SUPREME COURT OF ARIZONA

AMERICAN FEDERATION OF STATE COUNTY AND MUNICIPAL EMPLOYEES, AFL-CIO, LOCAL 2384; et al., Plaintiffs/Appellants, v. CITY OF PHOENIX, et al., Defendants/Appellees.	Arizona Supreme Court No. CV-19-0143-PR Court of Appeals Division One No. 1 CA-CV 18-0027 Maricopa County Superior Court No. CV2014-011778

DEFENDANTS/APPELLEES' SUPPLEMENTAL BRIEF

Colin F. Campbell (004955)
Eric M. Fraser (027241)
Hayleigh S. Crawford (032326)
OSBORN MALEDON, P.A.
2929 North Central Avenue, Ste. 2100
Phoenix, Arizona 85012
(602) 640-9000
ccampbell@omlaw.com
efraser@omlaw.com
hcrawford@omlaw.com

Attorneys for Defendants/Appellees

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES*

Page(s)

Cases

---

* This table does not include the historical statutes cited in the table on pages 4-5.

Constitutional & Charter Provisions

Other Authorities

INTRODUCTION

Both this case (*AFSCME Local 2384*) and *Piccioli v. City of Phoenix* (No. CV-19-0116-PR) present two core issues: (1) whether a one-time, lump-sum cashout for accrued leave at retirement is pensionable "compensation" under the Charter; and (2) if not, whether a mistaken past practice creates a constitutionally protected contractual right under the Pension and Contracts Clauses, Ariz. Const. art. XXIX, § 1 and art. XXV.

For efficiency, the *Piccioli* supplemental brief explains why a one-time, lump-sum retirement cashout for accrued leave is not part of an employee's pensionable compensation under the Charter's plain text. This supplemental brief addresses the members' alternative theory that the City's erroneous past practice creates a constitutionally protected contractual right to continue pension spiking in perpetuity.

ARGUMENT

I. Absent an express right to include accrued leave cashouts in pension calculations under the Charter, neither *Yeazell* nor the Pension Clause apply.

A. *Yeazell* and the Pension Clause protect only the terms and benefits provided in the Charter.

In *Yeazell v. Copins*, this Court held that public employee retirement benefits are contractual rights rather than illegal gratuities. Thirty years later,

Arizona adopted a pension protection clause into the Constitution. Ariz. Const. art. XXIX, § 1. The Pension Clause did two things. First, it codified *Yeazell*'s holding by expressly stating that the Contracts Clause applies to public retirement benefits. Second, it added another layer of protection by prohibiting any diminishment or impairment of public retirement benefits.

In effect, "[t]he pension protection clause enables employees to 'lock in' pension rights that exist when they become employed . . . ." *Underwood v. City of Chicago*, 84 N.E.3d 420, 428, ¶¶ 25-26 (Ill. App. Ct. 2017).[1] But, at the same time, contract principles and the Pension Clause "only protect whatever pension rights [a public employee] has under applicable law," *Cross v. Elected Officials' Ret. Plan*, 234 Ariz. 595, 599, ¶ 9 (App. 2014). And those rights are defined by the "actual terms of the contract or pension." *Underwood*, 84 N.E.3d at 428, ¶¶ 25-26 ("The scope of the pension protection clause's application is 'governed by the actual terms of the contract or pension.'" (citation omitted)). Thus, "without a contractual or statutory

[1] Arizona's pension clause is based on almost identical clauses from Illinois and New York, and Arizona courts often look to those states' caselaw for guidance on the application of our own pension clause. *See, e.g.*, *Fields v. Elected Officials' Ret. Plan*, 234 Ariz. 214, 219, ¶ 28 (2014).

commitment to create a benefit, there is nothing that the pension protection clause can protect." *Id.*; *see also Matthews v. Chicago Transit Auth.*, 51 N.E.3d 753, 771, ¶ 59 (Ill. 2016) ("While the pension protection clause guarantees the vested rights provided in the contract that defines a participant's retirement system membership, it does not change the terms of that contract or the essential nature of the rights it confers.").

In short, the members only "get what the statute or contract that grants the rights expressly says they get." *Underwood*, 84 N.E.3d. at 431, ¶ 39. Here, the Charter sets the terms and benefits of COPERS. It is the City's organic law and binds the City just like the Arizona Constitution binds the State. Because the Charter does not grant the members a right to spike pensions with accrued leave cashouts (*see Piccioli* Supp. Br. at 6-19), neither contract principles nor the Pension Clause protect the practice as a "public retirement system benefit." Ariz. Const. art. XXIX, § 1. (*See also* Defendants/Appellees' Answering Brief, *AFSCME Local 2384 v. City of Phoenix*, No. 1 CA-CV 18-0027 (Ariz. Ct. App. July 5, 2018) (hereafter "City's *AFSCME* Answering Br.") at 59-65.)

B. Unlike the pension cases the members cite, the Charter does not explicitly authorize pension spiking.

Because the Charter does not expressly provide the members with a right to boost their pensions with accrued leave cashouts, these cases differ from *Yeazell* and its progeny. (*See* Defendants/Appellants/Cross-Appellees' Opening Brief, *Piccioli v. City of Phoenix*, No. 1 CA-CV 16-0690 (Ariz. Ct. App. Mar. 31, 2017) at 56-60.) As shown in the table below, this Court has addressed alterations to the benefits of a public pension plan in five cases. But each of those cases involved diminishing the benefits explicitly granted by the retirement plan terms. None of them involved changing administrative practice to bring the plan into compliance with the plan terms.

Case	Plan term at issue	Challenged action
Yeazell v. Copins, 98 Ariz. 109, 111 (1965)	Police Pension Act of 1937 (currently codified at A.R.S. § 9-925) provided that police officer was entitled to pension at rate equal to half of average monthly compensation for one year before retirement.	Legislature amended statute to change pension rate to half of average monthly compensation for five years before retirement.
Norton v. Ariz. Dep't of Public Safety Local Ret. Bd., 150 Ariz. 303, 304-06 (1986)	A.R.S. § 38-849(D) (1983) provided that former employees re-hired within two years could reinstate their PSPRS service credits upon fulfilling certain conditions precedent.	Fund manager refused to reinstate PSPRS service credits of employee who met all requirements under A.R.S. § 38-849(D) (1983).

Thurston v. Judges' Ret. Plan, 179 Ariz. 49, 50 (1994)	A.R.S. § 38-801(C) (1976) provided that surviving spouse of judge was entitled to monthly benefits equal to 1/3 of monthly benefit being paid to judge at death.	Legislature amended statute to increase surviving spouse monthly benefits to 2/3 of monthly benefit being paid to judge at death.
Fields v. Elected Officials' Ret. Plan, 234 Ariz. 214, 217, ¶ 9 (2014)	A.R.S. § 38-818 (1998) provided that elected officials were entitled to permanent benefit increases if investment returns exceeded 9%.	Legislature amended statute to require investment returns above 10.5% before benefit increases would be paid.
Hall v. Elected Officials' Ret. Plan, 241 Ariz. 33, 36-37, ¶¶ 4, 8 (2016)	A.R.S. § 38-810 (1987) set employee share of required annual pension contributions at 7%.	Legislature amended statute to increase employee share of annual pension contributions to lesser of 13% of employee's gross salary or a variable rate.

For those cases to apply, the Phoenix voters would have had to have voted to change COPERS's terms and benefits by amending the charter. The voters made no such changes, however. Instead, the City modified its practice to conform with the controlling provisions of the Charter. For that reason, analytically this case and *Piccioli* are more like *Wade v. Ariz. State Ret. Sys.*, 241 Ariz. 559 (2017) than they are *Yeazell*.

In *Wade*, this Court addressed whether contributions made to the Arizona State Retirement System on behalf of employees were pensionable "compensation" under the relevant pension statute. 241 Ariz. at 560, ¶ 1. Because there had been no change to the express terms of the retirement

plan, *Yeazell* and the Pension Clause simply never came into play. *Wade*, as in this case, simply presented a pure question of statutory interpretation. *See id.* at 563, ¶ 22.

II. Past practice does not give the members an independent vested right to retirement benefits protected by the Pension Clause.

A. The Charter controls what is and is not compensation for pension purposes.

Faced with the Charter's textual limitations, the members urge this Court to hold that the City's past practice can give rise to a constitutionally protected contractual right to continue spiking pensions with accrued leave cashouts in perpetuity. But doing so would contravene settled law and ignore the intent of the taxpayers responsible for paying the pension bill.

The Charter is the first and last word on what is and is not compensation. *See Paddock v. Brisbois*, 35 Ariz. 214, 220-21 (1929). Because the Charter's text is clear, it cannot be varied by contract or with extrinsic evidence of past practice. *See id.*; *Holland v. City of Chicago*, 682 N.E.2d 323, 328 (Ill. App. Ct. 1997) (observing that although "the Pension Code should be liberally construed in favor of the . . . intended group of beneficiaries," that general rule "does not permit this court, under the guise of statutory

construction, to substitute different provisions or to otherwise depart from the plain meaning of the words employed" (citations omitted)).

Even if the Court were to consider extrinsic evidence, however, past practice cannot create a prospective right that conflicts with the Charter. *See, e.g.*, *Paddock*, 35 Ariz. at 221; *City of Countryside v. City of Countryside Police Pension Bd. of Tr.*, 122 N.E.3d 297, 318, ¶ 69 (Ill. App. Ct. 2019) (rejecting argument that City was bound by its prior agreement with unions which purported to alter the statutory pension formula); *Rose v. City of Hayward*, 179 Cal.Rptr. 287 (Ct. App. 1981) (refusing to give legal significance to long-standing administrative interpretation as to pensionability of holiday pay; "where there is no ambiguity in a statute and the administrative interpretation of it is clearly erroneous, even the fact that such administrative interpretation is a longstanding one does not give it legal sanction" (citation omitted)), *disapproved of on other grounds by Noel v. Thrifty Payless, Inc.*, 445 P.3d 626 (Cal. 2019).

To the contrary, the City is authorized and obligated to correct its mistake if its past practice deviated from the Charter. As a matter of law, the City may even recoup money it has already paid in violation of the Charter. *See Cross*, 234 Ariz. at 601, ¶ 15; *see also* Charter ch. XXIV, art. II, § 36

(authorizing the COPERS Board to take legal action to recover overpayments to members). Thus, the City acted well within its legal authority when it *prospectively* corrected its erroneous past practice. *Cf. City of Countryside*, 122 N.E.3d at 321, ¶ 83 ("The pension protection clause does not prevent the court from imposing a remedy to bring the retirees' pensions to the correct level permitted by law existing upon their retirements.").

Offering—even promising—more generous pension benefits than the plan allows does not invoke the Pension Clause. The Charter does not merely set a floor on pension benefits; it is the *only* source of pension benefits. The City cannot, for example, lure a library director from Chicago by promising to double COPERS's benefit ratio from 2% to 4%. That would violate the Charter, and the City would be obligated to correct its mistake. It would not create a constitutional right to receive that pension for the rest of the library director's career. (*See* City's *AFSCME* Answering Br. at 67-69.) *Cf. City of Countryside*, 122 N.E.3d at 318, ¶ 69 ("If the defendants' arguments were correct, then a city administration and the union could agree to grant officers million-dollar-a-year pensions, and future administrations would be helpless but to find some way to fund that largesse for decades, despite the limitations on funding imposed by state law.").

That's not to say the employee would have no remedy. For example, in *Cross v. Elected Officials' Ret. Plan*, 234 Ariz. at 605-07, ¶¶ 36-45, the court allowed the government to recalculate erroneous pension payments, but remanded for a potential equitable estoppel claim about recoupment of previous overpayments. As explained below (Argument § III.D), that's why the City implemented a "snapshot" approach which grandfathers in all unused sick and vacation leave accrued in reliance on the City's mistaken past practice. But that past practice does not trigger the Pension Clause or create a *prospective* right to deviate from the Charter with respect to future leave accrued after the City recognized and fixed its mistake.

The City's past practice should play no role in interpreting the Charter. As a charter city, Phoenix is bound by the Charter in the same way that the state is bound by the constitution. *Paddock*, 35 Ariz. at 220-21; *Kendall v. Malcolm*, 98 Ariz. 329, 334 (1965) ("The charter of a city is its organic law bearing the same relation as the constitution of the state bears to its statutes."). Courts do not mold their interpretation of the Arizona Constitution to fit the practices of the state government. That's exactly backwards. Likewise, the Court should not mold its interpretation of the

Charter to fit the City's past practices, particularly when the City has admitted that its past practice was a mistake.

B. The Court should not follow outlier decisions from Washington, a state without a pension clause.

Relying on two out-of-state cases, the Members urge this Court to adopt a new rule of law that would allow a mistaken administrative practice to create a permanent, vested pension right under the Arizona Constitution. (*Piccioli* Pet. at 20; *AFSCME* Pet. at 17.) But neither case supports this outcome, particularly in Arizona.

First, *Kranker v. Levitt* interpreted an ambiguous pension statute; it did not decide whether past administrative practice can create an independent right beyond the plan's express terms. *See* 327 N.Y.S.2d 259 (Sup. Ct. 1971), *aff'd*, 281 N.E.2d 840 (N.Y. 1972).

Second, *Bowles v. Wash. Dep't of Ret. Sys.*, 847 P.2d 440 (Wash. 1993) is an outlier, and would be unworkable in practice under Arizona's Pension Clause. Although *Bowles* held that employees had a vested right in an administrative practice that conflicted with the explicit terms of the pension plan, that holding is the exception, not the rule. In fact, no other jurisdiction has followed *Bowles* to reach the same conclusion.

Moreover, given Arizona's strong public pension benefits, it is particularly ill-suited to a rule like the one adopted in *Bowles*. (*See* City's *AFSCME* Br. at 70-71.) Unlike Washington, Arizona's constitution explicitly protects public retirement benefits. Thus, in Washington, the government could fix the mistake *prospectively*. But following *Bowles* in Arizona would mean that employees could claim new, *constitutionally protected* and *prospective* pension rights based on every presentation, handbook, and administrative practice that touches on retirement benefits. Arizona's pension clause creates a ratcheting effect: pension benefits for current employees can go up, but can never go down. Allowing a government administrator's mistaken practice to trigger Arizona's ratcheting system would make it practically impossible to administer public retirement systems. Instead, that constitutional ratcheting system should engage only for actual plan terms as adopted by the voters.

III. The City's revised regulations do not impact any vested rights.

Finally, even if past practice could give rise to a vested contractual right to treat lump-sum cashouts for accrued leave as pensionable compensation, the City's revised administrative regulations would not impair those rights because they operate prospectively only. Under revised

AR 2.441 and revised AR 2.18, employees and retirees who relied on the City's past practice will continue to receive the full benefit of any sick and vacation leave accrued prior to the effective date of the revisions.

A. The Pension Clause protects retirement benefits, not employment benefits generally.

The right that the members claim in this case flows from the City's administrative regulations, not the Charter. Consequently, it is a general benefit of employment, *not* a retirement benefit. *Cf. Pisani v. City of Springfield*, 73 N.E.3d 129, 137, ¶ 26 (Ill. App. Ct. 2017) ("Because the vacation buyback provision was in defendant's ordinance instead of in Illinois statutory law, it was not a benefit of the 'contractual relationship' to which the pension protection clause refers."). The Pension Clause does not prevent the City from altering a general employment benefit merely because it may affect the pension an employee will ultimately receive. *See id.*; *see also Gilmore v. City of Mattoon*, -- N.E.3d --, 2019 WL 5205476 at *8, ¶ 40 (Ill. App. Ct. Oct. 16, 2019) (finding no pension clause violation where the "changes were all part of the terms of employment between the City and plaintiffs, not something which involved their . . . pensions directly").

For example, the City could decide to reduce or modify vacation and sick leave benefits in various ways. The City can even eliminate vacation and sick leave cashouts entirely. *See Bennett v. Beard*, 27 Ariz. App. 534, 536-37 (1976) (reasoning that if the government has the authority to terminate an employee, it likewise has the authority to change the terms of an employee's future employment by way of compensation). Thus, the members cannot be vested in the leave cashouts *prospectively,* because the City can make future changes to these benefits, up to and including elimination, in its discretion. *See id.*; *cf. Pisani*, 73 N.E.3d at 137, ¶ 26 (holding that city did not violate pension clause when it revised ordinance to eliminate vacation leave buyback provision).

The Illinois Supreme Court applied this reasoning in *Peters v. City of Springfield*, 311 N.E.2d 107 (1974). There, the court held that a city could lower the maximum retirement age for current employees, even though this would ultimately reduce their benefits under the pension formula. *Id.* at 111-12. The court noted that while any change to the formula's variables (salary and length of service) would necessarily impact pension benefits, that does not mean the city cannot change the terms of employment prospectively. *Id.* at 112; *see also Pisani*, 73 N.E.3d at 131, ¶ 4 ("Changes in the terms and

conditions of employment that indirectly affect the amount of a pension by affecting a number that is plugged into the pension formula are not 'diminish[ments] or impair[ments]' of pension benefits, within the meaning of the pension protection clause. Ill. Const. 1970, art. XIII, § 5."). Thus, the City remains free to modify employment benefits prospectively, even if the changes impact the pension benefit that a member ultimately receives.

B. General employment benefits are protected by ordinary contract principles, not the Pension Clause.

As discussed in Argument § II.A, the Charter controls the terms and benefits of COPERS membership. The Contracts Clause therefore cannot create rights beyond what the plan provides. *See Cross*, 234 Ariz. at 599, ¶ 9 (noting that contract principles and the Pension Clause "only protect whatever pension rights [a public employee] has under applicable law"). Thus, like their Pension Clause claim, the members' Contracts Clause claim rises and falls on the statutory construction issue. (*Piccioli* Supp. Br. at 6-18.)

Moreover, any side contract for pension benefits is ultra vires and void. (Argument § II.A; *see also* City's *AFSCME* Answering Br. at 67-69.) And if the side contract is for something other than a retirement benefit, then you do not get the lifetime ratcheting effect of the Pension Clause. Rather, public

employees' rights to general benefits of employment are protected by ordinary contract law.

C. Under ordinary contract law, employees do not vest in leave benefits until they are earned.

In contrast to retirement benefits under the Pension Clause, an employee does not have a vested contractual right to an employment benefit until it is earned. *See, e.g.*, *Bennett*, 27 Ariz. App. at 536-37 (concluding that *Yeazell* prohibited the state from reducing accumulated annual leave employees had already earned, which had vested, but that *Yeazell* did not prohibit prospectively changing "future benefits as yet unvested"). The contractual right to future benefits not yet earned by working has not yet accrued:

> In both [*Bennett* and *Yeazell*], the courts recognized that a vested contractual right to benefits existed *only when an employee had already performed services and earned benefits*, the payment of which was to be made at a future date. This same rationale does not apply where a city has merely adopted an ordinance which provides for the payment of certain benefits, and *an employee has yet to perform services* entitling him to those benefits.

Abbott v. City of Tempe, 129 Ariz. 273, 278-79 (App. 1981) (emphases added); *accord Smith v. City of Phoenix*, 175 Ariz. 509, 515 (App. 1992) (rejecting argument that public employees acquire vested rights in all statutory

provisions in effect at the beginning of employment that may potentially affect their employment in the future under Contracts Clause). Indeed, this Court recognized in *Hall v. Elected Officials' Ret. Plan* that unearned annual leave, vacation credits, and sick leave are among the "employment rights that do not vest until the 'condition' of service is satisfied." 241 Ariz. at 44, ¶ 31 (citing *Fund Manager, Pub. Safety Pers. Ret. Sys. v. Phoenix Police Dep't Pub. Safety Pers. Ret. Sys. Bd.*, 151 Ariz. 487, 490 (App. 1986)).

The money that the members claim a vested right to include in their pension calculations is payable only when an employee retires or separates from the City. Since none of the members retired or left the City before the revisions took effect, none of them had a vested right to a cashout under the former regulations. *See Abbott*, 129 Ariz. at 278-79; *see also Peters*, 311 N.E.2d at 111-12 (reasoning that employees who had not yet retired were not vested in a particular maximum retirement age). The City is therefore free to modify this employment benefit prospectively.

D. The City's revised administrative regulations do not impact any benefits previously accrued.

As the City detailed in its briefing to the Court of Appeals, both AR 2.441 and AR 2.18 utilize a "snapshot" approach which ensures that

employees do not lose any benefit from leave accrued under the City's past practice. (*See, e.g.*, City's *AFSCME* Answering Br. at 74-76.)[2] Under the revised regulations, all employees (the members included) may still count all of the hours accrued in reliance on the City's erroneous past practice toward their pensionable compensation when they retire. The members are not retroactively deprived of any benefits, nor are they required to pay more money to receive the same benefit originally promised. *Cf., e.g., Yeazell*, 98 Ariz. 109 (holding retroactive deprivation violated pensioner's vested rights); *Hall v. Elected Officials' Ret. Plan*, 241 Ariz. 33 (2016) (requiring members to contribute more money to receive same pension benefit violated vested rights). In short, the members will continue to receive the full benefit of all leave accrued in reliance on the City's mistaken practice.

IV. The City's treatment of other fringe benefits does not affect the pensionability of retirement leave cashouts.

Finally, the members point to annual vacation leave sell-backs, which are available to certain labor groups under AR 2.18, as evidence that one-time cashouts for unused vacation leave at retirement or termination should

[2] Copies of AR 2.441 and AR 2.18 are available at the City's *AFSCME* Answering Brief at CAPP236-40 and CAPP183-89, respectively.

be counted towards COPERS pensions. But vacation leave sell-backs differ in both kind and quantity from one-time retirement cashouts for unused vacation leave. Under AR 2.18, eligible employees can sell back a limited amount of unused vacation leave *every year*. By contrast, an employee can "cash out" *all* unused vacation leave accrued during his or her career only once, and only when the employee stops working for the City. As explained in the *Piccioli* Supplemental Brief (at 12-13), the extraordinary and one-off nature of the retirement leave cashouts is why they result in pension "spiking," while regularly available and recurring payments (like annual sell-backs) do not.

Moreover, how the City treats other kinds of fringe leave benefits does not inform whether a one-time accrued leave cashout at retirement is pensionable under the Charter's text. As discussed in Argument § II.A, the Charter defines and limits the City's authority with respect to pensions. The Court should not mold its analysis of the Charter's text to fit the City's practice. Once the Court rules on these pension-spiking cases, the City will evaluate its treatment of all types of payments to employees (including sell-backs) to determine which payments are pensionable under the Charter as construed by this Court. Interpreting the Charter to fit the City's current

treatment of various fringe benefits is precisely backwards. The City must mold its practices to this Court's interpretation of the Charter, not the other way around.

CONCLUSION

For many years, the City erroneously counted retirement cashouts for accrued leave towards employees' pensionable compensation. But a one-time, lump-sum payout for unused leave is not part of an employee's regular annual pay, and thus cannot be included in the calculation of an employee's pension benefit under the Charter. Once it realized its mistake, the City took pains to design a practical and equitable solution that balances the City's legal obligation to follow the Charter and the practical consequences of its mistaken past practice. This Court should affirm the superior court and court of appeals.

RESPECTFULLY SUBMITTED this 20th day of February, 2020.

OSBORN MALEDON, P.A.

By /s/ Eric M. Fraser

Colin F. Campbell
Eric M. Fraser
Hayleigh S. Crawford
2929 North Central Avenue, Ste. 2100
Phoenix, Arizona 85012

Attorneys for Defendants/Appellees