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Chief Executive Officer/Clerk
Superior Court of CA County of Santa Clara
BY_____ DEPUTY

Ann Vizcondo

SUPERIOR COURT OF CALIFORNIA

COUNTY OF SANTA CLARA

SAN JOSE POLICE OFFICERS' ASSOCIATION, Plaintiff, vs. CITY OF SAN JOSE, et al., Defendants.	Case No. 1-12-CV-225926 (Consolidated with 1-12-CV-225928, 1-12-CV-226570, 1-12-CV-226574, 1-12-CV-227864, and 1-12-CV-233660)
AND CONSOLIDATED ACTIONS AND RELATED CROSS-COMPLAINT	STATEMENT OF DECISION (Code of Civil Procedure 632; Rule of Court 3.1590)

Plaintiffs have challenged the validity of several provisions of the "Sustainable Retirement Benefits and Compensation Act", known as Measure B, a voter-approved amendment to the Charter of the City of San Jose ("the City"). Much like the amici curiae League of California Cities and California State Association of Counties in *Retired Employees Ass'n of Orange County v. County of Orange* (2011) 52 Cal.4th 1171, 1188 ("*REAOC*"), the City here argues that Measure B was "a measured and thoughtful response to an ever-increasing unfunded liability." However, the question before this Court, as was the question before the Supreme Court in *REAOC*, "is one of law, not of policy." The legal question is whether and to what extent Measure B violates vested rights.

I. BACKGROUND AND PROCEDURAL HISTORY

The City is a charter city, with the most recent and operative charter being the 1965 Charter. Article XV, section 1500 of the Charter (Ex. 701 at POA007114) requires the City Council to establish and maintain a retirement plan for all officers and employees of the City. The Charter provides for two separate retirement systems ("systems" or "plans"), administered by two different retirement boards: the 1961 Police and Fire Department Plan, covering sworn employees in the City's police and fire departments, and the 1975 Federated City Employees Retirement Plan, covering "miscellaneous" or "civilian" employees in the City's workforce.

The Charter also specifies certain "minimum benefits" and authorizes the City Council to define the plan benefits and other details concerning plan administration. By ordinances codified in the Municipal Code, the City Council has adopted, and has amended from time to time, the various plan definitions relating to contributions, eligibility, and benefits. As with other defined benefit plans, San Jose pension benefits are generally defined by age, a percentage of final defined salary, and years of service.

For many years, the City's workforce has been mostly unionized, with many employees represented by labor organizations. The labor organizations have collectively bargained with the City over wages, hours and other terms and conditions of employment. When agreements have been reached, they are reduced to writing in labor contracts, referred to as "memoranda of agreements" or "MOAs." For police and fire employees, the City Charter permits arbitration to resolve bargaining impasses, including disputes about certain pension issues such as pension contribution rates. For civilian employees, bargaining impasses are resolved under the Meyers-Milias-Brown Act, Government Code section 3500, et seq.

Beginning in approximately 2008, the City was faced with fiscal challenges precipitated by the recession. Tax and other revenues declined. The City's retirement costs climbed steeply, driven in part by an overall multi-billion-dollar unfunded liability. In part due to the worldwide stock market decline, the corpus of the retirement funds lost over $1 billion in a single year. The

unfunded liability was also the result of a larger retiree pool, modified actuarial analyses, enhanced benefits and higher final salaries.

Responding to the budget crisis, the City eliminated numerous jobs and reduced City services, including public safety, libraries, community centers, parks and other taxpayer services. The City adopted a fiscal reform plan that called for a variety of cost reduction measures. The fiscal reform plan expressly called for an effort to adjust retirement costs, including a possible charter amendment. The City considered, but did not ultimately adopt, a declaration of fiscal emergency. In March 2010, the City Council voted to place Measure B on the ballot, and on June 5, 2012, approximately 70% of the City's voters enacted Measure B.

Measure B contains fifteen sections, and begins with legislative findings. Among other things, the voters found that "[t]he City's ability to provide its citizens with Essential City Services has been and continues to be threatened by budget cuts caused mainly by the climbing costs of employee benefit programs, and exacerbated by the economic crisis." (Section 1501-A) The voters also found that current and projected reductions in service "will endanger the health, safety and well-being of the residents of San Jose." Further, "[w]ithout the reasonable cost containment provided in this Act, the economic viability of the City, and hence, the City's employment benefit programs, will be placed at imminent risk." *Id.*

After the election, several lawsuits challenging parts of Measure B were filed on behalf of: (1) the San Jose Police Officers Association ("POA"), representing employees who are members of the 1961 San Jose Police and Fire Department Retirement Plan ("Police and Fire Plan"); (2) the American Federation of State, County, and Municipal Employees, Local 101 ("AFSCME"), representing employees who are members of the 1975 Federated City Employees' Retirement Plan ("Federated Plan"); (3) Robert Sapien, Mary Kathleen McCarthy, Thanh Ho, Randy Sekany, and Ken Heredia, who are active and retired members of the Police and Fire Plan (collectively, "Sapien Plaintiffs"); (4) Teresa Harris, Jon Reger, and Moses Serrano, who are active and retired members of the Federated Plan (collectively, "Harris Plaintiffs"); (5) John Mukhar, Dale Dapp, James Atkins, William Buffington, and Kirk Pennington, who are active

and retired members of the Federated Plan (collectively, "Mukhar Plaintiffs"); and (6) the San Jose Retired Employees Association ("REA"). The City also filed its own cross-complaint for declaratory relief. The Sapien Plaintiffs, the Harris Plaintiffs, and the Mukhar Plaintiffs (collectively, "Individual Plaintiffs") were jointly represented at trial.

Plaintiffs challenge the following sections of Measure B: Section 1504-A (Reservation of Voter Authority), Section 1506-A (Current Employees), Section 1507-A (One Time Voluntary Election Program ("VEP")), Section 1509-A (Disability Retirements), Section 1510-A (Emergency Measures to Contain Retiree Cost of Living Adjustments), Section 1511-A (Supplemental Payments to Retirees), Section 1512-A (Retiree Healthcare), Section 1513-A (Actuarial Soundness), Section 11514-A (Savings), and Section 1515-A (Severability).

The lawsuits were consolidated for trial, and a court trial was held on July 22-26, 2013. The following causes of action went to trial:

Breach of Contract (POA's Sixth Cause of Action)

Takings Clause, Cal. Const., art. I, Section 19 (Individual Plaintiffs' Fourth Cause of Action, AFSCME's Third Cause of Action, REA's First Cause of Action, Count II, and Second Cause of Action for Declaratory Relief)

Due Process, Cal Const., art. I, Section 7 (Individual Plaintiffs' First Cause of Action, AFSCME's Fourth Cause of Action, REA's First Cause of Action, Count III and Second Cause of Action, Declaratory Relief)

Impairment of Contract, Cal. Const., art. I, Section 9 (POA's First Cause of Action, Individual Plaintiffs' Second Cause of Action, AFSCME's First Cause of Action, REA's First Cause of Action, Count I, and Second Cause of Action for Declaratory Relief)

Freedom of Speech, Right to Petition, Cal. Const., art. I, Sections 2, 3 (SJPOA's Fourth Cause of Action, AFSCME's Sixth Cause of Action)

Pension Protection Act, Cal. Const., art. XVI, Section 17 (SJPOA"s Eighth Cause of Action, AFSCME's Fifth Cause of Action, REA's First Cause of Action, Count V, Second Cause of Action for Declaratory Relief)

Promissory and Equitable Estoppel (AFSCME's Eighth Cause of Action)

Writ of Mandate (AFSCME's Eleventh Cause of Action)

The City brings the following causes of action for declaratory relief:

Contracts Clause, Article I, Section 10, United States Constitution

Takings Clause, 5th and 14th Amendments, United States Constitution

Due Process Clause, 5th and 14th Amendments, United States Constitution

At trial, the parties reached stipulations concerning the admission of numerous exhibits. The parties submitted a stipulation on July 26, 2013, confirming the admission and authenticity of numerous exhibits. The parties also entered into the following substantive stipulations:

Severability: All parties agreed that Measure B is severable and that the Court has the authority to adjudicate its legality section by section.

New hires: No plaintiff contends that Measure B is illegal as to future employees. Based on this stipulation, the Court finds that the Measure B sections at issue in this case can proceed as to new employees.

Bill of attainder: AFSCME dismissed with prejudice its second cause of action for bill of attainder.

The POA called four witnesses: Mike Fehr, Pete Salvi and John Robb, current and former POA members, who testified concerning the City's provision of a subsidy in the amount of the premium for the "lowest cost" plan offered City employees; and Bob Leininger, a Federated plan retiree, who testified that he received a retirement system newsletter in the mail.

AFSCME called three witnesses: Charles Allen, an AFSCME union representative, who testified concerning union negotiations over contributions for retiree healthcare costs; Margaret Martinez, a Federated retiree, who testified concerning "lowest cost plan"; and Dan Doonan, an AFSCME employee called as a "labor economist," who testified concerning cost of living statistics and other financial topics.

The Individual Plaintiffs called actuary Thomas Lowman as an expert witness, who testified about general actuarial principles of government defined-benefit plans.

REA did not call any witnesses.

The City called four witnesses: Sharon Erickson, City Auditor, who testified concerning audit reports on the sustainability of the City's pension system and the need for reform in the disability retirement system; Debra Figone, City Manager, who testified concerning City budget shortfalls and service reductions related to increased retirement costs; Alex Gurza, Deputy City Manager and head of the Office of Employee Relations, who testified concerning City and union labor negotiations over employee pension and retiree health contribution rates, labor contracts and City retirement benefits; and John Bartel, an outside actuarial expert who testified concerning the nature of the SRBR.

As of the last scheduled day of trial (July 26, 2013), certain outstanding exhibits remained in dispute and so the Court scheduled the further date of August 26, 2013, to complete the receipt of evidence. Certain parties reached a subsequent stipulation dated August 13, 2013, and all parties withdrew objections concerning the final submission of exhibits. Accordingly, the remaining outstanding exhibits were admitted without objection, the additional trial date of August 26, 2013, was vacated, and the evidence was closed.

Pursuant to stipulation and order, all parties on September 10, 2013, simultaneously submitted written closing arguments and proposed statements of decision.

Despite the fact that the evidence was closed, the City's post-trial brief attached as Exhibit L an unsigned Proposed Statement of Decision in San Francisco Superior Court Case No. CPF-13-512788. On September 16, 2013, the Individual Plaintiffs objected to the submission of Exhibit L; on September 18, 2013, AFSCME also so objected, and on the same date, SJPOA joined in the Individual Plaintiffs' objections. Because the evidence was closed, and the City did not obtain or seek an order to reopen, the Court will not consider Exhibit L.

The parties appeared on October 10, 2013, to address the Court's questions concerning the proposed statements of decision, and the matter was at that time submitted. Pursuant to Code of Civil Procedure section 632 and Rule of Court 3.1590, the Court issued a tentative decision filed on December 20, 2013. Thereafter the parties filed objections and requests for a different

statement of decision, and on January 31, 2014, the parties appeared to address the Court's questions concerning the objections and requests. At the Court's request, on February 4, 2014, AFSCME filed a brief addressing a question from the January 31, 2014 hearing. The City presented a reply letter on February 11, 2014.

II. ANALYSIS OF RECORD EVIDENCE AND THE LAW

A. Threshold Legal Principles

1. Presumption of Statutory Validity

"All presumptions favor the validity of a statute. The court may not declare it invalid unless it is clearly so." *Tobe v. City of Santa Ana*, 9 Cal.4th 1069, 1102 ("*Tobe*")(1995). The parties generally agree that the challenges to all sections of Measure B are facial challenges, with the exception of the challenges to sections 1512-A(a) and 1512-A(c) which are both facial and as-applied. (Reporter's Transcript ("RT") October 10, 2013, at 87:19-90:21.) In the case of a facial challenge, "petitioners must demonstrate that the act's provisions inevitably pose a present total and fatal conflict with applicable constitutional prohibitions." *Tobe, supra,* 9 Cal.4th at 1084, quoting *Pacific Legal Foundation v. Brown* (1981) 29 Cal.3d 168, 180-81.

2. Pension Benefits as Vested Rights

"[I]t is presumed that a statutory scheme is not intended to create private contractual or vested rights and a person who asserts the creation of a contract with the state has the burden of overcoming that presumption." *Walsh v. Board of Administration* (1992) 4 Cal.App.4th 682, 697 ("*Walsh*"). Generally "legislation in California may be said to create contractual rights when the statutory language or circumstances accompanying its passage 'clearly … evince a legislative intent to create private rights of a contractual nature enforceable against the [governmental body].'" *REOAC*, 52 Cal.4th at 1187, quoting *Valdes v. Cory* (1983) 139 Cal.App.3d 773, 786. "In California law, a legislative intent to grant contractual rights can be implied from a statute if it contains an unambiguous element of exchange of consideration by a private party for consideration offered by the state." *California Teachers Assn. v. Cory* (1984) 155 Cal.App.3d 494, 505 (enforcing implied contract concerning funding of retirement benefits).

"A public employee's pension constitutes an element of compensation, and a vested contractual right to pension benefits accrues upon acceptance of employment. Such a pension right may not be destroyed, once vested, without impairing a contractual obligation of the employing public entity." *Betts v. Board of Administration* (1978) 21 Cal.3d 859, 863 (Supreme Court issued writ to require Board to set retirement benefits based on statutes in effect during employment); see also *Allen v. City of Long Beach* (1955) 45 Cal.2d 128 ("*Allen/Long Beach*")(replacement of fluctuating benefit system based on salary of current occupant of position with a fixed system based on employee's highest salary, and contribution increase, impair vested right). The right to earn a pension vests in the sense that it cannot be destroyed by charter amendment even before retirement. *Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 855-856 ("*Kern*")(elimination of pension system impairs vested rights). Charters and municipal codes are valid and enforceable sources of vested property rights. *See International Assn. of Firefighters v. San Diego* (1983) 34 Cal.3d 292, 302 (charter, ordinances, and municipal codes); *REAOC*, *supra*, 52 Cal.4th at 1194 (ordinances).

The vested rights doctrine does not mean that pension provisions cannot be changed. "Not every change in a retirement law constitutes an impairment of the obligations of contracts, however. [Citation omitted.] Nor does every impairment run afoul of the contract clause." *Allen v. Board of Administration of the Public Employees Retirement System* (1983) 34 Cal.3d 114, 119 ("*Allen/Board*")(benefits properly limited by subsequent change which confined benefits to reasonable expectations and avoided windfalls). The protection against impairment of contract "does not exact a rigidly literal fulfillment" (*id.*, at 119-120, quoting *City of El Paso v. Simmons* (1965) 379 U.S. 497, 508 ("*Simmons*")). "[A]n employee may acquire a vested contractual right to a pension but [] this right is not rigidly fixed by the specific terms of the legislation in effect during any particular period in which he serves. The statutory language is subject to the implied qualification that the governing body may make modifications and changes in the system. The employee does not have a right to any fixed or definite benefits, but only to a substantial or reasonable pension. There is no inconsistency therefore in holding that he

has a vested right to a pension but that the amount, terms and conditions of the benefits may be altered." *Kern, supra,* 29 Cal.2d at 855.

The law imposes restrictions on the employer's ability to make changes: "An employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system. [Citations omitted.] To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages. [Citations omitted.]... Constitutional decisions 'have never given a law which imposes unforeseen advantages or burdens on a contracting party constitutional immunity against change.' [Citation omitted]" *Allen/Board, supra,* 45 Cal.2d at 131. "[T]he propriety of a modification is not dependent upon the ability to strike a precise dollar balance between benefit and detriment. It is enough that a modification does not frustrate the reasonable expectations of the parties to the contract of employment [citation omitted]." *Frank v. Board of Administration* (1976) 56 Cal.App.3d 236, 242 ("*Frank*").

3. The Charter's Reservation of Rights

The City relies on two "reservation of rights" clauses in the Charter which permit the City to "amend or otherwise change" its retirement plans and to "repeal or amend" any retirement system. Specifically, Section 1500 (Exhibit 5216, at SJRJN000062) provides, in pertinent part:

> Subject to other provisions in this Article, the Council may at any time, or from time to time, amend or otherwise change any retirement plan or plans or adopt or establish a new or different plan or plans for all or any officers or employees....

Similarly, section 1503 (Exhibit 5216, at SJRJN000063-64) provides, in pertinent part:

> However, subject to other provisions of this Article, the Council shall at all times have the power and right to repeal or amend any such retirement system or systems, and to adopt or establish a new or different plan or plans for all or any officers or employees....

The City argues that these "reservation of rights" clauses preclude the creation of vested

rights, relying on the decision in *Walsh, supra*, 4 Cal.App.4th at 700: "The modification of a retirement plan pursuant to a reservation of the power to do so is consistent with the terms of any contract extended by the plan and does not violate the contract clause of the federal constitution."

Plaintiffs argue that the reservation of rights clauses do not preclude their vested rights claims because: (1) the clauses are inapplicable by their own terms; (2) such clauses are not generally enforceable; and (3) the sparse case law does not support the application of these clauses specifically in the pension context to preclude the creation of vested rights.

First, Plaintiffs contend that the Charter's reservation of rights by its own terms applies only to actions *by the Council*, and that Measure B was not an action by the Council but rather by the voters. On this basis, Plaintiffs further argue that *Walsh* does not apply to preclude a claim of contract impairment because Measure B is **not** a "modification of a retirement plan pursuant to a reservation of rights". In this regard, Plaintiffs rely on *Legislature v. Eu* (1991) 54 Cal.3d 492 ("*Eu*"), which held that the Constitutional reservation of rights in favor of the Legislature did not apply to legislation passed by voter initiative rather than by a vote of the Legislature. However, Measure B was **not** legislation passed by voter initiative—but rather is a Charter amendment. The Council performed the tasks with respect to Measure B that the law allows and requires: to place it on the ballot and later to implement it by ordinance (Cal. Const., Art. XI, section 3(b); Ordinance No. 29174, Ordinance No. 29198). But a vote of the people was the proper means to amend the Charter. Plaintiffs' argument based on *Eu* would compel an anomalous result whereby the people who, through the reservation of rights clauses, gave the Council authority to retain control over pension changes, do not themselves have that power by way of approving a Charter amendment. In any event, the *Eu* court found that the initiative statute was outside the reservation of rights for another reason not pertinent in this case: a reservation of rights to "limit" retirement benefits did not authorize *termination* of those benefits. In this case, the reservation of rights clause reserves the authority to "amend or otherwise change" the City's retirement plans, which is consistent with Measure B.

Plaintiffs further contend that the reservation of rights clauses should be interpreted to

permit only benefit increases, and not decreases. On its face this is an unreasonable construction: there could be no possible vested rights issue when benefits are simply increased. The "reservation of rights" clauses were added to the Charter in 1965 Charter, at the same time as the "minimum benefits" sections. It is reasonable to conclude that while the minimum benefits specified in the Charter may likely be considered vested, any increases beyond those minimums could be subject to the express right of modification: here, with respect to the pension contributions paid by active employees. To construe the Charter otherwise would render the reservation of rights clauses meaningless, which violates a fundamental rule of construction. See *City and County of San Francisco v. Farrell* (1982) 32 Cal.3d 47, 54 ("an interpretation which would render terms surplusage should be avoided").

With respect to Plaintiffs' contention that reservation-of-rights clauses are generally not enforceable, the authorities on which Plaintiffs rely are not applicable. *Air Cal, Inc. v. San Francisco* (N.D.Cal. 1986) 638 F.Supp.659; *Continental Illinois. Nat'l Bank & Trust Co. v. Washington* (9th Cir. 1983) 696 F.2d 692; *Southern Cal. Gas Co. v. City of Santa Ana* (9th Cir. 2003) 336 F.3d 885. These cases all involve negotiated contracts between public and private entities, with general clauses reserving "police powers".

Finally, Plaintiffs argue that, despite the sweeping language in *Walsh* that modification to retirement benefits made pursuant to a reservation of rights does not violate vested rights, the case does *not* stand for the proposition that a reservation of rights necessarily precludes the creation of vested rights. Indeed, no other authority has been cited for such a broad conclusion. Moreover, the position argued by the City is contrary to the Supreme Court's language in *Eu*: "Significantly, we have never suggested that the mere existence of [the reservation of rights at] article IV, section 4, precludes legislators from acquiring pension rights protected by the state or federal contract clauses." *Eu, supra*, 54 Cal.3d at 529. Finally, the language of *Walsh* itself supports Plantiffs' argument that the case should be limited to its peculiar facts: in connection with the unique circumstances of the change from a part-time "citizens'" legislature to a full-time legislature, members' salary nearly tripled, and pension benefits tied to the new salary were a

windfall not contemplated under the prior system. In the last sentence of footnote 6, the District Court of Appeal in *Walsh* distinguishes the Supreme Court's ruling in *Eu* with this observation: "The question whether a former member of the Legislature acquired a contractual right to wholly unmodifiable pension benefits when he served during a time when the LRL was neither actuarially funded nor supported by a continuing appropriation, was not a question which was implicated in the *Legislature* v. *Eu* decision." *Walsh, supra*, 4 Cal.App.4th at 700. Accordingly, this Court concludes that a reservation of rights does not of itself preclude the creation of vested rights.

B. Section 1504-A: Reservation of Voter Authority

Section 1504-A reserves voter authority to "consider any change in matters related to pension and other post-employment benefits," and requires voter approval for any increases to pension or retiree healthcare benefits, other than Tier 2 benefit plans. (Exhibit 5216, at SJRJN000069.)

Only the REA challenges this section, claiming that it violates retirees' vested right to have the City Council empowered to grant increases in retirement benefits. This question is purely a facial challenge.

Article XI, section 5(b)(4) of the California constitution grants "plenary authority" for a city charter "to provide therein or by amendment thereto" for the ''compensation" of city officers and employees:

> It shall be competent in all city charters to provide, in addition to those provisions allowable by this Constitution, and by the laws of the State for: (1) the constitution, regulation, and government of the city police force (2) subgovernment in all or part of a city (3) conduct of city elections and (4) *plenary authority is hereby granted*, subject only to the restrictions of this article, *to provide therein or by amendment thereto*, the manner in which, the method by which, the times at which, and the terms for which the several *municipal officers and employees whose compensation is paid by the city shall be elected or appointed, and for their removal, and for their compensation*, and for the number of deputies, clerks and other employees that each shall have, and *for the compensation, method of appointment, qualifications, tenure of office and removal of such deputies, clerks and other employees.*" [Emphases added]

Given this plenary authority, a city charter may require electoral approval of the compensation of city officers and employees. See *Munoz v. City of San Diego*, 37 Cal.App.3d 1, 4 (1974) (upholding city charter provision that required council member salaries to be decided by the electorate "because it has been constitutionally committed to a political department of government, i.e., the electorate, and not to the courts"). Retirement benefits relate to compensation. *Downey v. Board of Administration*, 47 Cal.App.3d 621, 629 (1975) ("It is clear that provisions for pensions relate to compensation and are municipal affairs within the meaning of the Constitution"). Therefore, Article XI, section 5(b) permits the voters to provide "by amendment" for voter approval of any increases in employee retirement benefits.

The REA does not address this authority, nor do they argue that Council implementation is itself a vested right. (REA's Post-Trial Brief, at 25-28.) Accordingly, the Court finds that Plaintiffs have not met their burden, and that Section 1504-A is valid.

C. Section 1506-A: Increased Pension Contributions

By its terms, Section 1506-A does not apply to retirees, to current employees governed by the Tier 2 Plan, or to current employees who opt into the VEP. With respect to all other current employees, this section provides for increased pension contributions up to 16%, but no more than 50% of the costs to amortize any non-Tier 2 pension unfunded liabilities.

Plaintiffs argue that they have an express statutory vested right to have the City pay unfunded actuarially accrued liabilities ("UAAL"), relying on numerous provisions of the SJMC, including sections 3.28.710, 3.28.880, and 3.36.1520A. The City's primary argument in opposition is that, without more, the Charter's reservation of rights precludes the creation of a vested right. As discussed above, the Court finds this argument unsupported by law. Second, the City argues that it has the right to regulate compensation and that the parties treated pension contributions as if they were an element of compensation.

SJMC section 3.28.710 (Exhibit 5302, at SJRJN000145), applicable to the Federated Plan, provides:

> ...[I]f and when, from time to time, the members' normal rate of contribution is hereafter amended or changed, *the new rate shall not include any amount designed to thereafter*

> *recover from members or return to members the difference between the amount of normal contributions theretofore actually require to be paid by member and any greater or lesser amount* which, because of amendments hereafter made to this system *or as a result of experience under this system*, said member should have theretofore been required to pay in order to make their normal contributions equal three-elevenths of the abovementioned pensions, allowances, and other benefits.... [Emphases added.]

SJMC section 3.36.1520A (Exhibit 5303, at SJRJN000332), applicable to the Police and Fire Plan, provides:

> The retirement board shall determine and fix, and from time to time it may change, the amount of monthly or biweekly contributions for current service which must be required of the City of San Jose and of members of this plan to make and keep this plan and the retirement system at all times actuarially sound. For the purpose of this section,... "contributions for current service" for member employed in the police department shall mean the sum of the normal costs for each actively employed member in the police department as determined under the entry age normal actuarial costs method, divided by the aggregate current compensation of such members. *Rates for current service* ***shall not*** *include any amount required to make up* ***any deficit*** *resulting from the fact that previous rates of contribution made by the city and members were inadequate to fund benefits attributable to service rendered by such members prior to the date of any change of rates,* and shall not include any amount required for payment of medical or dental insurance benefits. [Emphases added.]

These provisions are consistent with the prior history requiring that the City pay UAALs. The 1946 Charter amendments expressly allocated UAALs to the City. (Exhibit 1, at POA005584 ("Any actuarial deficiency in the fund shall be made up over a period of years by gifts, waivers, donations, earnings and contributions *by the City*.")(Emphasis added).) The 1961 Charter amendments retained this requirement, but added a provision allowing for increased benefits in exchange for which employees paid UAAL. (Exhibit 2, at POA005619-20.) The 1965 Charter also required an actuarially sound system. (Exhibit 5215, at SJRJN000437.) In 1971, a Council resolution provided that member contributions "shall not include any amount required to make up any deficit resulting from the fact that previous rates of contribution thereto made by the City and by such members were inadequate ...." (Exhibit 3, at POA005622.) In 1979, the Council enacted Resolution 19690, the precursor to the current SJMC language. (Exhibit 4, at POA005627.)

Moreover, the City acted consistently with its being obligated to pay UAALs. For

example, Mr. Gurza's October 23, 2009 memorandum to the Mayor and the Council unambiguously states that: "...[T]he San Jose Municipal Code provides that the City is responsible for **100%** of the unfunded liability for the pension benefit." (Exhibit 445, at AFSCME002650 (Emphasis in original).) See also, e.g., Exhibit 401, 1993 Federated System Annual Report, at AFSCME002957: "...[T]he City of San Jose Municipal Code states that part of the pension liabilities under the System is to be shared by the members and the City on a 3:8 ratio, part is to be shared on a 42:58 ratio, and *the balance is the responsibility of the City alone.*" (Emphasis added); Exhibit 328, Federated Handbook 1990, at AFSCME001238: contribution rates changes are not retroactive.

City ordinances can "manifest[] an express intent" that the City pay for certain obligations for a pension system. *Ass'n of Blue Collar Workers v. Wills* (1986) 187 Cal.App.3d 780, 789 ("*Wills*"). The City relies on the 2010 Municipal Code changes to argue that the ordinances in effect at the time Measure B was passed authorize additional employee contributions toward unfunded liabilities. But the City overstates the effect of those ordinances which, by their terms, acknowledge that contributions to fund UAALs are ones "that the city would otherwise be required to make...." (Exhibits 5302 (SJMC 3.28.955) and 5303 (SJMC 3.36.1525).)

The City also attempts to distinguish *Wills* on the ground that it did "not involve a history of pension contribution rates being treated as a component of 'total compensation.'" (City's Post-Trial Brief at 26:10-11.) Specifically, the City argues that because in 2010 some bargaining units proposed additional pension contributions to address UAALs, this conduct is inconsistent with the existence of vested rights. The City does not address how the conduct by only a portion of the bargaining units could affect the rights of employees not members of those units: for example, AFSCME made no such proposal. More significantly, the City provides no authority which supports the remarkable proposition that, under the circumstances of such proposals, pension benefits could be transformed into compensation and that rights thereto would be forfeited by a clear, unmistakable, intelligent and voluntary waiver. The City has not met the

high burden that the law imposes on proof of such waivers in public employment. *Choate v. Celite Corp.* (2013) 215 Cal.App.4th 1460, 1466.

Accordingly, Plaintiffs have shown a vested right to have the City pay UAALs; Section 1506-A impairs that right. The City argues in the alternative that, even if there is a vested right that is impaired, Section 1506-A is nevertheless valid as it offers a "comparable new advantage" (*Allen/Long Beach,* 45 Cal.2d at 131: "...[C]hanges in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages.") The City has not argued that Section 1506-A, although imposing the disadvantage of increased contribution rates, offers a countervailing advantage. Instead, the City's argument is that increased contribution rates are more advantageous than a wage cut. In other words, the City does not suggest that Section 1506-A offers a comparable new advantage to the law previously in place, but instead that it is a better alternative than a third choice. The logic of this argument is: if the third choice is sufficiently unacceptable, then the challenged law is valid because it is better than the third choice even if it offers no advantage over the previous law.

At trial, the City conceded that it had no authority for that novel interpretation of the "comparable new advantage" doctrine. Then the City rephrases the doctrine, in imprecise language in post-trial briefing and argument, as "whether the comparable new advantage had to *relate to* a benefit in existence before the comparable new advantage was enacted" (City's Post-Trial Brief, at 29:12-13 (emphasis added)). Based on this rephrasing, the City then contends that *Claypool v. Wilson* (1992) 4 Cal.App.4th 646 ("*Claypool*"), holds that a comparable new advantage can be "based on" another aspect of the same law that is challenged. This distorts the "comparable new advantage" doctrine, and misreads *Claypool*. In that case, the court of appeal compared the loss of the benefits under the previous law ("loss of potentially higher benefits under the Extraordinary Performance Account Program") with the effects of the new law. *(Claypool*, 4 Cal.App.4th at 668-69.) *Claypool* provides no support of the City's illogical formulation of the "comparable new advantage" rule. Thus, the fact that increased employee contributions may be more beneficial to employees than straight pay reductions is irrelevant, and

does not render the increased contributions a "comparable new advantage" compared to the pre-Measure B system.

Accordingly, Section 1506-A impairs vested rights and is invalid.

D. Section 1507-A: One Time Voluntary Election Program

Section 1507-A provides an alternative retirement plan, expressly contingent on IRS approval, for employees who wish to avoid increased contribution rates. The City argues that the challenge to this section is "a repetition" of the challenge to section 1506-A. (City's Post-Trial Brief, at 38:7.) Plaintiffs contend that section 1507-A may be unlawful even if section 1506-A is not. Specifically, the POA complains that members wishing to enroll in VEP would not be able to do so in the absence of IRS approval. (POA Post-Trial Brief, at 15: 3-5.)

In its Request for a Different Statement of Decision, filed January 6, 2014 ("Request"), the City asked for a "clarification" that section 1507-A is not invalid "except to the extent that the VEP is tied to section 1506-A…". (Request, at 2:9-10.) The City urges that section 1507-A is "a stand-alone section" (id., at 1:24-25): i.e., because the discrete sections of Measure B are generally severable, section 1507-A is valid notwithstanding the invalidity of section 1506-A. However, this request ignores the language, structure and obvious purpose of section 1507-A: a voluntary alternative to section 1506-A. The City claims that section 1507-A "does not reference" section 1506-A (Request at 2:2)—presumably meaning that section 1507-A does not mention section 1506-A by number. However, section 1506-A is referenced in that sense that it is the program to which section 1507-A is expressly intended to be an "alternative retirement program" into which employees may "opt". (Section 1507-A, first paragraph.) The City does not explain how section 1507-A could be a voluntary alternative election given the invalidity of section 1506-A. For these reasons, Section 1507-A is also invalid.

The City also requests that the Court clarify that it "does not intend to interfere or offer any opinion regarding the City's pending request to the Internal Revenue Service [] for approval of the VEP." (Request, at 2:11-13.) The City does not identify any portion of the Tentative Decision as giving rise to this concern. The IRS approval was not an issue at trial, nor has it

been addressed in this Statement of Decision.

E. Section 1509-A: Disability Retirement

In April 2011, the City Auditor issued a report that concluded that the disability retirement system needed reform. (Exhibit 5103.) The report noted the unusually high number of police and fire employees who retired on disability, the high rate of approvals, and the number of employees granted disability retirement but still able to work. (*Id.*, at SJ001549-50, SJ001553-54, SJ001560-64; RT at 467-69.)

Measure B incorporated recommendations from the report: creation of an independent panel with medical expertise to decide disability retirement applications; appeal to a hearing officer; and clarification that the purpose of disability retirement was to provide income for those unable to work but not yet eligible for service retirement. (Exhibit 5103, at SJ001573; RT at 477.)

1. Expert Board to Determine Disability

Before Measure B, disability retirement determinations were made by retirement board members consisting of members of the public, as well as employees and retirees who are members of the plan. (Exhibit 5103, at SJ001544-45, SJ001556-58.) Consistent with the Auditor's recommendations, Section 1509-A(c) requires instead that disability determinations be made by an independent panel of medical experts.

Relying on the Article 16, section 17 of the California Constitution concerning the fiduciary responsibilities of the board of a public retirement system over "investment of moneys and administration of the system", Plaintiffs claim that they have a vested right to have the "fiduciaries" for the retirement system – the members of the Retirement Board—make the eligibility decision concerning every disability retirement. However, Plaintiffs do not have a vested right, or any other right, in the composition of the body that makes disability determinations. *Whitmire v. City of Eureka*, 29 Cal.App.3d 28, 34 (1972) (where "only administrative and procedural changes" were involved, ordinances restructuring the Commission charged with collecting and disbursing the funds of the police and fire retirement system did not

violate vested rights), cited in *Claypool*, *supra*, 4 Cal.App.4th at 670 ("although active and retired members have a vested right to a pension, they do not have a vested right to control the administration of the plan which provides for the payment of pensions").

Following the Tentative Decision, Plaintiffs attempted to distinguish *Whitmire* by claiming that that case does not deal with transferring fiduciary responsibilities outside the board, but this argument begs the question: what is the scope of section 17, and what changes are administrative and therefore allowable? The change of the decision-making body set forth in Measure B appears to be considerably farther from the core purpose of section 17 to protect retirement funds than were the changes allowed in *Whitmire* and *Claypool*.

Plaintiffs did not meet their burden of proof with respect to this section.

2. Definition of Disability

Section 1509-A also changes the eligibility requirements for obtaining a disability retirement by requiring that employees be unable to work. For Federated employees, the employee must be unable to "perform any other jobs described in the City's classification plan"; for Police and Fire employees, the employee must be unable to "perform any other jobs in the City's classification plan in the employee's department." (Section 1509-A(b).)

Plaintiffs claim that the change in the eligibility criteria violates their vested rights because it denies a disability retirement to a worker who can do any job, even a clerk's job, with no requirement that such job be offered. As the City points out, Plaintiffs' reliance on *Newman v. City of Oakland Retirement Board* (1978) 80 Cal.App.3d 450, is unavailing, as that case involved an officer who had already retired and was collecting a pension, when the department change the eligibility criteria and recalled him. Plaintiffs also rely on *Frank, supra,* 56 Cal.App.3d at 245 (allowing benefits under statute in place when employee began working, despite subsequent statutory change before injury), involving new eligibility rules which would have decreased the employee's benefits by 80%: such "nominal" benefits "obviously never intended to provide self-sufficiency" thwarted the employee's reasonable expectation.

The City argues that section 1509-A does not violate the reasonable expectations of

employees because it changes *only eligibility and not benefits*. *Frank* is not properly distinguished, as the City claims, as involving only a change in benefits "rather than eligibility" (City's Post-Trial Brief, at 41:9): in fact, it involves both. The City relies on *Gatewood v. Board of Retirement* (1985)175 Cal.App.3d 311, 321 ("*Gatewood*")(change in statutory definition of disability valid, but writ issued because evidence did not support finding that disability was not service-connected), for the proposition that a statutory change that alters only eligibility requirements "to restore the original purpose of disability retirements" is therefore valid. (City's Post-Trial Brief, at 41:9-12.) *Gatewood*, although it is helpful to the City, does not stand for such a broad proposition. In that case, the change in the statutory definition of eligibility resulted only in a "semantic, not substantive" difference. *Gatewood, supra*, 175 Cal.App.3d at 316. The City does not, and could not, argue that the eligibility changes in section 1509-A are merely "semantic". What is instructive about *Gatewood* is the alternative analysis under the *Allen/Board* test: that "any modification of pension rights (1) must be reasonable, (2) must bear a material relation to the theory and successful operation of the pension system, and (3) when resulting in disadvantage to employees, must also afford comparable new advantages." *Id.*, at 320. The constitutionally permissible modification in *Gatewood*, like section 1509-A, "does not eliminate service-connected disability pensions; nor does it reduce benefits." *Id.*, at 321. The question here is whether section 1509-A "reasonably refine[s] the threshold criteria for award of a service-connected disability" (*id.*), because it has a material relationship to the successful operation of the system and offers comparable new advantages.

The eligibility changes in section 1509-A are reasonable and related to the successful operation of the system. (Exhibit 5103, at SJ001559-66.) Over time, employees were not placed in alternative positions, thus creating the anomaly, noted by the Auditor, of City employees, retired for disability on substantial pensions, who were still able to work. (*Id.*) The report recommended that the eligibility criteria for disability retirement be modified to provide benefits "to those employees who are incapable of engaging in any gainful employment." (*Id.*, at 1566.)

Section 1509-A also provides a countervailing advantage: a decrease in the amount of

time the employee must be disabled before being eligible for retirement – from "permanent" or "at least until the disabled person attains the age of fifty-five (55) years" to "at least one year" (compare Exhibit 5216 at SJRJN000065 (Charter Section 1504(d)) to Exhibit 5216 at SJRJN000074 (Measure B, Section 1509-A(b)(iii))). Although the City contends that there is another countervailing advantage in the language that it "may" provide contributions to long-term disability insurance for work-related injuries (Exhibit 5216 at SJRJN000074 (Section 1509 A(d))), that discretionary term offers only a possible benefit which is not sufficient. *Teachers Retirement Board v. Genest* (2007) 154 Cal.App.4th 1012, 1037-38 ("*Genest*").

Plaintiffs argued that the "advantage" of reducing the waiting period for eligibility is "meager" and may not apply in every case. (POA Post-Trial Brief, at 17:10-17.) However, the analysis does not require that a new advantage be equivalent: "a precise dollar balance between benefit and detriment" is not necessary. *Frank, supra*, 56 Cal.App.3d at 244. "It is enough that a modification does not frustrate the reasonable expectations of the parties to the contract of employment." *Lyon v. Flournoy* (1969) 271 Cal.App.2d 774, 782. This is, of course, consistent with the notion that, prior to retirement, "the employee does not have a right to any fixed or definite benefits but only to a substantial or reasonable pension." *Wallace v. City of Fresno* (1954) 42 Cal.22 180, 183.

After the Tentative Decision, Plaintiffs argued that the "countervailing advantage" doctrine is not satisfied, even in the case of a facial challenge, unless there is a new advantage *for each and every employee*. In this regard, Plaintiffs rely on *Wisley v. City of San Diego* (1961) 188 Cal.App.2d 482, 486, which was an action by individuals to recover excess salary deductions and not a facial challenge. Plaintiffs have turned on its head the controlling principle in a facial challenge such as this one: it is not the City's burden to show that every employee will receive a new advantage, but rather Plaintiffs who "must demonstrate that the act's provisions inevitably pose a present total and fatal conflict with applicable constitutional prohibitions." *Tobe, supra,* 9 Cal.4th at 1084.

Section 1509-A is a permissible modification of disability retirement benefits.

F. Section 1510-A: Cost of Living Adjustments

Section 1510-A provides that, if the Council adopts a resolution declaring "a fiscal and service level emergency", the City may, for a period of up to five years, suspend all or part of the COLA payments due to all retirees. If the Council later determines that "the fiscal emergency has eased sufficiently to permit the City to provide essential services", it shall restore COLAs—*prospectively only*. If all or part of the COLA is restored, it shall not exceed 3% for current retirees and current employees and 1.5% for employees who are in VEP or Tier 2.

Plaintiffs challenge this provision on the ground that it impairs a vested right to COLA payments. The evidence at trial establishes such a vested right:

- In April 1970, the City Council passed Ordinance No. 15118 (Exhibit 606 at REA000445-000473) enacting SJMC Chapter 9, Article II, Part 6, which provided COLAs for retirement allowances and survivorship allowances based upon percentage changes in the applicable Consumer Price Index. (Exhibit 606 at REA000448.) Prior to 2006, the SJMC provided for an annual COLA based upon the percentage increase in the applicable Consumer Price Index published by the United States Department of Labor with a "cap" of three percent. (Exhibit 606 at REA000447.)

- In February 2006, the City Council passed Ordinance No. 27652, adding SJMC Section 3.44.160, which provided for fixed three-percent annual COLAs. (Exhibit 630, REA000561.) Section 3.44.160 of the current SJMC states in pertinent part at paragraph (a)(1):

> Each retirement allowance and each survivorship allowance which is payable under Chapter 3.24 or Chapter 3.28 in any subject year which begins on or after April 1, 2006, together with any increases or decreases in the amount of any such allowance which were previously made pursuant to this Chapter 3.44, shall be increased by three percent per annum in lieu of the increase otherwise provided in this chapter. The first such three percent increase shall be made on April 1, 2006. (Exhibit 602, REA000441)

- Throughout this entire time, employees funded a portion of this COLA benefit by paying contributions that, in part, were designed to fund an annual three-percent COLA. Even prior to the passage of Ordinance No. 27652, the employees' contribution rate attributable to the COLA was based on an actuarial assumption that the COLA would increase 3% annually. (RT

353:12-24; see also, Exhibit 651 at REA000781, which shows that employees contributed 1.61% of their income towards COLAs.)

The City does not argue that there is no vested right to COLA payments, but responds that the issue is not ripe for adjudication, and that the section is not invalid because it does not prohibit the City from paying back suspended payments when the Council determines the emergency is over. Furthermore, the City argues, even vested rights may be suspended in an emergency, relying on *Valdes v. Cory* (1983) 139 Cal.App.3d 773, 790-91 ("*Valdes*").

The City's ripeness argument is not well taken. The City cites *San Bernardino Public Employees Ass'n v. City of Fontana* (1998) 67 Cal.App.4th 1215, 1226, for the proposition that "where the City has not yet modified retirement benefits, the matter is not ripe for review" (City's Post-Trial Brief, at 43:19-20). However, here the City has modified benefits, in the form of Measure B. The City's claim is not well taken that Plaintiffs may not challenge this provision until the City has declared an emergency and then failed to exercise its discretion to make payments it had been obligated to make. *Genest*, *supra*, 154 Cal.App.4th at 1037-38.

The City argues that *Valdes* supports the notion that vested rights can be suspended in an emergency. There are several difficulties with this argument. First, the holding in *Valdes* does not support this proposition, since in that case the Court of Appeal issued peremptory writs directing the State to fulfill its obligations under the pension system despite legislative direction that payments not be made: "We therefore conclude the state has failed to meet its burden of demonstrating that the impairment of petitioners' rights is warranted by an 'emergency' serving to protect a 'basic interest of society.'" *Valdes, supra*, 139 Cal.App.3d at 791. Second, Section 1510-A does not require an emergency to impair these vested rights, but simply a Council resolution declaring an emergency. *Sonoma County Organization for Public Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 311 (Supreme Court issued writ directing local entities to pay salary increases despite their contention that the existence of a fiscal emergency allowed them to avoid such obligations: it is "always open to judicial inquiry" whether an emergency exists (quoting *Home Building & Loan Ass'n v. Blaisdell* (1934) 290 U.S. 398, 442)). Third, Section 1510-A does not merely suspend or defer benefits: it gives the City the authority to

withhold them altogether. One of the *Valdes* factors to be considered in evaluating whether a legislative impairment of vested rights may be warranted on grounds of necessity, is that: "the enactment is designed as a temporary measure, during which time the vested contract rights are not lost but merely deferred for a brief period, interest running during the temporary deferment." *Valdes*, 139 Cal.App.3d at 790-91, quoting *Olson v. Cory* (1980) 27 Cal.3d 532, 539. In authorizing denial of benefits rather than mere deferral, Section 1510-A exceeds the scope of what *Valdes* contemplates as potentially allowable.

Accordingly, Section 1510-A is unlawful and invalid.

G. <u>Section 1511-A: Supplemental Retiree Benefit Reserve</u>

Section 1511-A discontinues the Supplemental Retiree Benefit Reserve ("SRBR"), and returns its assets "to the appropriate retirement trust fund." It further provides that "[a]ny supplemental payments to retirees in addition to the benefits authorized herein shall not be funded from plan assets."

The Municipal Code provides for two SRBR plans (Exhibits 5302 and 5303): one in the Federated plan (SJMC 3.28.340), and one in the Police and Fire Plan (SJMC 3.36.580). The purpose of the SRBR was to provide a source of funding for supplemental benefits. (SJMC 3.28.340(E)(1); 3.36.580.)

The City contends that SRBR distributions are within the discretion of the City, and therefore there can be no vested rights to such distributions and the SRBR may properly be eliminated. Plaintiffs claim that a vested right does exist because distributions from the Fire and Police Plan are mandatory, not discretionary, and that in any event discretion under the Federated Plan to authorize distributions does not warrant elimination of the SRBR altogether. AFSCME and REA make a further argument that section 1511-A violates the Pension Protection Act (California Constitution, article XVI, section 17).

As a preliminary matter, the Court rejects Plaintiffs' challenge with respect to any retiree who "retired prior to the effective date" when the SRBR program came into effect. *Claypool, supra,* 4 Cal.App.4th at 660. There could not possibly be a vested right with respect to such

retirees because they did not perform any work that could possibly create a right to the benefit. *Id.*

With respect to other employees, the Court has considered both the language and the history of these Municipal Code provisions. When the Federated SRBR was initially established in 1986, the reserve was designed to allow "the retirees [to] benefit when the money in the fund [of the retirement system] grows because of superior investment performance." (Exhibit 5701 at SJRJN000493; see also Exhibit 5719.) At that time, the Federated System was fully funded (Exhibit 5700): the concept was that adjustments would be made "based on ...the availability of funds in the retirement system" and the reserve was to be funded by "excess earnings". (Exhibit 5701.) Likewise, when the Police and Fire SRBR was established in 2001, the system was fully funded. (Exhibit 6030.)

Excess earnings are, however, not "free", as both actuarial experts agreed at trial. (RT 296 (Lowman) and 965 (Bartel).) "Skimming" excess assets when earnings are high and not returning funds in years in which the system has losses, does in fact have a cost to the system. (RT at 286-87 (Lowman); 964-65 (Bartel).) That cost was not taken into account until 2011 when actuaries assigned and subtracted a cost for the SRBR. (RT at 290-92 (Lowman); 967-68, 971-72 (Bartel).)

The terms of the Federated SRBR reserve to the Council discretion to determine whether any distributions will be made at all (SJMC Section 3.28.340(E)(2)):

> Upon request of the city council or on its own motion, the board **may** make recommendations to the city council regarding the distribution, **if any**, of the supplemental retiree benefit reserve to retired members, survivors of members, and survivors or retired members. The city council, after consideration of the recommendation of the board, **shall determine** the distribution, **if any**, of the supplemental retiree benefit reserve to said persons. (Emphasis added.)

Indeed, from 1986 to 1999, the Council did not authorize any SRBR distributions to retirees, but used the SRBR funds to pay for other retirement benefits and considered eliminating SRBR if it became unable to fund new benefits. (Exhibits 5703 and 5704.)

Starting during the technology bubble in 2000 and until 2009, the Council did authorize distributions. Also during that time, a SRBR was established for the Police and Fire Plan, for

employees receiving benefits effective June 30, 2001. (Exhibit 5303, at Section 3.36.580(D)(3).) The board was directed to develop a methodology for distributions: "[u]pon approval of the methodology by the city council, the board shall make distributions in accordance with such methodology." (*Id.*, at Section 3.36.580(D)(5).) The plan contemplated that there are circumstances in which distributions shall not be made. (*Id.*, at Section 3.36.580(D)(6): "[T]he board shall not transfer or distribute funds in the SRBR if such transfer or distribution would reduce the SRBR principal.")

In 2010, SRBR distributions ceased and have not resumed. (See Section 3.36.580(D)(2), directing that distributions shall not be made in 2010, 2011, 2012 or 2013 prior to June 30, 2013.) The Council approved the suspension of distributions beginning in 2010 because of significant unfunded liabilities. (Exhibits 5707-5709, 5717, 5718.)

Based on this history, Plaintiffs argue that even though the Federated Plan expressly reserves to the Council the discretion to make any distribution at all, the City does not have discretion to eliminate the SRBR altogether. In essence, Plaintiffs argue that they have a vested right to the existence of a segregated reserve which is not required to be distributed. Plaintiffs do not identify any statutory language that would support such an illogical result.

While Plaintiffs cite the requirement of SJMC 3.28.070(B)(4) that assets of the SRBR must be allocated to members when the fund is terminated, they do not, and cannot, contend that upon discontinuance of the SRBR, those funds will be used for any purpose other than the retirement system. To the contrary, Section 1511-A expressly provides that "the assets [of the SRBR shall be] returned to the appropriate retirement trust fund." Plaintiffs claim instead that it is unconstitutional for the City to use the SRBR assets to "offset what it would have otherwise been required to pay into the retirement system for that year." (AFSCME Post-Trial Brief, at 20:24-25.) But using the funds for the retirement system is not the same as using the funds "to [the City's] own advantage" (*id.*, at 20:25)—given that there is no right to distribution of the funds as SRBR benefits. *Claypool*, *supra*, 4 Cal.App.4th at 660-61 (funds which offset employer

obligations are nevertheless committed to fund pension benefits). Plaintiffs have failed to establish a vested right to the existence of a SRBR under the Federated Plan.

The related argument based on the Pension Protection Act fares no better. That statute provides that the assets of a pension fund shall be held for the exclusive purpose of providing benefits and defraying expenses of the system. The evidence at trial showed that the SRBR was not a separate "trust" but rather a reserve, and the funds remain available for the benefit of retirees in an "appropriate retirement trust fund." (Section 1511-A.) *Claypool*, 4 Cal.App.4th at 674 (using former supplemental COLA funds to reduce employer contributions to PERS did not violate Cal. Const., art. XVI, § 17, where the funds "continue to be 'held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system'"). The fact that this transfer of funds could lead to a decrease in the City's contribution rates is not equivalent to use of fund assets for an improper purpose. The record does not show a violation of the Pension Protection Act.

The language in the Police and Fire Plan is materially different from the Federated Plan. The POA points out that the only element of discretion reserved to the City in the Police and Fire Plan is to approve the board's methodology, which the City did in 2002, and so now nothing is left but for the board to make distributions. The City's contention that "no retiree [under the Police and Fire SRBR] was guaranteed … any payment at all" (City's Post-Trial Brief, at 49:16) is contrary to the language of the Municipal Code.

The City argues, in the alternative, that even if there is a vested right to SRBR distributions under the Police and Fire Plan, Section 1511-A is still valid because it remedies "unforeseen burdens" of the SRBR. "Constitutional decisions 'have never given a law which imposes unforeseen advantages or burdens on a contracting party constitutional immunity against change.'" *Allen/Board, supra,* 34 Cal.3d at 120 (quoting *Simmons*, *supra*, 379 U.S. at 515). *Allen/Board* concerned a 1947 statute by which legislators' pension COLAs were tied to the pay of current legislators. Then, in 1966, when legislative salaries increased dramatically

with the transition to a full-time legislature, a new law removed the COLA link to current salaries and replaced it with a COLA based on CPI. The Supreme Court held that the 1966 revision was valid notwithstanding vested rights under the 1947 law, because of the unforeseen burdens on the state and undue windfall to retirees of COLA payments based on greatly increased salaries never earned by members not in office but not yet retired in 1966.

Plaintiffs respond that there is no "unintended consequence" because the City itself enacted the SRBR. (POA Post-Trial Brief, at 23:3-4.) This argument fails to justify why the rule should not be applied here: if the City had foreseen the unintended consequence of the SRBR "skimming", it could have written around it, but the same, of course, is true for the failure of the legislature in 1947 to draft around a major increase in incumbent salaries. Plaintiffs further argue that there is no evidence that the parties had a reasonable expectation that the SRBR would be abolished rather than amended. (*Id.*, at 23:21-22.) This argument misses the point: the record evidence shows that the reserve was established at a time when the system was fully funded, and the actuaries did not factor in the cost of the "skimming" until years later. The SRBR was, by its terms, intended to apply to "superior investment performance" by the system—and not to a fund with billions in unfunded liabilities. Finally, Plaintiffs argue that "[e]ven the plaintiffs in *Allen[/Board]* received a comparable new benefit" (id., at 23:23-24)--but *Allen/Board* does not describe the alternative statutory formulation in those terms, nor does it hold that this is a requirement under the "unforeseen burden" doctrine.

For these reasons, there is no constitutional impediment to Section 1511-A.

H. <u>Section 1512-A: Retiree Healthcare</u>

1. <u>Minimum Contributions</u>

Section 1512-A(a) provides: "Existing and new employees must contribute a minimum of 50% of the cost of retiree healthcare, including both normal cost and unfunded liabilities."

With respect to the final phrase of the section relating to the specific inclusion of unfunded liabilities in the cost of retiree healthcare, the City correctly argues that Plaintiffs have not met the heavy burden under *REAOC* to establish an implied vested right. The Municipal

Code does not grant employees protection against contribution to unfunded liabilities relating to healthcare benefits (SJMC 3.28.385(C) and 3.36.575(D)). Moreover, the conduct of the parties negates such an implied right: the evidence presented at trial through Mr. Lowman and Mr. Gurza showed that employees have contributed for years to unfunded liabilities for healthcare benefits. (RT 793-794, 853-854; Exhibits 5501-5502, 5504-5508.) The stipulation concerning the effective date of Section 1512-A renders ineffective POA's argument that there has been a violation of the MOA (which will expire before the stipulated effective date).

The City does not argue that there is no vested right in the "one to one" ratio, but instead claims that this section "simply moved the existing 'one to one' funding ratio from the Municipal Code into the Charter." (City's Post-Trial Brief, at 54:9-10.) However, this argument is at odds with the plain language of Measure B: it ignores "a minimum of"—which clearly would authorize an employee contribution requirement greater than 50%, which in turn impairs the vested right to have the City pay "one to one".

At the hearing following the responses to the Tentative Decision, the City invoked *Borikas v. Alameda Unified School District* (2013) 214 Cal.App.4th 135, 166 ("*Borikas*"), to support an argument made for the first time that the Court should sever out the phrase "a minimum of". Because the City had not previously made this argument, the Court offered Plaintiffs an opportunity to address the argument but none accepted this offer. The Court has now reviewed *Borikas* which involved a taxpayer challenge to a parcel tax and sets forth the law as to severing out phrases or words from invalid statutory language. Here as in *Borikas*, there is statutory language allowing severance: specifically, section 1515-A(a). Such language is persuasive, though not conclusive, evidence of the intent of the enacting body: in this case, the voters. *Borikas*, *supra*, 214 Cal.App.4th at 165. In addition, the parties to this case have explicitly stipulated to severability.

In addition to these factors, the Court has also considered whether the phrase is grammatically and functionally separable. Id., at 166. The phrase "a minimum of" is separable in both aspects. Finally, the Court has considered whether the phrase is also "volitionally

separable". Id., at 167. Given the record evidence concerning the history of the relevant charter sections and the statements of findings and intent in Measure B itself, Section 1512-A(a) without the subject phrase "reflects a 'substantial' portion of the electorate's purpose" (id., quoting *Gerken v. Fair Political Practices Com.* (1993) 6 Cal.4th 707, 715), and can and should be saved.

Accordingly, the phrase "a minimum of" is severed and section 1512-A(a) is otherwise valid.

2. Reservation of Rights

Section 1512-A(b) provides: "No retiree healthcare plan or benefit shall grant any vested right, as the City retains its power to amend, change or terminate any plan provisions."

REA argues that this section is invalid because it makes unvested rights out of vested rights: specifically, "the right to health care and dental coverage and premium contributions". (REA Post-Trial Brief, at 16:17-19.) This assertion overlooks the precise language in Section 1512-A(b): i.e., that no *plan* or *benefit* shall create a vested right.

Plaintiffs have not argued, and definitely have not proved, that there is a vested right to a particular plan or a particular benefit, as distinct from a vested right to health care and dental coverage in general. The City is correct that "[t]his section does not change the status quo, but rather (1) reflects what vested rights currently exist, since it does not propose to take them away, and (2) declares an intent not to create any new vested rights." (City's Post-Trial Brief, at 57:3-5.)

On this facial challenge, Plaintiffs have failed to prove that there is no application of this section that would be legal. Accordingly, the challenge to this section fails.

3. Low Cost Plan

Section 1512-A(c) provides: "For purposes of retiree healthcare benefits, 'low cost plan' shall be defined as the medical plan which has been the lowest monthly premium available to any active employee in either the Police and Fire Department Retirement Plan or Federated City Employees' Retirement System."

The previous "low cost plan" terms for retiree healthcare benefits under the Federated

Plan and the Police and Fire Plan involve different language and different histories, and so are analyzed separately.

a. *Federated Plan*

Retiree health benefits under the Federated Plan are governed by SJMC 3.28.1980B(1):

> The portion of the premium to be paid from the medical benefits account, or trust fund established by Chapter 3.52, shall be the portion that represents an amount equivalent to **the lowest of the premiums for single or family medical insurance coverage**, for which the member or survivor is eligible and in which the member or survivor enrolls under the provisions of this part, **which is available to an employee of the city** at such time as said premium is due and owing. [Emphases added.]

Plaintiffs advance two arguments as to how Section 1512-A(c) violates a vested right. First, they argue that "members were vested in their right to retiree healthcare free of high deductibles or exorbitant costs" (AFSCME Post-Trial Brief, at 35:13-14): i.e., a vested right to a particular plan. However, the City is correct that plaintiffs had not met their high burden under *REAOC* to provide "clear" and "unmistakable" evidence of an implied vested right preventing the City from changing plan designs.

Plaintiffs also argue that the prior language contained an additional limitation that Section 1512-A(c) lacks: specifically, that the lowest cost plan must be one "for which the member or survivor is eligible". (AFSCME Post-Trial Brief, at 35:26-36:8.) Plaintiffs explain that this omission is significant because, under the new language, the member may not be eligible for the lowest cost plan and therefore would not have an option to choose a plan that is fully paid for.

In its post-trial brief, the City addressed only the first argument and not this one. (City's Post-Trial Brief, at 59:5-7.) On January 31, 2014, at the post-Tentative Decision hearing, the City presented a "Revised Request for Different Statement of Decision", raising new arguments on this issue. AFSCME addressed the City's Revised Request orally at the hearing, and initially declined but later accepted the Court's request that AFSCME's position be stated in a supplemental brief, which was filed on February 4, 2014. The City responded by letter dated February 11, 2014.

The phrase "for which the member or survivor is eligible" in SJMC 3.28.1980B(1)

modifies "coverage"—not a particular benefit plan. The word "plan" (referring to a plan of medical coverage, as distinct from the Federated "Plan") does not appear in the code section. Eligibility for coverage, as described in SJMC 3.28.1970A and B, does not relate to a specific benefit plan and is not evaluated by the status of benefit plans at the time of an individual's retirement. The contrary interpretation would effectively give an employee or retiree a vested right to a particular benefit plan, which, as explained above, is not supported by the evidence.

Accordingly, with respect to the Federated Plan, Section 1512-A(c) does not impair a vested right and is valid.

b. *Police and Fire Plan*

Implemented on July 27, 1984, Ordinance 21686 (Exhibit 6, former SJMC 3.36.1930) provided that police and fire employees were entitled to retiree healthcare benefits with payment of premiums "in the same amount as is currently paid by an employee of the City in the classification from which the member retired." Ordinance 25615, the pre-Measure B version of SJMC 3.36.1930, was implemented on July 31, 1998, and provided:

> For the purposes of this section, "lowest cost medical plan" means that medical plan (single or family coverage as applicable to the coverage selected by the member, former member or survivor):
> 1. Which is an eligible medical plan as defined in Section 3.36.1940; and
> 2. Which has the **lowest monthly premium of all eligible medical plans then in effect**, determined as of the time the premium is due and owing. [Emphasis added.]

Plaintiffs argue that this language creates "an *express* vested right to the lowest cost plan available to any city employee and an *implied* vested right to the lowest cost plan available to Police Officers." (POA Post-Trial Brief, at 25:13-15 (emphasis in original).) The City does not dispute the former. Plaintiffs claim that the implied vested right was established by course of conduct and the 1997 Bogue arbitration award which resulted in the revision to the SJMC.

Neither of these bases provides the "clear" and "unmistakable" evidence required under *REAOC*. The POA cites language from the Bogue award which does not specify comparability to active police officers as opposed to active city employees (POA Post-Trial Brief, at 26:18-23; Exhibit 35), so that award provides no basis for an implied right. Similarly, SJMC 3.36.1930,

amended "to implement the Bogue arbitration decision" also contains no indication that the "lowest cost medical plan" refers only to police and fire employees, but instead refers generally to "the lowest monthly premium of all eligible medical plans then in effect". (POA Post-Trial Brief, at 26:24-27:3.) The POA claims that the revised code section is "ambiguous" because the ordinance relates only to police and fire employees. But the logical inference to be drawn from the *deletion* of the prior language specifically establishing that the baseline was police officer benefits ("in the classification from which the member retired") and its replacement with more general language ("all eligible medical plans then in effect") negates the existence of an implied right.

The "course of conduct" argument relies on testimony by retiring officers that they understood their benefits would be tied to those of active officers, but such understanding is not persuasive proof of a course of conduct by the City. More persuasive is the fact that no one from the City told Officer Fehr that his benefit would be tied to the "lowest cost plan" for active officers as opposed to active City employees. (RT 92-93.) The fact that actuarial reports (Exhibits 15-18 and 23) and benefit sheets that related only to the police and fire retirement system did not refer to other employees not covered by that system is of little significance. Lastly, Plaintiffs rely on Exhibit 51, a memorandum from City Manager Debra Figone, as a representation that retiree healthcare benefits are vested rights, but that sheds no light on the specific question of whether the "lowest cost plan" is tied to all City employees or only police and fire employees.

Plaintiffs rely on two pleading cases for general propositions concerning evidence that may bear on implied rights. *Requa v. Regents of the University of California* (2012) 213 Cal.App.4th 213; *International Brotherhood of Electrical Workers, Local 1245 v.City of Redding* (2012) 210 Cal.App.4th 1114. However, applying the evidentiary standard specified in *REAOC*, Plaintiffs have failed to meet their burden that such an implied right exists. See also *Sappington v. Orange Unified School Dist.* (2004) 119 Cal.App.4th 949, 953 ("Generous benefits that exceed what is promised in a contract are just that: generous. They reflect a magnanimous spirit, not a

contractual mandate.").

Therefore, with respect to the Police and Fire Plan, Section 1512-A(c) does not impair a vested right and is valid.

I. Section 1513-A: Actuarial Soundness

Section 1513-A requires that pension plans be actuarially sound, minimize risks to the City and its residents, and be prudent and reasonable in light of economic climate, among other things. Plaintiffs assert a facial challenge that this section violates the state Pension Protection Act because it requires the retirement boards to consider the interest of "taxpayers with respect to the costs of the plans" (Section 1513-A(c)(ii).) They contend that the Pension Protection Act requires retirement boards to keep paramount the interests of retirees and beneficiaries.

However, the record includes ordinances stating that the actuarial soundness of the Federated and Police and Fire Plans is to be determined consistent with the Pension Protection Act. (Exhibits 5300, 5301.) Thus, Plaintiffs have not shown that this section inevitably poses a "present total and fatal conflict" with the Constitution. *Tobe, supra,* 9 Cal.4th at 1084. Plaintiffs have not met their burden of proof that Section 1512-A is invalid under any cause of action.

J. Section 1514-A : Alternative of Wage Reduction

Section 1514-A provides that, in the event that the Court determines that Section 1506-A(b) is "illegal, invalid or unenforceable", then the City may accomplish equivalent savings through pay reduction.

Plaintiffs do not dispute that the City has plenary authority to control employee compensation. Instead, they contend that this provision violates their constitutional rights to free speech and petition because it threatens to reduce "salaries to dissuade successful legal challenges." (POA Post-Trial Brief, at 47:16.)

The logic of Plaintiffs' argument is lacking. Section 1514-A does not impose "a cost or risk upon the exercise of a right to a hearing… [that] has no other purpose or effect than to chill the assertion of constitutional rights by penalizing those who choose to exercise them." *California Teachers Ass'n v. State of California* (1999) 20 Cal.4th 327, 338 (imposition of half

the cost of administrative hearing to determine propriety of employment termination chilled right of teacher to have such hearing). It simply recites what is already the law: that the City may adjust employee compensation "to the maximum extent permitted by law". Section 1514-A. Plaintiffs' challenge is unavailing.

K. Section 1515-A: Severability

Section 1515-A provides a general severability clause, stating at subsection (b) that if "any ordinance adopted" pursuant to Measure B is "held to be invalid, unconstitutional or otherwise unenforceable by a final judgment, the matter shall be referred to the City Council for determination as to whether to amend the ordinance consistent with the judgment, or whether to determine the section severable and ineffective."

Plaintiffs contend that this section violates the separation of powers doctrine because it is the role of the courts, not the Council, to determine whether "the section is severable and ineffective." However, this argument elevates form over substance. The language addresses a circumstance in which a court has entered a judgment, and provides that the Council shall then determine, essentially, whether to revise the ordinance or to treat it as ineffective. Nothing in this language is inconsistent with the common practice of letting government defendants exercise discretion in complying with judgments. *Common Cause v. Board of Supervisors* (1989) 49 Cal.3d 432, 445-446 ("although a court may issue a writ of mandate requiring legislative or executive action to conform to the law, it may not substitute its discretion for that of legislative or executive bodies in matters committed to the discretion of those branches").

Plaintiffs have not met their burden of proof to show that Section 1515-A is invalid under any cause of action.

L. Additional Causes of Action

1. Equitable and Promissory Estoppel

AFSCME asserts an "equitable estoppel" claim, which requires proof of: "(1) a representation or concealment of material facts (2) made with knowledge, actual or virtual, of the true facts (3) to a party ignorant, actually and permissibly, of the truth (4) with the intention,

actual or virtual, that the latter act upon it and (5) that the party actually was induced to act upon it." *Walsh, supra,* 4 Cal.App.4th at 709.

AFSCME did not meet this burden. First, since AFSCME is relying on statements made outside City ordinances, promissory estoppel will not lie, because in San Jose, the Charter requires that retirement plans must be enacted by ordinance. City Charter Section 1500; *San Diego City Firefighters, Local 145 v. Bd. of Admin. of San Diego City Emples. Ret. Sys.* (2012) 206 Cal.App.4th 594, 610-11 ("When there has been no compliance with the relevant charter provision, the city may not be liable in quasi-contract and will not be estopped to deny the validity of the contract."). Similarly, there is no viable claim for estoppel when the agency making the statement has no authority to grant the benefits promised. *Medina v. Board of Retirement* (2013) 112 Cal.App.4th 864, 869. AFSCME did not offer any evidence that the City departments that issued various booklets and flyers had any authority to enlarge City retirement benefits.

But in any event, AFSCME did not prove at trial that the City misrepresented any fact, or that anyone was actually induced to act. In particular, ASFCME did not establish that any of its witnesses accepted employment and continued working for the City based on any misrepresentation about benefits. Jeffrey Rhoads could not cite to any other job with better pay, or with better benefits, that he had been offered but had rejected in preference for his City job. (RT 114-118.) Margaret Martinez testified that her own private understanding of Exhibit 51, the 2008 Figone memorandum, was that the City was not planning to change healthcare benefits, but she did not claim to have continued employment, or given up more lucrative employment, based on the memorandum. (RT 322-333.) Even if they had testified as to detrimental reliance, their testimony would not establish a basis for any relief for AFSCME.

Based on the evidence at trial, AFSCME did not prove its claim for promissory and equitable estoppel.

2. Bane Act

Both the POA and AFSCME have asserted a violation of the Bane Act, California Civil

Code section 52.1 ("Section 52.1" or "Bane Act"), to "seek redress in the Superior Court for violation of constitutional rights." Neither argued this claim in their post-trial briefs, and they did not prove this cause of action at trial.

First, AFSCME and POA do not have standing because Section 52.1 "is limited to plaintiffs who themselves have been the subject of violence or threats." *Bay Area Rapid Transit Dist. v. Superior Court* (1995) 38 Cal.App.4th 141, 142, 144. There is no statutory authority or precedent for conferring associational standing for Section 52.1 claims.

Second, Section 52.1 is not a vehicle for redress of constitutional harms. A constitutional violation on its own – without the requisite threat, intimidation, or coercion – does not implicate Section 52.1. *Shoyoye v. County of Los Angeles* (2012) 203 Cal.App.4th 947, 957, 959 ("in pursuing relief for those constitutional violations under section 52.1," plaintiffs must allege the acts "were accompanied by the requisite threats, intimidation, or coercion").

Third, Plaintiffs did not offer any testimony of physical, verbal or written threats or intimidation. They claim coercion because they may be forced to choose between paying more for an existing pension plan or accepting an inferior plan. That would be an economic choice, not the egregious "coercion" contemplated by Section 52.1. *City and County of San Francisco v. Ballard* (2006) 136 Cal.App.4th 381, 408 (where plaintiff alleged City coerced him by threatening to impose $15 million in penalties and "partial demolition" of his building if he did not perform "unrequired construction", the court found he had "not alleged and the record does not establish any conduct that rises to the level of a threat of violence or coercion" under Section 52.1).

Based on the evidence at trial, AFSCME and the POA have not proven a violation of the Bane Act under any of their causes of action.

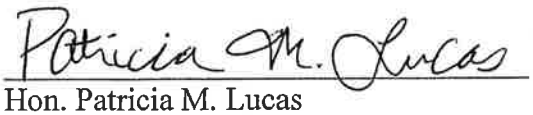
M. <u>City's Cross-Complaint for Declaratory Relief</u>

The City filed a cross-complaint seeking a declaration that certain provisions of Measure B are lawful under the Federal Constitution. However, the City has not argued that federal law applies to require a different outcome, and in any event, given the foregoing, this Court exercises

its discretion to find that the relief requested is "not necessary or proper … under all the circumstances." *Meyer v. Sprint Spectrum* (2009) 45 Cal.4th 634, 647.

Plaintiffs are ordered to prepare a form of judgment consistent with this decision.

Dated: February 19, 2014



Hon. Patricia M. Lucas
Judge of the Superior Court

IN THE SUPERIOR COURT OF CALIFORNIA IN AND FOR THE COUNTY OF SANTA CLARA	**Endorsed F I L E D** Date: February 20, 2014 DAVID YAMASAKI Chief Executive Officer Clerk Superior Court of CA County of Santa Clara
In Re the Matter of: San Jose Police Officers' Association VS City of San Jose, et al	By: Ann Vizconde Ann Vizconde, Deputy
PROOF OF SERVICE BY MAIL OF: Statement of Decision	**Case Number:** 1-11-CV 211989

CLERK'S CERTIFICATE OF SERVICE: I certify that I am not a party to this case and that a true copy of this document was mailed first class, postage fully prepaid, in a sealed envelope addressed as shown below and the document was mailed at SAN JOSE, CALIFORNIA on: February 20, 2014

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