins, Brent Warren, all filed on or about November 27, 2012 in Case No. MSN12-1870.)

In the fall and winter of 2009, as a result of prior appellate court rulings relating to the determination of "compensation earnable" and "final compensation," the Retirement Board conducted open, public discussions on whether to change the CCCERA Final Compensation Policy. Ultimately, the Retirement Board decided that, as to the then-current CCCERA members, CCCERA would honor its obligation to its members and would not attempt to change the longstanding CCCERA Final Compensation Policy, although new members joining CCCERA on or after January 1, 2011 would be offered a reduced benefit pursuant to a revised policy addendum. This resolution was therefore in keeping with California's vested rights doctrine, discussed below. The Retirement Board's minutes from January 11, 2010 meeting are attached as Exhibit J to the CCCERA Joint Statement and reflect the following comments by Retirement Administrator Leedom:

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> Leedom noted the Compensation for Retirement Purposes policy was developed and implemented before the Paulson and Waldon cases. The Board policy, on CCCERA's website, was implemented in 1997 and last revised in January 1998. There have been no changes to the policy since that date. She then summarized the policy. She noted the Board of Retirement, in the interest of fairness, decided to apply the same terms of the Paulson Settlement to all members, regardless of their status. This included all active and deferred members of CCCERA. Leedom reviewed how staff has provided information regarding this policy to members, under the Board's direction. Virtually all communication regarding benefit calculations from the retirement system to its membership has reflected this 1997 policy, including the members' handbook, annual benefit statements, retiree seminars and retirement interviews. Based on the Board's 1997 compensation policy, CCCERA's actuaries have included an assumption for terminal pay when determining future retirement contribution rates, beginning in the first valuation following the Paulson settlement.

On October 10, 2012, after the passage of A.B. 340 and A.B. 197, the CCCERA Retirement Board conducted an open and public meeting to study and discuss the impact of the new legislation. The Board took no action at that meeting, but again considered the matter on October 30, 2012.

At the October 30 meeting, the Retirement Board passed a motion by a majority vote that effective January 1, 2013 it would implement a new policy regarding the calculation of retirement benefits for any member *retiring* on or after that date. The new policy would exclude terminal pay from being included in "compensation earnable" and "final compensation," except to the extent the amounts were both earned and payable during the member's final compensation period of service (either one year or three years, depending on the member's tier in the retirement system). As a consequence, the calculation of retiring members' retirement benefits will not include all of the amounts potentially includable under the prior CCCERA Final Compensation Policy, resulting in a significant decrease in members' pensions.

Additionally, on April 10, 2013, the CCCERA Retirement Board held another meeting to further consider implementation of A.B. 197. At that meeting, the CCCERA Board's General Counsel acknowledged that under CCCERA's Final Compensation Policy, standby and on-call pay are included as compensation earnable for the purposes of calculating retirement benefits for employees who became members prior to January 1, 2011. The Board's Fiduciary Counsel recommended that the Board eliminate standby and on-call pay from compensation earnable for employees who became members prior to January 1, 2011, but that this determination not be

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implemented due to the order of the court in the instant litigation staying the implementation of A.B. 197 by CCCERA. The CCCERA Retirement Board passed a motion by a majority vote to support its Fiduciary Counsel's recommendation. (See RJN Exh. A, pp. 5-6 [approved minutes of the Retirement Board's April 10, 2013 meeting].) If the Board implements its determination regarding standby and on-call pay, the calculation of retiring members' retirement benefits will also fail to include these pay items which were includable under the prior CCCERA Final Compensation Policy.

Neither CCCERA nor any of the participating employers in CCCERA have provided members represented by Petitioners any new advantage in exchange for the effect of applying A.B. 197 to the calculation of the retirement benefits of CCCERA members.

D. ALAMEDA COUNTY

Like CCCERA, ACERA entered into a court-approved settlement agreement after the *Ventura* decision (the "ACERA Settlement"). In 1999, ACERA settled *Alameda County Employees' Retirement Association v. County of Alameda, et al*. (Alameda County Superior Court Case No. 797354-7), which sought a determination of ACERA's rights and responsibilities with respect to eligibility, retroactivity, and vacation accrual and contributions by members in exchange for increased benefits pursuant to the *Ventura* decision. (RJN Exh. B [ACERA *Ventura* Settlement Agreement].) Under the ACERA Settlement, ACERA, the affected employee organizations, the County of Alameda, and various intervening employees agreed to the adoption of new definitions for "compensation earnable" and "final compensation."[7]

The ACERA Settlement obligated ACERA to adopt the following definitions of "compensation earnable" and "final compensation":

> "Compensation earnable," for purposes of calculating pensionable compensation, shall include all items of remuneration paid to County and district employees in cash for services rendered or special skills, including base salary; shift premiums; incentive pay or pay premiums that recognize special duties, qualifications, or skills; allowances automatically paid to designated employees in recognition of expenses related to employment without reference to the actual expense incurred;

[7] ACERA's members are current and former employees (and their beneficiaries) of the following participating employers: Alameda County, Alameda County Medical Center, Alameda County Superior Court, First Five of Alameda County, Housing Authority of Alameda County, Livermore Area Recreation and Park District, and Alameda County Office of Education.

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> nonstandard compensation relating to paid time off in lieu of overtime pay, no matter how designated on the relevant payroll system, taken during the regular course of employment, but excluding any amount paid in cash in a lump sum either prior to or upon termination and provided such nonstandard compensation does not increase the Member's compensation eamable or accrued retirement credit above the average compensation eamable and accrued retirement credit of other Members in the same job classification; other leave paid as salary or as lump sum(s) in lieu of paid leave and pay for hours worked above forty hours per week where those hours are ordinarily worked by the employee in the employee's permanent work assignment, mandated by the County or applicable Memorandum of Understanding;
>
> "Final Compensation" shall be the average compensation earnable by a Member during the period determined to be the Member's final compensation period as elected by the Member, that is, the average annual compensation during the one year, or averaged over three years where applicable, except 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. All lump sum cash payments for accrued, unused paid leave of any kind other than vacation leave and/or sick leave shall be excluded from final compensation.

Thus, under the terms of the ACERA Settlement, ACERA is contractually obligated to include vacation and sick leave cash outs in an amount equal to what the employee earned during his or her final compensation period. It does not require ACERA members to cash out their vacation and sick leave before separating from employment, allowing them to receive the pay at termination.

For over a decade, ACERA has included these and other payments in employees' "compensation earnable" for the purposes of calculating their pension benefits and has made this fact known through its benefits handbooks, policies, and practice. Among the included payments have been terminal pay—the cashing out of accrued leave at termination—on-call pay, standby pay, call-back pay, emergency response pay, and more. Like in Contra Costa County, employees have been encouraged to take advantage of the inclusion of these payments in pension calculations and have relied on statements that these payments would be included in such calculations.

Additionally, ACERA's actuarial valuations have included the assumption that ACERA members' final compensation would include terminal pay and compensation for the other forms of pay at issue. (See RJN Exhs. C [Analysis of Actuarial Experience During the Period December 1, 2007 to November 30, 2010], pp. 51-55 [acknowledging that terminal pay was

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included in retiring members' pension benefits]; D [Actuarial Evaluation and Review as of December 31, 2010], p. 59 [assuming terminal pay will be included in calculating pension benefits]; E [Actuarial Evaluation and Review as of December 31, 2011], p. 66 [same].) In ACERA's actuarial valuation for the period ending December 31, 2011, for example, the actuary assumed that terminal pay would increase safety members' final compensation by 4-10%, and general members' final compensation by 3-8%. (RJN Exh. E.) This assumption resulted in higher normal cost payments by employers and employees into ACERA's trust fund.

Like CCCERA and MCERA, ACERA's contribution rates are based on the amount of money projected to be needed to fund employees' future benefits. (See Gov. Code, § 31453.5.) Because ACERA collected contributions based on the actuarial assumption that the subject compensation would be included in employees' pension benefits, the cost of funding those benefits has already been factored into contributions. A ruling that the subject compensation cannot be treated as "final compensation" would mean that ACERA collected more money than it was entitled to collect from its members and participating employers.

Despite all of this, with the passage of A.B. 197, the ACERA Retirement Board determined that with respect to current or "legacy" members—those employed before January 1, 2013—it was obligated to exclude various payments from "compensation earnable" under A.B. 197.[8] (RJN Exh. F at Ex. C [Verified Petition by Alameda County Deputy Sheriffs' Assoc. et al.

[8] The types of affected compensation at Alameda County include the following pay codes: 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 (CWS ERU 24hr Shift OnCall Cov.); 830 (CWS ERU A-Hrs Shift OnCall Cov); 837 (Canine Care W/C (T/L)); 852 (K-9 Care Excess); 905 (Member, Planning Commission); 906 (Member, Board of Zoning Adjmnt); 910 (Civil Service Commission); 912 (Member, 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); I50 (Converted 5D DSA In-Lieu Payoff); ICO (In-lieu Payoff-Court (Expire)); IDO (DSA In-lieu Payoff); IEO (In-Lieu Pay Off (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). There are also affected pay codes at other participating ACERA employers that will no longer be included as compensation earnable.

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("Alameda Petition") filed on Dec. 6, 2012 in Alameda County Superior Court Case No. RG12658890].)

E. MERCED COUNTY

Following *Ventura*, MCERA, acting through its retirement board, joined the County of Merced and the Merced Cemetery District, in entering into a court-approved settlement agreement with a class of current employees and pre-October 1, 1997 retirees ("MCERA Settlement"). The MCERA Settlement establishes the forms of employee compensation that would (and would not) be used in determining MCERA members' retirement benefits. As in the other counties, this settlement resolved a class action lawsuit initiated by members in order to clarify and compel compliance with *Ventura*. As to members retiring in and after October 1997, the MCERA Settlement provides that MCERA would include within "compensation earnable" the vacation and other leave accrued in members' final compensation period up to "a maximum of 160 hours of annual leave, a maximum of one year's annual leave accrual, or the number of annual leave hours actually included in the member's vacation pay-off, whichever is less." (See RJN Exh. G at Ex. A [Merced Petitioners' First Amended Petition ("Merced Petition"), filed on Dec. 20, 2012, in Merced Superior Court Case No. CV 003073].)

After the MCERA Settlement, the MCERA Retirement Board adopted Resolution No. 00-02 which provided for the inclusion of up to 160 hours of vacation pay-out in members' "compensation earnable" effective October 1, 1997. (See RJN Exh. H at Ex. A [Decl. of Mary McWatters filed Dec. 7, 2012 in Merced Superior Court Case No. CV003073 ("McWatters Decl.")].) In conformity with the MCERA Settlement and its Resolution, the MCERA Retirement Board posted on its website a "Quick Overview" which affirmed that MCERA will include all annual leave sell backs that are made during the final compensation period (the "25th pay period") in retirement allowance calculations, as well as the leave pay-out on termination up to a maximum of 160 hours ("terminal pay"). (See Merced Petition, Exh. B.) MCERA has also provided to its members, through its website, an Employee Member Handbook ("Member Handbook"). (See Merced Petition, Exh. C.) The Member Handbook again confirms that accrued leave sold back during the 25th pay period *and* lump-sum payments at termination up to

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160 hours will be applied toward a member's final average compensation. Indeed, MCERA has endeavored not only to inform its membership of the right to use the accrued leave payouts in retirement planning but has *actively* encouraged them to do so. (See Merced Petition, Exh. C.) Notably, MCERA has explained in its Member Handbook that members can *optimize* their retirement benefit by accumulating vacation hours up to 160 hours prior to termination. (*Ibid.*)

The pension benefits provided to MCERA members since 1997 have been relied upon by MCERA members in determining at what age and number of years of service they should retire in order to have maximized their retirement benefits. (See McWatters Decl. (Merced), ¶ 11; RJN Exhs. I, ¶ 7 [Decl. of Sandra Gonzalez-Diaz filed Dec. 7, 2012 in Merced Superior Court Case No. CV003073 ("Gonzalez-Diaz Decl.")]; J, ¶ 6 [Decl. of Jeffrey Miller filed Dec. 7, 2012 in Merced Superior Court Case No. CV003073 ("Miller Decl.")].) Petitioner employee organizations, and the MCERA members that they represent, had no reason to believe that members' pension benefits would be constitutionally diminished or taken away. MCERA members have relied upon the MCERA Retirement Board's continued affirmations that the pension benefits would be calculated as promised once a MCERA member retires. (See McWatters Decl. (Merced), ¶¶ 8-9; Miller Decl. (Merced), ¶¶ 4-5; Gonzalez-Diaz Decl. (Merced), ¶¶ 4-5.) As a result of the MCERA Retirement Board's decision to include the 160 hours of terminal leave pay-outs in the calculation of MCERA members' retirement benefits, Merced County has effectively used this retirement benefit as a tool to retain qualified personnel. (See McWatters Decl. (Merced), ¶ 10; Miller Decl. (Merced), ¶ 6; Gonzalez-Diaz Decl. (Merced), ¶ 6.)

Despite the Merced petitioners' objections and the MCERA Board's own longstanding recognition of its existing members' rights to have their final compensation calculated in a manner consistent with the MCERA Settlement, on October 11, 2012 and November 8, 2012, the MCERA Retirement Board took action to implement A.B. 197 effective January 1, 2013. (See Merced Petition, Exhs. E, F; McWatters Decl. (Merced), Exh. D.) According to MCERA:

> As of January 1, 2013, MCERA will exclude from compensation earnable, the 160 hours of terminal vacation payoff provided in the Merced Ventura Settlement Agreement in calculating pension allowances for all members who retire on or after January 1, 2013.

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(Merced Petition, Exh. E, emphasis excluded.)

The MCERA Retirement Board itself admits in the "frequently asked questions" section of its October 11, 2012 newsletter that there may be some constitutional implications resulting from the implementation of A.B. 197 as it relates to current members:

> I am a current member, I have always expected to include up to 160 hours of my vacation pay outs in my pension calculation, don't I have a constitutional right to this?
> The answer to this question is not clear. However, it is clear that MCERA may not make this determination and must comply with the language of the new legislation until a Court directs MCERA to do otherwise.

(Merced Petition, Exh. E, emphasis excluded.)

As a result of the MCERA Retirement Board's decision to implement A.B. 197, MCERA members that are unable or elect not to retire on or before December 31, 2012, will have their retirement benefit reduced by as much as $347.00 per month. (See McWatters Decl. (Merced), ¶ 12; Miller Decl. (Merced), ¶ 7; and Gonzalez-Diaz Decl. (Merced), ¶ 7.) Not surprisingly, many MCERA members are now forced to consider early retirement.

II. ARGUMENT

The primary legal issue before the court is whether prior to the passage of A.B. 197 the Retirement Boards were authorized to include the various disputed items of compensation as "compensation earnable" for the purposes of calculating pension benefits. As Petitioners show here, the Retirement Boards are vested with broad authority to determine what compensation should be considered "compensation earnable," especially in light of the *Guelfi* decision. Legacy employees—those individuals who were employed by a participating ACERA, CCCERA, or MCERA employer before January 1, 2013—have constitutionally protected rights to the inclusion of those payments in their pension calculations.

Because this case concerns pension rights, any ambiguity or uncertainty must be construed in favor of the employee or pensioner. (*Ventura*, supra, 16 Cal.3d at p. 490.) Courts have long held that pension provisions are to be liberally construed in favor of employees and pensioners so as to reduce the uncertainty retirees might face. (*Terry v. City of Berkeley* (1953) 41 Cal.2d 698, 702; *United Firefighters of Los Angeles City v. City of Los Angeles* (1989) 210 CalApp.3d 1095,

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1102 [public employee's entitlement to pension is "clearly 'favored' by the law" and pension laws are liberally construed to protect retirees from economic insecurity]; 69 Ops.Cal.Atty.Gen. 20 (1986) [1986 WL 193399 at *4] ["Having established that some ambiguity may exist in the 1937 law with respect to the meaning of 'member' as used in section 31461.1 . . . we believe that the resolution of the question presented should be determined from the following rule of statutory construction. As stated recently in *Flint v. Sacramento County Employees' Retirement Assn.* (1985) 164 Cal.App.3d 659, 666: 'It is well established that pension legislation "should be liberally construed resolving all ambiguities in favor of the applicant,"'" citations omitted].) Additionally, the courts have acknowledged that retirement boards' interpretation of the statutes they administer is entitled to deference and should not be overturned unless clearly erroneous. (*Neeley v. Bd. of Retirement of Fresno County* (1974) 36 Cal.App.3d 815, 820, citing *Rivera v. City of Fresno* (1971) 6 Cal.3d 132, 140.) Both of these principles are especially crucial here, because CERL has maintained essentially the same definition of compensation earnable since its enactment in 1937, and, until A.B. 197, nothing in the language of CERL had ever prohibited the Retirement Boards from including the five disputed pay categories. Given the longstanding statutory language, which favors the discretion of the Retirement Boards, there is no basis for finding that they exceeded their authority.

Finally, as Petitioners also show, even if the court finds that any of the Retirement Boards exceeded their authority by including the disputed payments in compensation earnable, employees would still have a vested right to the inclusion of these payments.

A. THE BOARDS WERE AUTHORIZED TO INCLUDE ALL OF THE LISTED PAY ITEMS AS COMPENSATION EARNABLE

Under the California constitution, the Retirement Boards have "plenary authority" over the retirement system, and they are charged with the "sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries." (Cal. Const., art. XVI, § 17 & subd. (a).) This authority is also reflected in CERL itself, which vests management of the retirement system in the Retirement Boards. (Gov. Code, § 31520; see also *Howard Jarvis Taxpayers' Assn. v. Bd. of*

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Supervisors of Los Angeles County (1996) 41 Cal.App.4th 1363, 1373.) The Retirement Boards' authority encompasses a broad range of powers, including the power to set employee and employer contribution levels, manage the systems' investments, make actuarial determinations, determine the amount of members' retirement allowance, and make administrative determinations and hear appeals regarding the provision of benefits. (See, e.g., Gov. Code, § 31522.8 [describing policies retirement board members must be educated in]; *Rau v. Sacramento County Retirement Bd.* (1966) 247 Cal.App.2d 234, 236 [retirement boards are quasi-judicial bodies]; *Howard Jarvis Taxpayers' Assn.*, *supra*, 41 Cal.App.4th at pp. 1373-1374; *Shelden v. Marin County Employees Retirement Assn.* (2010) 189 Cal.App.4th 458, 461 [retirement boards are vested with the authority to determine retirees' benefits].) This broad authority also extends to the power to determine what is "compensation earnable," which the Retirement Boards properly exercised when they included the disputed payments in pension calculations for legacy employees.

1. *GUELFI* AND OTHER DECISIONS ESTABLISH THAT THE RETIREMENT BOARDS HAD THE AUTHORITY TO DEEM A PAY CATEGORY "COMPENSATION EARNABLE," EVEN IF CERL DID NOT REQUIRE INCLUSION OF THOSE PAYMENTS

CERL accords broad discretion to county retirement boards to determine the elements of compensation includable within their respective pension benefit calculation. Government Code section 31461 provides that "'[c]ompensation earnable' by a member means the average compensation *as determined by the board . . . .*" (Emphasis added.) Under *Guelfi v. Marin County Employees' Retirement Assn.* (1983) 145 Cal.App.3d 297 and other cases, this means that the Retirement Boards have the power to include compensation in pension calculations beyond what is required by CERL. In other words, while there is a minimum level, or floor, required by section 31461,[9] each county board of retirement retains discretion to include other payments in compensation earnable. This discretion comes with the concomitant fiduciary obligation under article 16, section 17, of the California Constitution to ensure the benefit is actuarially funded.

[9] As discussed below, *Ventura* overturned *Guelfi*'s determinations as to whether particular payments were *required* to be considered compensation earnable (*supra*, 16 Cal.4th at p. 505), but placed no limits on what a Retirement Board *may* include. *Guelfi*'s statements regarding the authority of CERL retirement boards to decide what to include as compensation earnable remains good law.

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According to *Guelfi*, section 31461 must "be read as vesting the Board with authority to determine, according to the guiding language contained therein, which elements of compensation constitute 'compensation earnable' for purposes of *inclusion or exclusion* from the calculation of 'final compensation.'" (*Supra*, 145 Cal.App.3d at p. 305, emphasis added.)

Although *Guelfi* found that educational incentive pay, uniform allowances, and overtime pay were not required to be considered compensation earnable, the decision states explicitly that it was deciding only whether the retirement board was required to include the disputed payments in pension calculations. The *Guelfi* court qualified its holding by stating that

> Nothing in this opinion should be taken as barring either the inclusion of uniform allowance, educational incentive pay and overtime in the calculation of benefits *should the Board decide to do so*, or the right of a retired member to continue receiving benefits according to such calculation once established. Our conclusion is only that CERL does not require inclusion of those items of remuneration for retirees.

(*Supra*, 145 Cal.App.3d at p. 307, fn. 6, emphasis added.) Accordingly, *Guelfi* does not stand for the proposition that the Retirement Boards are prohibited from including these types of pay. To the contrary, *Guelfi* make clear that the Retirement Boards have the authority to include the payments disputed here. While CERL sets a minimum, non-discretionary definition of compensation earnable, the Retirement Boards also have the discretionary power to include other types of pay as well.

Guelfi's finding follows logically from the fact that CERL retirement boards are vested with the authority to manage the county retirement systems and the fact that, until A.B. 197, CERL did not further specify what was meant by "compensation earnable," other than that it excluded unscheduled or irregular overtime. (See Gov. Code, § 31461.6.) Each Retirement Board is charged with administering its own retirement system, which is completely independent from any other system. The individual Retirement Board must necessarily make decisions about what compensation should or should not be included in pension calculations, and these determinations establish the contours of members' pension rights. But in the absence of any specific prohibitions limiting their powers, retirement boards do not abuse their authority by making such discretionary determinations, even if they include payments beyond what CERL

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requires.

This understanding of the CERL retirement boards' authority is not limited just to *Guelfi*. Significantly, in *Ventura,* even though the California Supreme Court overturned *Guelfi*'s analysis of whether particular payments were required to be compensation earnable, it directly acknowledged *Guelfi*'s holding that "[t]he retirement board was free to include those benefits in its retirement calculation if it elected to do so, but CERL did not require that they be included." (*Ventura, supra,* 16 Cal.4th at p. 492.) But at no point did the court disapprove of this language or the idea that CERL retirement boards have this kind of discretionary authority. (See *Ventura, supra*, 16 Cal.4th 483.)

In *Howard Jarvis Taxpayers' Association*, the court noted that CERL "should not be taken as barring the inclusion of [the excluded pay] items should the board decide to do so." (*Supra*, 41 Cal.App.4th at p. 1374, citing *Guelfi*.) The *Howard Jarvis* court similarly concluded that retirement boards have "the statutory authority to determine which items of remuneration are included in the calculation of retirement benefits, consistent with section 31460," again underscoring the authority vested in the Retirement Boards. (*Ibid.*)

Similarly, in *County of Marin Assn. of Firefighters v. Marin County Employees Retirement Assn.* (1994) 30 Cal.App.4th 1638, the court discussed retirement board authority in the context of how the retirement board must proceed given its determination that holiday pay was required to be included as compensation earnable. The court noted that retirement boards did not have the authority to exclude payments required to be included by CERL, but it contrasted this with the rule established by *Guelfi*, that other payments could also be included, as determined by the board. (*Id.* at p. 1646, quoting *Guelfi*, *supra*, 145 Cal.App.3d at p. 305.) However, to the extent a retirement board determined that a pay item was required to be included, it must base pension calculations on the inclusion of that payment.

Finally, the Retirement Boards' discretion and authority is also illustrated by the recently decided *Chisom v. Board of Retirement of County of Fresno Employees' Retirement Association* (July 16, 2013, F064259) ___ Cal.App.4th ___ [2013 WL 3942713]. In *Chisom*, the Fresno County retirement system entered into two successive settlements of post-*Ventura* litigation,

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agreeing both times to provide an enhanced benefit formula and also agreeing to supplement the retirement benefits of individuals who had retired before 2001 by $15 per month for each year of service, up to 30 years of service. (*Id.* at *2-*3.) None of these terms were provided for or expressly authorized by CERL; rather, the retirement board agreed to them under its inherent authority and discretion to manage the retirement system. Notably, the court did not challenge the retirement board's discretion to enhance retirement benefits, tacitly acknowledging that retirement boards can contract to provide benefits beyond those mandated by CERL.

In short, the Retirement Boards here have properly exercised their authority to include the disputed payments as compensation earnable, whether this means leave cash-outs, on-call pay, or some other form of compensation now contested by the State. The only possible limitation on this power is Government Code section 31461.6, which states that compensation earnable "shall not include overtime premium pay" except if the hours worked are "normally scheduled or regular working hours." (Gov. Code, § 31461.6.) Even then, until this section was added in 2000 (Stats. 2000, ch. 966, § 3, pp. 7065-7066 [RJN Exh. K]), the Retirement Boards could have included unscheduled overtime payments in pension calculations under *Guelfi*. (*Supra*, 145 Cal.App.3d at p. 307, fn. 6.) Overtime, of course, is not at issue here, but the principle of retirement board authority remains, and the Retirement Boards' actions before January 1, 2013 certainly did not exceed their authority.

2. THE RETIREMENT BOARDS WERE REQUIRED AFTER *VENTURA* TO INCLUDE DISPUTED PAYMENTS AS COMPENSATION EARNABLE AND THEY DID NOT EXCEED THEIR AUTHORITY IN SETTLING POST-*VENTURA* LITIGATION ON THOSE TERMS

a. *VENTURA* SIGNIFICANTLY CHANGED WHAT CERL RETIREMENT BOARDS UNDERSTOOD TO BE REQUIRED AS COMPENSATION EARNABLE

After *Guelfi*, CERL retirement boards conformed to that decision's holding in assessing which items of compensation are includable for pension purposes. However, the state Supreme Court's subsequent decision in *Ventura* fundamentally transformed the boards' understanding and required them to include many of the now-disputed payments in pension calculations. (See *Chisom, supra,* 2013 WL 3942713 at *2.) Whereas *Guelfi* had previously made this optional,

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Ventura now made it mandatory under CERL for a broad range of payments. It was in this context that the Retirement Boards all settled lawsuits addressing what would be considered compensation earnable, which further created contractual obligations as to what they must include in pension calculations.

Under *Ventura*, "items of 'compensation' paid in cash, even if not earned by all employees in the same grade or class, *must be included* in the 'compensation earnable' and 'final compensation' on which an employees' pension is based." (*Supra*, 16 Cal.4th at p. 487, emphasis added; see also *In re Retirement Cases* (2003) 110 Cal.App.4th 426, 440-441; *Chisom, supra*, 2013 WL 3942713 at *2.) This is much broader than the rubric established by *Guelfi*, which was far more restrictive in its understanding of what CERL required. Importantly, while *Ventura* held that *Guelfi* was incorrect in its determinations of what was required to be considered compensation earnable, the *Ventura* court did not overrule or even address *Guelfi*'s analysis of retirement boards' authority to include additional pay items. (See *Ventura*, *supra*, 16 Cal.4th at pp. 492, 505 [acknowledging *Guelfi*'s statements regarding retirement board authority but overruling the case only to the extent it was inconsistent with *Ventura*'s determinations of what is compensation earnable].)

In particular, the *Ventura* court decided that remuneration such as bilingual pay, uniform allowances, educational incentive pay, pay for being on-call during meal periods, pay in lieu of taking accrued leave, pay for working on a holiday, and pay for special skills or for longevity must all be considered compensation earnable. (*Supra*, 16 Cal.4th at pp. 488-489, 505.) These items were therefore required to be included in final compensation and to form the basis for CERL pension calculations. (*Id.* at p. 505.) The only exception identified in *Ventura* was overtime pay, which the *Ventura* plaintiffs did not claim was compensation earnable. (*Id.* at pp. 488, 500.)

As the Supreme Court explained, there are three steps to determining final compensation for pension calculations. First, any payment must be "compensation," which is defined as "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." (Gov. Code, § 31460;

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Ventura, *supra*, 16 Cal.4th at p. 494.) Compensation under CERL does not include "the monetary value of board, lodging, fuel, laundry, or other advantages furnished to a member," but the Supreme Court ruled that if the employee received a cash payment instead of receiving the advantage in kind, then the remuneration would be considered "compensation." (*Ventura*, *supra*, 16 Cal.4th at p. 497; Gov. Code, § 31460.) Thus, all of the payments at issue in *Ventura* were found to be compensation under CERL. (*Supra*, 16 Cal.4th at pp. 497-499.)

Second, compensation must also qualify as "compensation earnable" to be included in pension calculations, and here the court had its most significant disagreement with *Guelfi*. As discussed above, the central meaning of "compensation earnable" is "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." (Gov. Code, § 31461.) Unlike *Guelfi*, *Ventura* found that this definition was ambiguous, because, among other things, the term could be construed as meaning (1) only the base pay for the position, (2) all compensation to all employees in the same grade or class of positions, or (3) the compensation for the individual retiring employee calculated over the average number of days worked by all employees in that grade or class. (*Supra*, 16 Cal.4th at p. 493.)

Looking then at the legislative history of CERL, the court held that compensation earnable must be determined based on the individual compensation received by a member, but calculated based on the average number of days worked by employees in the same grade or class for the applicable time period. (*Ventura*, *supra*, 16 Cal.4th at p. 504.) In other words, even though not all employees in the same grade or class receive a particular item of compensation, that would not prevent an individual employee from having that pay included as compensation earnable, although the total compensation earnable would be calculated based on the average days worked by employees in the same grade or class rather than the particular days or hours worked by the individual. (*Ibid.*)

Under this understanding of compensation earnable, the third step of determining "final compensation" then becomes a matter of calculating the compensation that would have been

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earned by the particular individual during the final compensation period—either one year or three, depending on the particular circumstances—based on the average number of days worked by employees in the same grade or class, but including the other individual items of compensation that individual received. (See *Ventura, supra*, 16 Cal.4th at pp. 493-494 [compensation earnable forms basis for final compensation calculation on which pensions are based].)

Given the very broad understanding of compensation earnable clarified by the Supreme Court, CERL retirement systems faced a barrage of litigation over pension calculations after *Ventura*. (*Chisom, supra*, 2013 WL 3942713 at *2.) On the one hand, *Ventura* now required that most of the pay categories disputed here had to be included as compensation earnable and final compensation. On the other hand, the post-*Ventura* litigation resulted in the settlement agreements noted above, which, in their own right, created contractual obligations on the part of the Retirement Boards.

b. *VENTURA* REQUIRES RETIREMENT BOARDS TO CONSIDER MOST, IF NOT ALL, OF THE DISPUTED PAY INCLUSIONS COMPENSATION EARNABLE

Given the broad rule in *Ventura*, most, if not all, of the disputed pay categories identified in the Phase One briefing order must be considered compensation earnable under the pre-A.B. 197 CERL. Plainly, the Retirement Boards could not have exceeded their authority by complying with the requirements of the law under *Ventura*.

First, with regard to payments for accrued leave greater than that which was both earned and payable during the final compensation period, *Ventura* requires that any cash out of leave be considered compensation earnable and does not make any distinction based on when the leave was accrued. (*Supra*, 16 Cal.4th at pp. 497, 504-505.) In fact, the leave cashed out in *Ventura* did not have to be accrued at a particular time, so *Ventura* clearly did not restrict pensionable leave cash out to only that earned and payable within the final compensation period. (*Id.* at pp. 488-489, fns. 6, 12.)

Further, regardless of what kind of leave is at issue—whether it be sick leave, vacation, or some other paid leave—when it is cashed out, the leave is, by definition, received as cash, and, as remuneration paid in cash, it is compensation under *Ventura*. (*Supra*, 16 Cal.4th at pp. 497-498.)

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Although the amount of cashed out leave will vary by individual, that does not preclude its inclusion as compensation earnable, and following *Ventura* such payments must be included in pension calculations. (*Id.* at pp. 487 [even if items of compensation are not earned by all employees in the same grade or class, they still must be included as compensation earnable and in final compensation], 504-505 [compensation earnable is based on pay received by the retiring employee].)

Second, with the exception of overtime, payments for services rendered outside of normal working hours are also required to be considered compensation earnable under *Ventura*. Such payments are of course remuneration received in cash, and in *Ventura* payments for being on-call during meal periods were considered compensation earnable. (*Supra*, 16 Cal.4th at p. 488, fn. 5 [employees received $60 biweekly pay for meal periods during which they were subject to call].) Inclusion of these payments did not depend on whether the service was rendered during or "outside normal working hours," and in fact, meal periods are not normal working hours, since employees are ostensibly supposed to be relieved of duty during those times. (See *Brinker Rest. Corp. v. Superior Court* (2012) 53 Cal.4th 1004, 1040 [meal period requires that employees be relieved of all duties].) Further, and again with the exception of overtime, nowhere does CERL distinguish between when the services were rendered for purposes of deciding whether such payments must be considered compensation earnable. Thus, to the extent that payments for services "rendered outside normal working hours" includes items such as on-call, standby, or similar pay, these were all required to be included as compensation earnable under *Ventura*.[10]

Third, compensation that could be received in kind by a member, but which instead is paid in cash, is plainly required to be compensation earnable under *Ventura* and included in pension calculations. As *Ventura* explained, CERL excludes from its definition of compensation remuneration that is furnished in kind, such as board, lodging, laundry, or other "advantages," relieving CERL systems from having to determine the monetary equivalent of such remuneration. (*Supra*, 16 Cal.4th at p. 497.) But the same is not true for cash that is received in lieu of in-kind

[10] There are also scenarios under which these kinds of payments would not be "outside normal working hours," as, for example, when being on call is a regular or scheduled part of the normal workweek.

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benefits. (*Ibid.*; *In re Retirement Cases*, *supra,* 110 Cal.App.4th at p. 440.) Thus, payments received in lieu of benefits or some other advantage—for instance, "Share the Savings" payments in Alameda County, which are received when an employee forgoes health insurance—is compensation and compensation earnable, and must be included as final compensation.

Fourth, again because *Ventura* does not require compensation to be received by all employees in the same grade or class, even one-time or ad hoc payments not received by all "similarly situated" employees are required to be considered compensation earnable under *Ventura*.[11] (See *supra,* 16 Cal.4th at p. 487.) So long as those payments are remuneration made in cash, as is inherent in the idea of even one-time or ad hoc payments, it does not matter whether other employees in the same grade or class also receive those payments—the payments still constitute compensation and compensation earnable, and therefore must be part of a member's final compensation.

Finally, while the State will likely argue that payments made at termination of employment are not required to be—and are even prohibited from being—compensation earnable under *In re Retirement Cases*, *supra*, 110 Cal.App.4th 428, and *Salus v. San Diego County Employees Retirement Assn.* (2004) 117 Cal.App.4th 734, *Ventura* itself did not make any such distinction. Accordingly, under the broad rule established by *Ventura*, payments made at termination of employment could well also be included as compensation earnable. Additionally, given the Retirement Boards' discretionary authority noted above, and the fact that they agreed to include these payments as compensation earnable before either *In re Retirement Cases* or *Salus* were decided, there is abundant reason to find that the Retirement Boards did not exceed their authority as to terminal pay.

Thus, as to most, if not all of the disputed payments, *Ventura* required the Retirement Boards to include them as compensation earnable, going well beyond the *Guelfi* paradigm, under which these payments were only optional. While A.B. 197 may change that going forward for

[11] A.B. 197 does not explain what is meant by "similarly situated" members, but regardless of how it is parsed, the Retirement Boards would have had the authority and would even be required to consider one-time payments as compensation earnable, even if not received by all "similarly situated' members in the same grade or class.

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new employees, it cannot change the fact that for legacy employees, the Retirement Boards were acting entirely within their authority when they set policies including the disputed payments in pension calculations.

c. THE RETIREMENT BOARDS WERE AUTHORIZED TO SETTLE POST-*VENTURA* LITIGATION OVER PENSION CALCULATIONS, INCLUDING BY AGREEING TO INCLUDE THE NOW-DISPUTED PAYMENTS IN PENSION CALCULATIONS

The settlement agreements noted above created contractual obligations on the part of the Retirement Boards to include disputed payments in their pension calculations, including pay received at termination of employment. It was well within the authority of the Retirement Boards to enter into those settlements after *Ventura*—indeed, it was entirely logical for them to do so in order to avoid the expense of additional litigation over what should have been included in pension calculations. More to the point, the Retirement Boards had an obligation to do so in light of their constitutionally imposed fiduciary duties. Because each agreement was approved by a reviewing court, there is no basis for claiming that the Retirement Boards exceeded their authority in thereafter adhering to the policies dictated by these judicially approved settlements.

Importantly, in ascertaining the nature of vested rights established through legislation or other official action, courts must construe the statute itself, but do so with reference to the law in effect at the time the action was taken. California courts have summarized this rule in the pension context: "We must not overlook the qualifying rule, however, that the nature and extent of respondent's statutory obligation must be ascertained not only from the language of the pension provisions but also from the judicial construction of this or similar legislation at the time the contractual relationship was established." (*Newman v. City of Oakland Retirement Bd.* (1978) 80 Cal.App.3d 450, 457-458; *Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 850 ["[t]he nature and extent of the city's obligation must be ascertained not only from the language of the pension provisions but also from the judicial construction of this or similar legislation at the time the contractual relationship was established."]; see also *Allen v. Bd. of Admin. of the Public Employees Retirement Sys.* (1983) 34 Cal.3d 114, 120.)

Settlement agreements, of course, are contractual obligations. (See, e.g., *Weddington*

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Productions, Inc. v. Flick (1998) 60 Cal.App.4th 793, 810.) They can therefore give rise to vested rights that are constitutionally protected against impairment. (See *Sonoma County Org. of Public Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 314 [finding vested rights in union contract were impaired by state legislation].) Inherent in the Retirement Boards' authority to manage their retirement systems is the power to settle litigation filed against the retirement systems, and given the state of the law after *Ventura*, there was nothing illicit or unauthorized about the Retirement Boards' actions when they settled the pending actions by agreeing to include certain payments as compensation earnable, including terminal pay. Nor did they exceed their authority by continuing to adhere to the agreements they struck, since those agreements were binding on them and had the power to create vested contractual rights. This provides yet another reason to find that the Retirement Boards did not exceed their authority, as well as a reason to find that employees could have vested rights in the disputed inclusions even if the Retirement Boards later lost the discretionary authority to include the disputed payments in pension calculations.

B. A.B. 197 DID NOT "CLARIFY" CERL BUT INSTEAD HAS IMPOSED NEW PROHIBITIONS THAT DID NOT PREVIOUSLY EXIST UNDER CERL

The State's argument against the Retirement Boards' authority rests almost exclusively on the idea that CERL has always prohibited the inclusion of the five disputed pay categories from compensation earnable and therefore that the Retirement Boards abused their discretion by including them in pension calculations. However, as discussed above, the Retirement Boards had the discretionary authority to include all of these payments as compensation earnable and in many cases were required to do so. Certainly nothing in the text of CERL indicated that they were prohibited from doing so. Rather, A.B. 197 has plainly amended the text of section 31461 to curtail the pension benefits that were previously provided under the statute. This is clearly a change in the law, but it cannot undo the fact that the Retirement Boards had the authority to confer the benefits to which members have now earned a vested right.

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1. *IN RE RETIREMENT CASES* AND *SALUS* DID NOT HOLD THAT RETIREMENT BOARDS WERE PROHIBITED FROM INCLUDING ACCRUED LEAVE CASH OUTS AS COMPENSATION EARNABLE

In re Retirement Cases (2003) 110 Cal.App.4th 426 and *Salus v. San Diego County Employees Retirement Assn.* (2004) 117 Cal.App.4th 734 are not to the contrary, because they do not prohibit Retirement Boards from including terminal pay in compensation earnable. In those cases, the question was whether CERL *required* vacation or sick leave cash-outs at retirement to be included when the retirement board had decided to exclude them, not whether a CERL retirement board could choose to include them.

As established above, CERL sets forth a *minimum* definition of "compensation earnable" gives individual county retirement systems discretion to determine to include additional pay categories. Again, *Ventura* and other cases addressed what CERL requires to be included, not what is prohibited or the extent of retirement board discretion. (See *Ventura*, *supra*, 16 Cal.45h at p. 487 ["After considering the language and legislative history of the pertinent CERL provisions, we conclude that the Legislature did not intend *to require* that a county include its contributions to an employee's deferred compensation plan in 'compensation' as defined in CERL," emphasis added].)

The plaintiffs in *In re Retirement* and *Salus* both challenged a retirement board's exclusion of certain pay from "compensation earnable," asserting that the items must be included under section 31461. (*In re Retirement*, *supra*, 110 Cal.App.4th at p. 434; *Salus*, *supra*, 117 Cal.App.4th at p. 740.) And both decisions confirm that post-retirement payments, or payments due upon separation, are not mandatory elements of compensation earnable under CERL. But neither case holds that county retirement boards are *prohibited* under CERL from including such pay as "compensation earnable" under the authority discussed above.

Thus, while the court in *In re Retirement Cases* did address "termination pay," which it defined as "one-time cash payments made to plan members upon retirement for accrued but unused compensatory time, sick leave time, and vacation or holiday time," it stated quite clearly that it was deciding that "termination pay that is received upon retirement *is not required* under

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CERL to be included in the calculation of pension benefits." (*Supra,* 110 Cal.App.4th at pp. 473, 476, emphasis added.) The court similarly stated that it was not addressing whether CERL prohibited the inclusion of terminal pay: "Because we are considering *what must be included* under the statute and we conclude that the items requested by plan members do not have to be included under CERL, *we need not consider L.A. County's argument that these items cannot be included* . . . ." (*Id.* at p. 472, fn. 20, emphasis added.)

Likewise, in *Salus*, a group of former employees contended that the cash payments they received at the time of their retirement in lieu of accrued sick leave should have been included in the calculation of their retirement benefits. Relying on *In re Retirement Cases,* the *Salus* court concluded: "Because the sick leave payments were not final compensation, defendant and respondent [retirement association] *was not required* to include the sick leave payments in calculating appellants' retirement benefits." (*Salus, supra,* 117 Cal.App.4th at p. 736.)

Finally, these cases at most address cash out of sick or vacation leave at termination but not any other category of pay disputed here. Therefore, these cases cannot be read as precluding the Retirement Boards from including other disputed pay items such as payments for leave greater than what was earned/payable during the final compensation period, compensation that had previously been provided in kind, one-time/ad-hoc payments not received by all similarly situated members of a class, or payments for services rendered outside normal working hours.

2. FOR DECADES, CERL HAS NOT HAD THE SAME EXCLUSIONS AS PERL AND THE EXCLUSIONS IN PERL CANNOT BE IMPUTED TO CERL

Petitioners anticipate that the State will also argue that CERL must be read the same way as the Public Employees' Retirement Law ("PERL"), Gov. Code section 20000 *et seq.*, which governs state and other employees' retirement benefits under the California Public Employees' Retirement System ("PERS"). However, the legislative history and distinct language in PERL and CERL establishes that they have taken very different evolutionary paths. Whereas PERL has been amended significantly to impose a wide array of prohibitions on what may be considered compensation earnable, similar amendments were never made to CERL until the passage of A.B. 197. Thus, the legislative evolution of each of the statutes indicates a specific intent to leave

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individual CERL retirement systems the discretionary authority to determine the elements of pensionable compensation while at the same time removing such authority from the governing board of PERS. Nothing prohibits counties from enrolling their employees in PERS (subject to the duty to bargain), and thus a county's decision to adopt and maintain a pension system under CERL suggests there is a meaningful difference between the requirements of each law.

Both the CERL and PERL definitions of "compensation earnable" were amended in 1993, but these amendments were very different in their effect, with CERL being left largely intact, and PERL being drastically revised to address perceived problems of pension "spiking." Before the 1993 amendments, CERL and PERL had similar definitions of compensation earnable, with similar language about the ability to determine what is "compensation earnable." (See *Ventura*, *supra*, 16 Cal.4th at pp. 503-504.) Thus, CERL 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." (Stats. 1947, ch. 424, § 1, p. 1264 [RJN Exh. L].) PERL similarly defined compensation earnable as "the average monthly compensation as determined by the board upon the basis of the average time put in by members in the same group or class of employment and at the same rate of pay." (*Ventura*, *supra*, 16 Cal.4th at p. 491; see also Stats. 1945, ch. 123, § 1, p. 575 [RJN Exh. M] [former Gov. Code section 20023, now section 20636, defining compensation earnable under PERL], subsequently amended by Stats. 1949, ch. 298, § 3, p.575 and Stats. 1949, ch. 1218, § 1, p. 2143.)

When amending CERL on September 8, 1993, the Legislature retained this discretionary language within CERL's definition of "compensation earnable." (Stats. 1993, ch. 396, § 3 [RJN Exh. N] [adding subdivision (b) to section 31461, affecting only counties of the "first class," i.e., Los Angeles County].) However, in its October 11, 1993 amendment to PERL, the Legislature implemented a very different approach, removing the PERS board's discretionary authority to define compensation earnable and, notably, specifically excluding several categories of compensation from compensation earnable. (Stats. 1993, ch. 1297, § 6, pp. 7691-7696 [RJN Exh. O] [prohibiting inclusion of final settlement pay, among others, from compensation earnable].)

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Despite making this drastic change to PERL just a month after the CERL amendment, the Legislature chose not to revisit the CERL amendment. Instead, it left the discretionary language in CERL intact and also did not create any new prohibitions on compensation earnable in CERL, as it did in PERL.

Moreover, the 1993 PERL amendment was specifically intended to address perceived pension "spiking" problems by restricting what could be included in pension calculations under PERL. The Legislative Counsel's Digest describes the bill as "recast[ing] and redefin[ing]" the terms "compensation" and "compensation earnable" under PERL, and the committee reports go even further, stating that the existing law applicable to PERS is "clearly flawed" and that in order to get at these problems, the bill would "provide[] substantial revisions of existing PERS law," including changes that would restrict what could be included in pension calculations. (See Legis. Counsel's Dig., Senate Bill No. 53 (1993-1994 Reg. Sess.) [RJN Exh. O]; Sen. Public Employment & Retirement Com., Rep. on Sen. Bill No. 53 (1993-1994 Reg. Sess.) March 29, 1993 [RJN Exh. P].) This plainly indicates that the Legislature was further restricting the definition of compensation earnable under PERL, but it never took similar action with regard to CERL.

Under these circumstances, the basic tenets of statutory interpretation necessarily lead to the conclusion that the Legislature's decision to keep discretionary authority for the county retirement board but not for the PERS board was intentional and not a mistake. (See *Ventura, supra*, 16 Cal.4th at p. 504 [the Legislature is presumed to be aware of other statutes on the same or analogous subject matter in which the same or analogous language is used].) That the State is ultimately responsible for PERS, but not county retirement systems governed by CERL, further indicates the Legislature "stayed its hand" with respect to local county pension matters, and there is simply no basis for finding that the exclusions in PERL and CERL were intended to be the same given all of the extensive changes to PERL over time.

Ventura noted that CERL and PERL should be read similarly when they employ identical language with respect to mandatory inclusions. But this is far different from holding that specified exclusions in PERL are attributable to CERL when only PERL has been amended to

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include them. (See *Ventura, supra*, 16 Cal.4th at pp. 504-505.) At best, *Ventura* noted that the mandatory inclusions in CERL and PERL were similar given their statutory origins, but these origins diverged given PERL's 1993 and other amendments. (*Ibid.*) But required inclusions are not the same as exclusions, and consistent with *Ventura*, CERL may be read as requiring the same inclusions that the Legislature spelled out as includable "special compensation" under PERL, even though the Legislature's restrictive amendments only to PERL indicate an intent not to similarly restrict CERL.

The difference between CERL and PERL is further supported by the history of the additional amendments to CERL in early 1995. Concerns about alleged "spiking" in CERL plans had been raised in the Senate bills leading up to the final 1995 amendment. (Sen. Public Employees & Retirement Com., Analysis of Sen. Bill No. 226 (1995-1996 Reg. Sess.) April 17, 1995 [RJN Exh. Q]; see also Sen. Rules Com., Off. of Sen. Floor Analyses, 3d reading analysis of Sen. Bill No. 226 (1995-1996 Reg. Sess.) April 4, 1995 [RJN Exh. R].) Yet, the Legislature again chose to retain the discretionary language in CERL when it passed the amendment on October 4, 1995, indicating that it intended that the county retirement boards retain their discretion to determine what items of pay could be included in compensation earnable. (See Stats. 1995, ch. 558, § 1, p. 4358 [RJN Exh. S].)

Thus, long before A.B. 197 and A.B. 340 were proposed, the scope of discretionary authority given to the respective boards in PERL and CERL were notably different. Furthermore, this discretionary authority extended beyond the definition of compensation. For example, unlike PERS where the *employee* contribution is uniform and set by law (e.g., 7% for miscellaneous and 9% for safety), under CERL, each county retirement board determines whether the employee contribution will be uniform or individualized. The general rule under CERL is that the *employee* rate is set for each individual, based, in part, on age at entry into the system. (Gov. Code § 31639.25; see also Gov. Code § 31639.3.)[12] Thus, under CERL, two employees, one aged 21 and one aged 35, who entered the retirement system as safety members in 2012 on the same day and

[12] Although this is the general rule, Government Code section 31639.26 provides that, under certain conditions, the county retirement board has the option of utilizing a uniform employee contribution rate, instead of one tailored to the each member's age at entry.

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for the same employer would pay very different employee rates. The 21 year old would pay an employee rate of 9.34% during his or her entire career while the 35 year old's employee rate would be 10.85%—a difference of more than 1.5%. Under PERL, both rates would be 9%. (Gov. Code § 31639.3.) When the two systems determine something as important as *employee* contributions in such a strikingly different manner, the only logical conclusion is that the statutes are distinct and were not intended to mirror one another.

In addition to the discretionary authority difference, the two statutes differ in other ways. For example, Government Code section 31460 of CERL provides that "'Compensation' means 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." In contrast, Government Code section 20630 in PERL offers a narrower definition of compensation. Section 20630 provides that "'compensation' means the remuneration paid out of funds controlled by the employer in payment for the member's services performed during *normal working hours* or for time during which the member is excused from work because of any of the following: holidays, sick leave, industrial disability leave, vacation, compensatory time off, [and] leave of absence." (Emphasis added.) Unlike PERL, the CERL definition does not exclude from compensation earnable the money received for services rendered outside of normal working hours.

Additionally, "CERL differs from the PERL legislation under consideration in that it excludes, rather than includes, the monetary value of an advantage provided in kind." (*Ventura*, *supra*, 16 Cal.4th at p. 504.) CERL specifically excludes "the monetary value of board, lodging, fuel, laundry, or other advantages furnished to a member" from the definition of "compensation." (Gov. Code, § 31460.) In contrast, PERL's definition of "special compensation" specifically includes "the monetary value, as determined by the board, of living quarters, board, lodging, fuel, laundry, and other advantages of any nature furnished to a member by his or her employer in payment for the member's services," as "compensation earnable." (Gov. Code, § 20636, subd. (3)(A).)

In sum, the legislative history and the distinctly different statutory language make it clear that CERL and PERL were not meant to be read as one and the same. Since its enactment in

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1937, CERL, even though amended on various occasions, has remained substantively unchanged for 75 years. After each change, the discretionary authority of county retirement boards to determine compensation earnable was preserved, and virtually no new prohibitions were imposed on CERL retirement calculations. PERL, on the other hand, was significantly amended in 1993 and before to remove the discretionary authority from the PERS board and to specifically exclude several categories of payment from "compensation earnable." Additionally, CERL's definitions of "compensation" and "compensation earnable" are broader and more inclusive than PERL's. Thus, it is evident that the Legislature intended that CERL and PERL remain distinct statutes, and there is no basis for importing wholesale the PERL prohibitions into CERL as the State would have it.

C. A RULING THAT THE BOARDS DID NOT HAVE AUTHORITY TO INCLUDE TERMINAL PAY IN FINAL COMPENSATION WOULD HAVE FAR-REACHING CONSEQUENCES AND BE DETRIMENTAL TO THE RETIREMENT SYSTEMS

For over a decade, the State has not objected to the Retirement Boards' inclusion of terminal pay and other disputed payments in members' final compensation, despite its claims that these practices have always been outlawed. During that time, the retirement systems paid pension benefits to thousands of retiring employees and collected contributions from active employees and their employers to fund such benefits in the future. Any attempt to undo that history would create logistical nightmares for the retirement systems, place significant financial burdens on retirees, and raise complex tax problems for the systems and their members.

Implicit in the State's position is that the Retirement Boards would need to recalculate retirees' pensions, pay back money collected for the purposes of paying benefits that were based on final compensation that included terminal pay, and recover money spent on such benefits in the past. This would create massive administrative burdens on the retirement systems, and impose devastating financial impacts on thousands of retirees who depend on the pension benefits they were told they would receive.

For more than a decade, the retirement systems have included such pay in the final compensation used to calculate retirees' pension benefits. (See, e.g., Alameda Petition, Exh. B

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[Member Handbook (Effective May 2008)], pp. 41-42.) As such, retirees reasonably relied on their understanding that their retirement income would be based on an amount that reflected the inclusion of such pay in their final compensation. (See, e.g., RJN Exh. T [Declaration of James D. Nelson in Support of Ex Parte Application for Order to Show Cause and For Temporary Restraining Order ("Nelson Decl."), ¶ 5, filed December 13, 2012 in Alameda County Superior Court Case No. RG12658890].) They based their retirement plans around this understanding. (*Id*. at ¶ 7.)

Each retiree and current employee could lose thousands of dollars in pension benefits each year for the rest of his retired life if terminal pay is not included in his final compensation. (See, e.g., Nelson Decl., ¶ 7 [stating that exclusion of terminal pay could reduce pension by 15%]; RJN Exh. U [Declaration of Robert Brock in Support of Ex Parte Application for Order to Show Cause and for Temporary Restraining Order ("Brock Decl."), ¶ 7 [exclusion of terminal pay could reduce pension by 10-15%], filed December 13, 2012 in Case No. RG12658890].) Compounding the injury, those retirees could lose even more money if they are forced to pay back money they received as a result of terminal pay being included in their pension benefits previously. The amount at issue is significant. For instance, ACERA's most recent actuarial valuation estimated that terminal pay is, on average, equivalent to 3% to 8.5% of an employee's final salary. (RJN Exh. V [ACERA Actuarial Valuation and Review as of December 31, 2012], p. 65.)

For the average employee in ACERA's General Tier 1, this would represent a loss of $6,958 dollars in his or her final compensation. (See RJN Exh. V [ACERA Actuarial Valuation and Review as of December 31, 2012], pp. 27 [listing average salary of General Tier 1 employees], 65 [assuming terminal pay for such employees is 8% of their final salary].) Assuming the employee retires with 30 years of service credit, eliminating terminal pay could reduce his pension benefits by over $5,000 per year.

It is important to note that different limitations periods apply to claims by members and claims by retirement systems. No limitation period applies for claims alleging a retirement system owes a member money. (Gov. Code, § 31540, subd. (b)(2).) On the other hand, a three-year limitations period applies to claims by a retirement system against its member or beneficiary.

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(Gov. Code, § 31540, subd. (b)(1).) Thus, retirees and members would likely be able to seek all overpayments they made on account of terminal pay being included in final compensation, while the associations will only be able to recover three years of benefits from retirees. As such, a ruling that the Retirement Boards were never allowed to include terminal pay in members' final compensation will likely harm the retirement systems significantly.

Additionally, in the event of an attempt to reverse the past inclusion of the subject pay items in compensation earnable, the parties to this litigation and the employees they represent (excluding the State of California) would be faced with significant tax consequences. All member contributions to the retirement systems are tax free. If the associations are required to refund excess contributions collected to fund benefits that included terminal pay, such refunds will likely constitute taxable income. A lump-sum payment of such excess contributions would likely increase the recipient's taxable income significantly in the year he receives it, potentially forcing him into a higher tax bracket for that year.

Additionally, any attempt to recalculate benefits paid to members could raise issues with their compliance with Internal Revenue Code section 415(b), which places a limit on the amount of pension benefits that can be paid from any qualified pension plan to employees. If retroactively reducing any retiree's benefits caused those benefits to fall below the cap on pension benefits, the retirement system could be faced with complex tax issues arising from the fact that pension benefits previously paid in excess of the cap were paid by the participating employers, and reported on W-2s.

D. EMPLOYEES STILL HAVE A VESTED RIGHT TO ANY INCLUSIONS THE COURT FINDS UNAUTHORIZED

1. PENSION BENEFITS ARE DEFERRED COMPENSATION THAT VESTS IMMEDIATELY UPON COMMENCEMENT OF EMPLOYMENT

Public pension benefits are offered "as an inducement to enter and continue in public employment" and "to provide agreed subsistence to retired public servants who have fulfilled their employment contracts." (*Carmon v. Alvord* (1982) 31 Cal.3d 318, 325, fn.4; *Bellus v. City of Eureka* (1968) 69 Cal.2d 336, 351; *Quintana v. Bd. of Administration* (1976) 54 Cal.App.3d

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1018, 1021.) Accordingly, our Supreme Court established long-ago that "[t]he pension provisions of a city charter are an indispensable part of the contract of employment between a city and its employees, creating a right to pension benefits as an integral part of compensation payable under such contract, *which vests upon acceptance of employment*." (*Abbott v. San Diego* (1958) 165 Cal.App.2d 511, 517, citations omitted and emphasis added.)

This doctrine—that pension benefits are vested rights that accrue upon the commencement of employment—is equally applicable to county employees covered by a CERL retirement system. (See, e.g., *Ross v. Bd. of Retirement of Alameda County Employees' Retirement Assn.* (1949) 92 Cal.App.2d 188, 193 ["the date the [retirement] ordinance became effective, it was part of every eligible officer or employee's contract that starting on January 1, 1948 he would be entitled to certain retirement benefits."].) Here, A.B. 197 impairs the vested rights of employees hired prior to its effective date because "upon acceptance of public employment [employees] acquire a vested right to a pension based on the system *then in effect*" and "on terms substantially equivalent to those then offered by the employer . . . ." (*United Firefighters v. Los Angeles* (1989) 210 Cal.App.3d 1095, 1102, emphasis added; *Pasadena Police Officers Assn. v. Pasadena* (1983) 147 Cal.App.3d 695, 703.) The vested rights doctrine extends to any additional or improved pension terms conferred during employment, which similarly become vested when granted. (*Betts v. Bd. of Admin.* (1978) 21 Cal.3d 492, 530.)

With respect to the pay items at issue in these litigations, it matters little when or how the pay items were incorporated into the retirement systems' definition of "compensation earnable." (*Abbott, supra,* 165 Cal.App.2d at p. 518 ["benefits become a part of the vested rights of the employees when conferred"].) Thus, employees may still have vested rights to the disputed inclusions, notwithstanding questions regarding the Retirement Boards' authority. Further, as explained below, employees may still have a vested right to the inclusions on the basis of their contributions toward their pensions, which have been calculated to include the disputed payments. Moreover, they may have a vested right through the compensation promised by the respective counties or other employers, and may separately enforce their rights to their pension benefits under the doctrine of estoppel.

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2. THE EMPLOYEES HAVE A VESTED RIGHT TO RECEIVE AN ANNUITY THAT INCLUDES THE PAY ITEMS AS "COMPENSATION EARNABLE" NOTWITHSTANDING THE RETIREMENT BOARDS' AUTHORITY

Employees and employers pre-fund the annuity benefit provided by the retirement systems through normal cost contributions. The contributions include the value of the pension annuity attributable to the components of compensation eliminated by A.B. 197. By paying directly towards the benefit, employees have a direct contractual right to receive the benefit towards which they contribute.

Indeed, actuarially sound prefunding is a constitutional mandate, and retirement system members have a constitutional right to an actuarially sound pension system. (See *Bd. of Admin. v. Wilson* (1997) 52 Cal.App.4th 1109 [holding that "in arrears" pension financing unconstitutionally impaired the contractual right to an actuarially sound retirement system and failed to provide comparable new advantages for its adverse effect]; see also *Valdes v. Cory* (1983) 139 Cal.App.3d 773 [suspension of employer contributions to retirement system for three months constituted an unconstitutional impairment of contractual relationships between members and their public employers].)

The duty to provide for actuarial sound funding is exclusively within the authority of the Retirement Board. (Cal. Const., art. XVI, § 17, subd. (e) ["The retirement board of a public pension or retirement system, consistent with the exclusive fiduciary responsibilities vested in it, shall have the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system."].) Therefore the retirement systems' actuaries have included the cost of providing an annuity that includes leave pay and other additional pay within their annual valuation, as reflected in plans' Comprehensive Annual Financial Reports ("CAFRs"). (See RJN Exh. W [CCCERA CAFR for the Year Ended Dec. 31, 2004] p. 32 [discussing plan's liability for leave cash outs by members upon termination], p. 26 [listing "other liabilities" in valuation of plan, which comprise the plan's liability for leave cash outs upon termination], pp. 36-37 [discussing *Ventura* decision, and requirement that plan include certain additional pay items when calculating members' retirement benefits], p. 40 [discussing

Paulson settlement]; RJN Exh. X [CCCERA CAFR for Years Ended Dec. 31, 2008 and 2009] p. 26 ["other liabilities"], p. 31 [discussion of plan's liability for leave cash outs], p. 40 [discussion of *Ventura* decision], p. 47 [discussion of *Paulson* settlement]; RJN Exh. Y [ACERA CAFR for the Years Ended Dec. 31, 2007 and 2008], p. 78 [summary of actuarial assumptions, including assumed additional 0.008 years of service per year of employment 'to anticipate conversion of unused sick leave for each year of employment."], p. 79 ['Terminal Pay Assumptions" reflecting "[a]dditional pay elements expected to be received during a member's final average earnings period."]; CCCERA Joint Statement, Exh. O.) As a result, the cost of the pay items as a component of final compensation are included in the present-value formula used to determine annual normal cost contributions.

To explain, the employers and employees annual contributions to the retirement systems include two components: (1) the present-value of future annuity benefits earned by the employees through their current year of service, or so-called "normal cost," and (2) the amortized cost of the system's unfunded actuarial liability, which would include liability associated with benefit enhancements that were not pre-funded at the time they were adopted if made retroactive. Because the retirement systems use the "entry-age normal" basis for computing the annual normal cost, the contributions include assumptions, or projections based on plan experience, with respect to employees' final compensation on their retirement date (and not on the basis of the compensation earned for that particular year of service). (See RJN Exh. C [ACERA Analysis of Actuarial Experience During the Period December 1, 2007 to November 30, 2010], pp. 51-54 [discussing terminal pay assumptions including assumptions regarding inclusion of vacation and sick leave cash-outs in "earnable compensation" for purposes of calculating retirement benefits and determining contributions]; RJN Exh. D [ACERA Actuarial Evaluation and Review as of December 31, 2010], p. 14 ["basic member [contribution] rates have been adjusted to anticipate conversion of terminal pay at retirement"].) These projections incorporate assumptions associated with the amount of compensation attributable to the pay items eliminated by A.B. 197.

The fact that employees have paid towards the benefits is conclusive in terms of establishing a vested right, regardless of whether CERL authorized the benefits or any other basis

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for vesting. This is because employees may obtain a vested right to retirement benefits quite apart from the mere performance of employment, but also though exchanging additional consideration for the contractual promise. As described in *Pasadena Police Officers Assn. v. City of Pasadena* (1983) 147 Cal.App.3d 695, 707, retirees obtained a vested right to a COLA benefit by electing to be included in a successor retirement plan. The court noted:

> By electing to come under the 1969 system, these members gave up their fixed pension and subjected themselves to the potential of a reduction in their pension should the cost of living index decline. By so agreeing, *the retirees gave consideration* for the city's promise to pay a fully adjustable pension (Civ. Code, § 1605) *and a contract was formed, a contract entitled to constitutional protection against impairment.*

(emphasis added, citing *Kern v. City of Long Beach, supra*, 29 Cal.2d at p. 853.) Thus, the payment of wages into the retirement system to fund the additional benefits associated with the pay items is consideration giving rise to a contract which the Legislature may not subsequently impair.

In addition to protections under the Contracts Clause, courts have held that retirement system members have a property interest in their retirement funds. (See, e.g., *Assn. of State Prosecutors v. Milwaukee County* (1996) 199 Wis.2d 549, 564 [544 N.W.2d 888, 894] ("[W]e hold that vested employees and retirees have protectable property interests in their retirement trust funds which the legislature cannot simply confiscate . . . ."); *People ex rel. Sklodowski v. State* (1994) 162 Ill.2d 117, 151 [642 N.E.2d 1180, 1194] (transfer of pension funds "substantially impaired pension benefits."); *Sgaglione v. Levitt* (1975) 37 N.Y.2d 507, 512 [337 N.E.2d 592, 594-5].) Like these jurisdictions, in California a public entity may not take private property for public use in the absence of just compensation, nor may a public entity pass regulations having the effect of depriving individuals of their property. (Cal. Const., art I, § 19.)

Because employees and employers have been paying for the present-value cost of the annuity benefits associated with compensation items that A.B. 197 purports to invalidate, and the employers have been paying for the amortized unfunded liability associated with the enhancements, A.B. 197 eliminates the benefit without providing any requisite compensation.

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3. THE RIGHT TO INCLUSION OF THE PAY CATEGORIES AT ISSUE ALSO VESTED BY THE EMPLOYERS' ACTIONS AND BY ESTOPPEL

Although CERL provides the Retirement Boards with authority to determine the items includable in "compensation earnable," pension benefits themselves are a form of employee compensation, the receipt of which is deferred until retirement. County Boards of Supervisors have plenary authority to set employee compensation, including pension benefits (subject to the duty to collectively bargain).

It has long been recognized that pension benefits are a form of compensation. (See, e.g., *Sweesy v. Los Angeles County Peace Officers' Retirement Bd.* (1941) 17 Cal.2d 356; *Terry v. City of Berkeley* (1953) 41 Cal.2d 698, 703 ["The pension payments are in effect deferred compensation . . . ."].) Therefore, the conferral of pension benefits is within the scope of authority delegated to the county Board of Supervisors.

Government Code section 25300 provides "[t]he board of supervisors shall prescribe the compensation of all county officers and shall provide for the number, compensation, tenure, appointment and conditions of employment of county employees. Except as otherwise required by Section 1 or 4 of Article XI of the California Constitution, such action may be taken by resolution of the board of supervisors as well as by ordinance." With respect to counties, the Supreme Court has specifically recognized that Government Code section 25300[13] provides for the conferral of retirement benefits which can become vested as a result of the Contracts Clause. (*Retired Employees Assn. of Orange County, Inc. v. County of Orange* (2011) 52 Cal.4th 1171, 1185 ["*REAOC*"].)

Indeed, in *REAOC* the Supreme Court noted, with respect to retirement benefits, that the legislature amended section 25300 to its current form in order to allow county Boards of Supervisors flexibility with respect to how compensation may be granted. (*REAOC, supra*, 52 Cal.4th at p. 1184 ["The legislative history of Government Code section 25300 plainly shows that

[13] This "compensation-fixing" language is common among California government code public-employer enabling statutes, for example Section 36506 which similarly states, with respect to cities, "[b]y resolution or ordinance, the city council shall fix the compensation of all appointive officers and employees."

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the purpose of the provision's second sentence was to provide a county board of supervisors with an alternative to acting by ordinance."].) Necessarily, counties can create vested rights through action authorized under 25300. Their authority to do so is plenary and constitutionally derived, and cannot be abrogated by the Legislature.

A review of the Legislature's limited authority to interfere with county employee compensation is therefore necessary to determine whether the Legislature impermissibly intruded into the counties' authority to confer pension benefits when it enacted A.B. 197.

California Constitution, article XI, section 1(b), applies to all counties and provides: "The governing body [of each county] shall provide for the number, compensation, tenure, and appointment of employees." With respect to charter counties, such as Alameda, article XI, section 4(f) of the Constitution provides for "[t]he fixing and regulation by governing bodies, by ordinance, of the . . . duties, qualifications, and compensation" of county employees. Subdivision (g) of the same provision specifies that a county charter supersedes general laws adopted by the Legislature. By way of example, section 12(B) of the Alameda Charter provides authority to the Board of Supervisors to fix compensation, and section 60 of that charter provides, with respect to performing County functions:

> The terms and conditions upon which such functions are to be performed by the county shall be fixed by agreement, which may provide for the consideration to be paid to the county, the including [*sic*] within county civil service with or without examination of any or all officers or employees who have been performing such functions for such city, town, district, or public agency, and for the terms and conditions upon which such persons are to be employed in the classified service of the county, *including pension or retirement benefits*, seniority, sick leave, vacation or any other rights or benefits granted county employees."

(See RJN Exh. Z.)

Regarding these constitutionally-derived powers, the Supreme Court has explained: "The constitutional language is quite clear and quite specific: the county, not the state, not someone else, shall provide for the compensation of its employees. Although the language does not expressly limit the power of the Legislature, it does so by necessary implication." (*County of Riverside v. Superior Court* (2003) 30 Cal.4th 278, 285; *In re Work Uniform Cases* (2005) 133 Cal.App.4th 328, 338.)

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Thus, a county has constitutional authority to provide for pension or other retirement benefits, and can create vested rights when it does so. Because the counties have constitutionally-derived plenary authority to set employee compensation, which includes pension benefits, to the extent the pensionable aspect of the pay items eliminated by A.B. 197 were obtained through either collective bargaining or any other duly-enacted authority of the Board of Supervisors, the vested rights that are created exist quite apart from CERL.

There are myriad ways in which counties can create such vested rights as a matter of contract. *REAOC* reiterated that one way is through collective bargaining. (*REAOC, supra,* 52 Cal.4th at 1182; see also *Sonoma County Org. of Public Employees, supra*, 23 Cal.3d 296 [finding constitutionally protected right to cost-of-living increase negotiated in union contract].) Retirement Boards themselves can enter into binding contracts. (See, e.g. *Chisom, supra,* 2013 WL 3942713.) Of course, multiple other means exist. (*Hunter v. Sparling* (1948) 87 Cal.App.2d 711, 721-722 [enforceable promise to pay pension benefits inferred from personnel policies]; *Kashmiri v. Regents of University of California* (2007) 156 Cal.App.4th 809, 828–833 [University's promise on its web site and in catalogues not to raise certain fees held to be an implied contract]; *REAOC, supra,* 52 Cal.4th at pp. 1176-1177 [section 25300 "does not prohibit a county from forming a contract with implied terms, inasmuch as contractual inasmuch as contractual rights may be implied from an ordinance or resolution when the language or circumstances accompanying its passage . . . ."]; see also *Requa v. Regents of Univ. of Cal.* (2012) 213 Cal.App.4th 213, 226-228 [implied contract for retiree medical benefits may arise from history of provision of the benefits and publications assuring employees of such benefits].)

Similarly, vested rights to pension benefits can arise through estoppel or reliance principles. Recognizing the "unique importance of pension rights to an employee's well-being" the Supreme Court has expressly recognized and affirmed the application of estoppel against government retirement agencies to protect those rights, particularly in cases where "employees were induced to accept and maintain employment on the basis of expectations fostered by widespread, long-continuing misrepresentations." (*Longshore v. County of Ventura* (1979) 25 Cal.3d 14, 28.) Likewise, *Crumpler v. Board of Administration* (1973) 32 Cal.App.3d 567, 585

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held the PERS board was equitably estopped from retroactively reclassifying certain animal control officers as non-safety members where the officers had paid the greater contributions required of safety members over the years. Because the animal control officers were offered the "benefit of their bargain" they were entitled to receive "what they had bargained and paid for." (See *Barrett v. Stanislaus County Employees Retirement Assn*. (1987) 189 Cal.App.3d 1593, 1608 [discussing *Crumpler*].) Note too that the Retirement Boards may be estopped from denying Petitioners' members their earned benefits through promises and other actions made by the counties under the doctrine of "privity of estoppel." (See *Crumpler*, *supra,* 32 Cal.App.3d at p. 582 ["The relationship between the city and the [retirement] board is such that estoppel of the city is binding on the board. An estoppel binds not only the immediate parties to the transaction but those in privity with them"].)

In sum, should the court entertain the State's argument that CERL did not authorize the inclusion of the various pay items within the definition of "compensation earnable" under CERL, employees nevertheless have earned a vested right to a pension annuity that includes these items as pensionable pay.

III. CONCLUSION

In considering the Retirement Boards' authority, it is important to understand that they are each charged with administering entirely separate retirement systems. While they all function under the guidelines established by CERL, the Retirement Boards necessarily make discretionary decisions about how to fund their respective systems and how to determine retirees' pensions. The law has never required that each CERL system operate exactly the same or that they function in the same manner as PERS does under PERL, with the same inclusions and exclusions. Individual retirement board discretion and authority is fundamentally built into CERL, and it extends to decisions about what to consider as compensation earnable. While A.B. 197 takes away authority that the Retirement Boards have, this is a new development that marks a distinct change in the discretion vested in CERL retirement boards; it plainly was not true before A.B. 197 took effect on January 1. Accordingly, Petitioners respectfully submit that the Retirement Boards were authorized to include in pension calculations the payments that they did, and if the

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court finds otherwise, Petitioners also submit that there is a strong basis for finding that under certain circumstances, employees may nevertheless have a vested right to such inclusions.

Respectfully Submitted,

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