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MEMORANDUM

TO: Retirement Board of the AC Transit Employees Retirement Plan

FROM: Russell Richeda, Legal Counsel

DATE: August 5, 2020

RE: Case Update (Alameda County DSA v. Alameda County Employees' Retirement System)

The California Supreme Court issued a very important, very lengthy (ninety-pages), unanimous decision on July 31, 2020 clarifying the status of the vested rights doctrine for public pensions in California.

The vested rights doctrine for public pensions prior to 2016 had been generally understood to mean that, once a public employee has been hired, that employee's pension benefits could not be reduced except where "comparable new advantages" had at the same time been provided to the employee. The vested rights doctrine was premised on the contract clauses of the federal and California constitutions and offered important protections to California public employees.

Precipitating litigation over vested rights was the passage in 2013 of the Public Employees Pension Reform Act ("PEPRA") which contained provisions that reduced pension benefits for existing employees, such as the elimination of additional retirement service credit, i.e., "airtime", without providing "comparable new advantages".

Two appellate court decisions beginning in 2016 restated the vested rights doctrine in a manner that offered far less protections to California public employees.

The California Supreme in its 2019 Cal Fire decision, while upholding PEPRA's elimination of airtime, confirmed the status of retirement benefits as deferred compensation and reserved a fuller discussion of vested rights for a future case.

The Alameda County DSA case is that case. As a bottom line, the California Supreme Court upheld against a vested right attack the provisions of PEPRA that eliminated from the definition of "pensionable compensation" items of pay that had previously been included in the definition. The Court also weighed in on the important issue of, when pension reductions are made, whether "comparable new advantages" "must" be given or only "should" be given, with the Court coming down on the side of "should". While that may sound bad for advocates of vested rights, the rest of the Court's decision will be more reassuring to them.

The Court tackled the vexing issue of when “comparable new advantages” had to be included to offset any pension reduction by announcing a somewhat complex two-test structure. If both of the two tests are passed, then “comparable new advantages” do not have to accompany pension reductions. This new two-test structure is thus very important.

The Court’s first test is that the pension reduction must bear some material relation of the theory of a pension system and its successful operation. The Court at various points labeled this the “proper purpose test”. Devotees of prior California Supreme Court vested rights decisions will note that this test is a restatement of prior case law. So, so far, no new legal ground broken on vested rights.

While the first test is basically a restatement of existing case law, what is more interesting is the Court’s conclusion that PEPRA with its pension reductions passed this test because PEPRA was intended to stop abuses, such as pension spiking, and manipulation of final compensation, and by so doing to maintain a retirement system’s fiscal integrity and to discourage pension gamesmanship. The Court provided detail to this test by noting that enacting pension reductions to appease taxpayers or to stem rising pension costs or to improve employer personnel matters were not proper purposes.

The Court’s second test is a bit intricate. It provides that “comparable new advantages” do not need to accompany pension reductions if providing comparable new advantages would undermine or be inconsistent with the modifications that passed the first test. The Court concluded that PEPRA passed this test as well because compensating advantages were not needed when it was pension abuses, i.e., features not integral to the operation of a pension system, that were being curbed. It is difficult off-hand to envision many other types of pension reductions that would satisfy this test.

Stepping back, on the one hand, the California Supreme Court in its Alameda County DSA decision upheld the legality of pension reductions without comparable new advantages. On the other hand, the permissible scope of such reductions has been made quite narrow.

The Court in the course of its lengthy opinion addressed other important legal issues. For present purposes, the most important ones are (1) the Court’s affirmation that the retirement boards of public retirement systems possess the authority to correct system errors and will not be “estopped” from correcting past erroneous construction of the statutes they are obligated to administer and (2) the Court’s affirmation that a legislative clarification of ambiguous statutes would not violate vested rights.

This office stands ready to elaborate on this brief summary of a very important decision.