California Court Issues Mixed Ruling on County 37 Act Retirement Guarantees for Legacy Members

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Ruling on a challenge by employees and unions to the constitutionality of the Public Employee Pension Reform Act of 2013 (PEPRA), the First District Court of Appeal issued a lengthy decision earlier this month that may pave the way for further attacks on the vested pension benefits of "legacy members" of county retirement systems. (*Alameda County Deputy Sheriff's Assn. v. Alameda County Employees' Retirement Assn. and Bd. of the Alameda County Employees' Retirement Assn.* (Jan. 8, 2018, No. A141913).) The court found PEPRA made substantial changes to county retirement benefits by removing vacation cash out and on-call pay from the calculation of pensionable compensation but returned to the trial court the question of whether those changes unlawfully impair the right of legacy members to existing pension benefits.

"Legacy members" of county retirement systems are those employees who were hired before PEPRA became law. New employees who become members of county retirement systems after January 1, 2013 are subject to the new law and are not affected by the court decision.

A Very Brief History of Pensionable Compensation

Under the County Employee Retirement Law (CERL), also known as the 1937 Act or 37 Act, pensionable compensation originally was limited to wages earned. However, after the landmark decision in *Ventura County Deputy Sheriffs' Assn. v. Board of Retirement* (1997) 16 Cal.4th 483, and in decisions and settlements after *Ventura*, the definition of "compensation earnable" for purposes of calculating retirement benefits in county retirement systems was expanded to include pay premiums, bonuses, holiday pay, on-call pay and, in some counties, cash out of accrued vacation and sick leave before or upon retirement.

PEPRA amended the definition of pensionable compensation for county employees by excluding on-call, call-back and standby pay as well as vacation and sick leave cash out from the calculation of retirement benefits. (See Gov. Code § 31461, subd. (b).) When the statute went into effect, the retirement systems in the three counties involved in this case – Alameda, Merced and Contra Costa – adopted rules excluding those and other items from pensionable compensation for active and retired legacy members.

Public employees and public employee unions in the three counties sued. The petitioners argued legacy members had a vested, contractual right to pension benefits based on the pre-PEPRA statute. They sought a ruling the PEPRA amendments at issue were unconstitutional because they impaired that contractual right in violation of state and federal contract clauses.

Court Addresses Disputed Items of Pensionable Compensation

The court issued rulings on four categories of potential compensation earnable that were disputed by the parties, as follows:

In-Service Leave Cash Out: The court overruled the trial court on the exclusion of leave cash outs before retirement, also called "in-service leave cash outs". Legacy members remain entitled to have vacation and sick leave cash outs taken during the final year of employment included in pensionable compensation.

Terminal Pay: However, cash outs at the time of retirement, also called "terminal pay", are excluded from pensionable compensation under the statute because they are intended to enhance retirement benefits. The court said there is no vested right to terminal pay.

On-Call Pay: On-call, standby and call back pay must continue to be included in pensionable compensation. The *Alameda* court upheld the trial court's order to the retirement boards to include pay outside of normal working hours in retirement calculations, so long as the pay was previously included, earned and required during the final compensation period, applicable to the entire class of employees, and not designed to enhance the pension.

Enhancement Payments: The court did not find any other specific categories of pay to be excluded from pensionable compensation on the basis those payments "enhanced" or "spiked" retirement benefits in violation of PEPRA. However, the court returned to the trial court the question whether the spiking prohibition imposed by PEPRA even applies to legacy members.

PEPRA Held to Have Substantially Altered County Retirement Benefits

The appellate court held PEPRA's changes to the definition of "compensation earnable" impacted legacy members' vested pension rights by removing on-call pay from pensionable compensation and excluding from retirement calculations any compensation a retirement board determines was used to spike retirement benefits. The court remanded these issues to the trial court to decide whether the changes impaired the members' vested rights, a legal analysis the trial court had not undertaken.

Pending before the California Supreme Court is *Marin Assn. of Public Employees v. Marin County Employees' Retirement Assn.* (2016) 2 Cal.App.5th 674. The *Marin* decision, also out of the First District Court of

Appeal, held public employee pension rights are not "immutable" and county retirement systems "may make reasonable modifications and changes in the pension system" to adjust to changing economic realities while still providing a "reasonable" retirement. The *Marin* court squarely rejected the longstanding "California rule" that has treated bargained-for pension benefits as a guaranteed, vested right.

The Supreme Court will review the *Marin* decision later this year. The court also will hear any appeal from the *Alameda* case, whether now or after a new ruling from the trial court, and is likely to consolidate the cases. The state high court eventually will render a decision that will affect the entire public employee retirement system in California. Taken together, the *Marin* and *Alameda* decisions open the door to dramatic changes in the retirement benefits available to legacy and post-PEPRA public employees.