Court Of Appeal Rejects Orange County’s Claim That 2001 Pension Benefit Violated California Constitution

By William F. Kay

Like many public agencies from the late 1990’s to 2002, Orange County negotiated an improvement in pension benefits with the union representing the county’s deputy sheriffs. In 2001 the pension formula was enhanced to 3% at 50, based on the highest year of pay.

The new formula applied to “all years of service” for current employees, including years of service prior to the new formula. The agreement was accompanied by an actuarial report projecting the prior year’s application would increase the county’s unfunded actuarial liability by $100M. In 2007 the pension fund’s actuary projected the unfunded liability at $187M, even though there had been no change in benefits since 2002.

In 2008, the county sued the Orange County Employees’ Retirement System (OCERS) and the deputy sheriffs association, claiming that the prior service credit was unconstitutional because:

- The retirement formula violated the California Constitution’s municipal debt limitation (Article XVI, section 18, subdivision (a)), by creating an immediate and legally enforceable debt or liability of $100 million, which exceeded the county’s available unappropriated funds for the year, without a vote of the citizens; and
- The prior service portion violated the California Constitution’s prohibition against the payment of extra compensation to public employees (Article XI, section 10), because the retroactive portion granted extra compensation to public employees after service had been rendered.

The Court of Appeal rejected both county claims.¹
Court Of Appeal Decision

Answering the question of whether the county violated the debt limitation without obtaining voter approval, the Court determined that the actuarial projection did not constitute “indebtedness” or “liability” within the meaning of the Constitution. Instead, it was an actuarial calculation that varied and that might or might not prove accurate depending upon the actual future events and experience.

Considering the second question of whether prior service credit violated the Constitution’s prohibition against extra compensation, the Court noted that no prior California court had applied this section to pension benefits. In addition, the Court confirmed prior decisions that pension benefits are vested at the time of initial employment plus any benefits conferred during the employee’s tenure with a public agency. Because these benefits were vested, under California law, they could not be undone once granted. The only exception to the immutability of core pension benefits under California law is when an employer’s change creating a disadvantage for the employee is accompanied by a comparable new advantage.

Important Legal Issues

This case has received substantial attention because of the issues involved and because of the large number of interest groups represented through amicus curiae (“friend of the court”) briefs. In addition to the law firms representing the parties, there were four amici for the county and three for the union. Generally this kind of interest indicates the decision will be appealed to the California Supreme Court.

The Court of Appeal’s decision is notable for a number of reasons:

- The Court determined that a pension’s Unfunded Accrued Actuarial Liability (UAAL) is not a measure of fiscal indebtedness for purposes of the Constitution. “Given the multiple assumptions about the future involved in calculating the OCERS UAAL (investment returns, pay increases, marital status at retirement, retiree and beneficiary life expectancies, salary increases, contribution rates, and inflation), it is clear that the UAAL is a highly variable amount, which may or may not prove accurate depending upon actual future events and experience.”

- The Court relied upon numerous court decisions, Attorney General Opinions, and even the Government Accounting Standards Board (GASB) principles in concluding that unfunded pension liabilities are different from fiscal accounting liabilities.
The Court summarized the current state of the law regarding vesting of pension benefits. Those currently dealing with the topic of vesting of pension benefits may find this legal summary helpful.

The Court noted that the county failed to address the issue of the constitutionality of specific Government Code provisions under the PERL\(^2\) and the CERL\(^3\) that allow increased pension benefits for state employees to be applied to prior years of service.

**Impact On Labor Relations And Pension Negotiations**

Although appeal is likely given the interest and the number of briefs by interest groups, the Court’s decision has several important implications for future negotiations over pension matters.

- First, this case will not allow a rollback of any prior service pension benefits based on the legal theories that granting prior service credit was unconstitutional. Relief from the substantial costs of pensions will need to come from some other avenue.

- Second, this case reviewed and affirmed that core pension benefits vest for current employees at the time of employment. Thus, a public employer may negotiate improvement for current employees, but cannot negotiate any lesser benefits without offsetting that disadvantage with a comparable advantage. The legal principle of vesting substantially limits the scope of bargaining on pension benefits for current employees.

- Third, given the statewide existence of unfunded actuarial liabilities, this case will not be the last. One of the new realities of public employment relations is that elected officials and taxpayer groups will continue to seek legal avenues to address the issue of funding current pension benefits.

- Finally, CALPELRA’s New Labor Relations Academy \(^8\) will address the strategies and options for negotiating pension and retiree medical (OPEB). This Academy is geared to assist those who will be managing bargaining on pensions and OPEB, and will cover the legal limits on the duty to bargain, some of which are reflected in this case.

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\(^1\) *County of Orange v. Association of Orange County Deputy Sheriffs, et. al.* (January 26, 2011, Case No. B218660). ([Decision available here.](#))

\(^2\) California Government Code Section 20000, et. seq.

\(^3\) California Government Code Section 31450, et. seq.
Labor Relations Academy 8 Schedule

February 16, 2011 (Wednesday)
NEW! Academy 8
Negotiating Pension Benefits, Retiree Medical, And Health Benefits
CarrAmerica Conference Center
4400 Rosewood Drive
Pleasanton, California 94588

March 8, 2011 (Tuesday)
NEW! Academy 8
Negotiating Pension Benefits, Retiree Medical, And Health Benefits
Centre At Sycamore Plaza
5000 Clark Avenue
Lakewood, California 90712

Learn more about all of CALPELRA’s Labor Relations Academies and register on-line at CALPELRA’s Web site.

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