
'California Rule' cases could have big implications for pension reform

by Maria Amante

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A case before the **California** Supreme Court could have “huge” implications for municipalities and how they approach pension benefits, said former San Jose Mayor Chuck Reed in an interview with *Debtwire Municipals*.

The California Supreme Court agreed to take a case surrounding the “California Rule” in September 2016 after a court of appeals in August 2016 ruled that certain pension impairments in **Marin County**, CA, were constitutional.

The California Rule stipulates that the pension offered at hire is a vested right for employees and protected by contract law and therefore cannot be cut unless offset by a new benefit of comparable value.

The appellate court’s ruling could weaken the California Rule if the California Supreme Court upholds the appellate court’s decision. The decision found that a new formula used by Marin County, which was intended to reduce pension spiking, was not an unconstitutional impairment of the employee contracts.

While a public employee has a vested right to a pension, that right is only to a “reasonable” pension, not an immutable entitlement to the most optimal formula of calculating the pension, according to the appellate court’s decision. In this case, Marin County stopped the practice of using unused vacation and leave, bonuses and terminal leave pay to calculate pension payouts, which was challenged in the court. The appellate court ruled that Marin County’s practice was acceptable.

“The impact could be huge, but it will be a resetting of the legal framework-- it doesn’t change the political environment,” Reed said. “It will change the political discussion and (provide) local governments the opportunity to negotiate changes that impact current employees.”

In December 2016, another appellate court in Alameda County found that employees only have the right to a “reasonable” pension, buttressing the Marin County ruling. In that case, the appellate court denied the request of Cal Fire Local 2881 to continue enforcing a benefit allowing public employees to purchase up to five years non-qualifying service credit.

This practice would have increased the pension benefits paid to state employees during their retirement, enabling purchasers to increase the amount of service credit factored into their pension payments.

Beyond the courts

The decision affecting Marin County has important implications statewide, but municipalities are waiting for the California Supreme Court’s ruling before taking any action on the ruling, said Marc Levinson, senior counselor at Orrick. Ultimately, even if the court overrules the Marin County and Alameda County decisions, the financial impact will be limited, Levinson said.

“I suspect people are taking a wait-and-see attitude,” Levinson said. “The (California) Supreme Court will tell us what the law is, but this case, it dealt with a way to eliminate pensions on a going forward, prospective basis – it didn’t impact what you’ve already earned. It’s not earth-changing, it’s important but not earth-changing.”

The question for these cases is whether the California Supreme Court establishes a “roadblock” for pension reform without legislative action, Levinson said. If the court overturns the ruling, it may leave local governments afraid to approach pension reform, he said.

The California Rule is an “overly broad” interpretation of what the state’s promised retirees, said

Alexander “Sasha” Volokh, a professor of law at Emory University. The Marin County ruling doesn’t properly interpret the rule – looking at prospective benefits, instead of retrospective – and could be overturned by the court, he said.

“Even if this case came to the right conclusion, the theory misinterprets case law about the California Rule,” Volokh said. “The California Court of Appeals decision that government can change benefits and is justified by fiscal crisis--that’s too broad a theory and could be badly used in other cases.”

If it’s upheld, it could be good for municipalities because it could end the practice of pension spiking, Volokh said.

But for that to happen, unions must agree to the change, which is a challenge to negotiate, Reed said.

“You’re limited in what you can negotiate, so there’s no way to solve the problem, which is skyrocketing unfunded liabilities,” Reed said. “But it changes the opportunity [if upheld] that when a city gets in trouble financially ... they can at least have the opportunity to negotiate something with regard to pension costs, which are going up faster than revenues.”

Pension reform on the ballot

If the California Supreme Court upholds both appellate court decisions, it also opens the door to a statewide ballot for pension reform, Reed said. The other consequence is nationwide, Reed said.

“It’s followed by a dozen states, so to the extent the [California] Supreme Court changes the rule’s interpretation, it could have a broader impact than California,” Reed said. “It does start the dominoes falling – we won’t know the impact in other states, but the California Rule has been cited [in other cases]. It calls into question all other states, and may set off the same discussion or litigation.”

The Marin County case is *Marin Association of Public Employees et al. v. Marin County Employees’ Retirement Association and the State of California*, case number A139610 in the Court of Appeal of the State of California First Appellate District Division Two.

The Alameda County case is *Cal Fire Local 2881 et al., v. California Public Employees’ Retirement System et al., and the State of California*, case number A142793 in the Court of Appeal of the State of California First Appellate District Division Three.