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WHAT WERE THEY THINKING?

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1. City committed unfair labor practice when it unilaterally terminated partial lump sum distribution option.

The International Association of Firefighters filed a charge of unfair labor practices with Pennsylvania Labor Relations Board after the City of Erie unilaterally eliminated a partial lump sum distribution option (PLSDO). The union alleged that the city's actions violated the duty to collectively bargain. The Labor Board entered an order holding that the city's unilateral elimination of the PLSDO violated the city's statutory duty to bargain since pensions are a mandatory subject of bargaining. The city appealed. The lower court reversed, holding that the city did not violate its bargaining obligations by unilaterally rescinding the PLSDO because the parties' agreement was not sufficiently clear. The union sought discretionary review to the Pennsylvania Supreme Court.

The city argued that it did not commit an unfair labor practice when it unilaterally repealed an ordinance. According to the city, the benefit was not contained in the parties' collective bargaining agreement or incorporated by reference therein. The city argued that it was permitted to rescind a benefit that was implemented independent of the collective bargaining process, so long as it demonstrated that the term was not bargained for and the city did not gain a bargaining advantage as a result.

In its opinion, the Court stated that it was useful to summarize foundational principles that underlie the case. The applicable statute, Act 111, provided that "Policemen or firemen ... shall ... have the right to bargain collectively with their public employers concerning the terms and conditions of their employment, including compensation, hours, working conditions, *retirement, pensions and other benefits.*"

The Court held that the parties are required to bargain over mandatory subjects of bargaining before a party may unilaterally change such benefits. The fact that a city changes benefits through the enactment or repeal of an ordinance does not alter this calculus. Indeed, if this were the case, a public employer could grant benefits through ordinances and simply unilaterally repeal them at will. Accordingly, the city committed an unfair labor practice when it, by ordinance, unilaterally

eliminated firefighters' PLSDO pension benefit without first collectively bargaining with union.

City of Erie v. Pennsylvania Labor Relations Board, **32 A.3d 625 (Pa. 2011)**

2. **New Mexico Teachers lack standing to recover 2008 investment losses.**

During the national economic crisis in 2007-2008, the New Mexico Educational Fund ("Fund") lost approximately $40 million on certain private equity investments. The Fund holds approximately $8.5 billion in assets used to pay benefits for 95,000 teachers and other participants. Teachers brought suit against the Fund, Board members and investment advisers for breach of fiduciary duty, violation of federal and state securities laws, aiding and abetting breach of fiduciary duty, and breach of contract. Plaintiffs alleged that they were injured by defendants' improper investments due to potential increased employee contributions, reduced services, tax increases, and the increased risk that the Fund would not have sufficient assets to satisfy its obligations in the future. The court held that plaintiffs could not show that their benefits were threatened, that the system was currently underfunded, or that the challenged investment caused the underfunding.

The court recognized that altering retirement eligibility or contribution requirements would require the legislature to act. Under these circumstances, plaintiffs lacked standing to sue. Plaintiffs' allegations that they faced the risk of tax increases, potential future benefit reductions or increased contribution levels, and that they were injured by the loss of principal, income, fees, and expenses did not establish an injury in fact fairly traceable to the defendants.

State governmental entities, including public employees/trustees acting within the scope of their duties, are immune from liability for any tort, except as waived by law. The court held that breach of fiduciary duty is not one of the tort claims for which the New Mexico legislature chose to waive governmental immunity under New Mexico's Tort Claims Act.

After granting the motion to dismiss in part, the federal district court remanded the case to New Mexico state court given a lack of subject matter jurisdiction.

Hill v. Vanderbilt Capital Advisors, 2011 WL 6013025 (D.N.M 2011)

3. **Retirement system was not contributorily negligent and thus actuary was liable for $72,000,000 in lost contributions and lost interest.**

Milliman was hired in 1982 to provide actuarial valuations for each of Maryland's state systems. In 2004, Milliman discovered a longstanding coding error during a replication audit. Milliman's calculations treated code "00" as meaning only a straight life annuity, even though code "00" also included 50% survivor spouse benefits. The State Board of Contract Appeals determined that Milliman had breached its contract to provide actuarial services. The System was awarded $34 million in lost contributions and $38 million in lost interest on those contributions. Milliman appealed arguing that the System was not damaged insofar as the taxpayers would fund any deficiency. Milliman also argued that the System was not harmed because notwithstanding the 22 years of actuarial errors, ultimately the System would become fully funded. The lower court determined that this perspective "subverts the entire function and purpose of actuarial analysis, which is to determine how much to contribute and when." If Milliman's arguments were accepted, it could satisfy its contractual obligations by training a monkey to punch random keys on a calculator. The Maryland Court of Appeals, the highest court in the state, agreed. It rejected Milliman's argument that the state retained the use of the contributions, which were not deposited into the System. The Court refused to recognize an offset, finding that the state and System are distinct entities.

According to the Court, to the extent that the data coding may have been confusing, the actuary bore an express duty to solicit further clarifying information until it accurately understood the information provided by the system. The court credited the testimony of a third-party actuarial expert, witnesses, and trustees that the System had suffered losses and was underfunded as a result of the errors.

On the voluminous records, the court held that substantial evidence supported the lower court's findings that Milliman repeatedly misinterpreted a data code associated with survivors' benefits. The System was not negligent in the development or transmission of the data. As a result, Milliman was fully liable and contributory negligence was not a bar to recovery.

Milliman, Inc. v. Maryland State Retirement and Pension System, 25 A.3d 988 (Md. 2011)

4. **Breach of fiduciary duty claim against investment consultant is not subject to dismissal based on Florida's economic loss rule.**

Three pension boards in the City of Lake Worth Florida brought a class action lawsuit against Merrill Lynch arising out of an SEC investigation of conflicts of interest and inadequate disclosure. The suit alleged a single count for breach of fiduciary duty. Plaintiffs asserted that Merrill sought and created a relationship of trust and confidence while serving as a gatekeeper. The complaint alleged that Merrill breached its duties by acting in its own interest and for its own benefit, using plan assets for its own profit without adequate disclosure.

Merrill moved to dismiss, arguing that the claim was barred by the economic loss rule, as it arises out of, or is intertwined with, a series of contracts between plaintiffs and Merrill Lynch. According to Merrill, the claim for breach of fiduciary duty is a camouflaged breach of contract claim. Merrill Lynch argued that regardless of how plaintiffs' labeled their claim as one for breach of fiduciary duty, the duties Merrill Lynch allegedly failed to perform arose from, and are inextricably intertwined with, the obligations outlined in the parties' written agreements. The plaintiffs responded that Merrill Lynch's fiduciary duties existed separate and apart from the parties' contracts and that the mere existence of a contract does not immunize Merrill or provide a free pass to cavalierly

repudiate its fiduciary duties and enrich itself through self-dealing at the expense of the class.

The economic loss rule is a judicially created doctrine that sets forth the circumstances under which a tort action is prohibited if the only damages suffered are economic losses. The rule applies when the parties are in contractual privity and one party seeks to recover damages in tort for matters arising out of the contract. The rule is designed to prevent parties to a contract from circumventing the allocation of losses set forth in the contract by bringing an action for economic loss in tort.

Nevertheless, where the duties breached do not arise under the contract, an action for an independent tort may exist even though the parties are in contractual privity. Accepting all factual allegations in the complaint as true and construing them in the light most favorable to plaintiffs, the court held that the complaint alleged facts which are distinct from a breach of contract claim. At this stage in the case, the court determined that the claim was both adequately pled and not barred by the economic loss rule. To the extent that discovery demonstrated that the duties allegedly breached by Merrill Lynch are in fact based on or inextricably intertwined with the parties' written agreements, the court indicted that it would revisit the issue.

Ultimately the case settled. The underlying issue of the application of the economic loss rule in fiduciary duty cases is currently pending on appeal at the Florida Supreme Court in an unrelated case. A *Florida Bar Journal* article was published this month exploring the complex topic which continues to befuddle the Florida courts.

Board of Trustees of the City of Lake Worth Employees' Retirement System v. Merrill Lynch Pierce Fenner & Smith, 2011 WL 2144658 (M.D.Fla. 2011)

5. <u>Pension Board's establishment of 30-day deadline to convert disability application to application for normal retirement constitutes improper rulemaking</u>.

A pension Board denied a member's application for retroactive service retirement benefits as untimely because she filed it more than 30 days after the Board denied her application for normal disability retirement benefits. After being notified of the denial of her disability benefits, the applicant was advised that she could convert her application for disability benefits into an application for normal retirement (for which she was eligible) within 30 days. However, there was no legal authority for the 30-day deadline. The applicant appealed the denial of disability benefits and did not immediately apply for normal retirement benefits. She applied for normal retirement benefits several years after the Board's denial of her disability application, but prior to the ultimate resolution of the appeal regarding denial of disability benefits. In applying for normal retirement, the applicant sought benefits retroactive to the date when she first applied for disability benefits. The Board repeatedly denied the applicant's request for retroactive benefits and litigation ensued. The court found that "[t]he Board's November 2006 letter advised [the applicant] of her right to appeal its decision, and, because she exercised that right, in effect, she did not receive final notice of denial of her benefits until the Supreme Court's June 2009 decision [affirming the denial of her disability benefits]." Ultimately, the court held that the Board improperly engaged in rulemaking by setting an arbitrary 30-day deadline to convert a disability application to an application for normal retirement.

<u>Bueno v. Bd. of Trustees</u>, 2011 WL 4482503 (N.J. Super. Ct. App. Div. 2011)

6. **<u>Statements from a pension fund representative do not necessarily amount to an "actual, clear and definite" promise in order to support a claim for a retiree's detrimental reliance on the representative's statements</u>.**

A former police officer and his wife sued the board of trustees of a pension fund contesting the amount of his retirement benefits. When the officer was eligible for early retirement and a few months away from normal retirement eligibility, he contacted the pension fund office. He was informed that his benefits "would be minimally affected and that [he] would still have [his] medical" benefits. However, after he submitted his binding retirement application, the officer was informed that he was not eligible for a service retirement and that his monthly benefit would be substantially less than he had expected. After his unsuccessful attempts to rescind his retirement application, the officer sued the pension fund for breach of contract and detrimental reliance. The appellate court found that the trial court incorrectly ruled that the detrimental reliance claim was barred by the statute of limitations. However, the appellate court found that the pension fund representative's statements did not amount to an "actual, clear and definite" promise. Therefore, the officer was unable to properly set forth a legal claim for detrimental reliance.

<u>Raby v. Bd. of Trustees of the Police and Fire Retirement System of the City of Detroit</u>, 2011 WL 921645 (Mich. App. 2011)

7. **<u>Judgment and sentence in a criminal matter are sufficient evidence to establish that a public employee has committed a forfeitable offense; employee's spouse without a vested interest in forfeited benefits does not have procedural due process rights</u>.**

After a pension fund ordered a benefit forfeiture of a judge convicted of felonies that violated his oath of office, the judge and his wife sought judicial review. The judge was convicted of indecent exposure committed during the performance of his duties. Rejecting the former judge's argument that his benefit forfeiture was inappropriate, the court

held that the judgment and sentence in the criminal matter against the former judge is sufficient to establish the fact that the judge had committed a forfeitable offense. The burden then shifted to the former judge, who failed to introduce sufficient evidence as to why his benefits should not be forfeited. He "presented as his defense that the felonies he committed did not disrupt the trials." The court found that "[w]hile that is an attempt to rebut the prima facie case, it is not a successful defense." Additionally, the court ruled that the former judge's spouse did not have a vested interest in the judge's retirement benefits so as to trigger any procedural due process rights.

<u>Thompson v. State of Oklahoma</u>, 264 P.3d 1251 (Okla. 2011)

8. **<u>Intended beneficiary is entitled to benefits calculated based upon the life expectancy of a former beneficiary who was fraudulently designated a beneficiary</u>.**

A former state employee's son was appointed her guardian due to her disabling drug addiction. On her behalf, the son submitted an application for disability retirement benefits, naming himself as beneficiary. A few years later, a court removed the guardianship over the former employee. At that time, she requested that her beneficiary designation be changed to another son. However, the retirement system denied the request and the son who formerly served as guardian began receiving benefits. The employee's estate sued the retirement system and the son receiving benefits, arguing that the son was guilty of "fraudulent and unauthorized misconduct" and that the system should have honored the employee's request to change her beneficiary. The court recognized that the pension plan "prohibits a change in beneficiary after the retired member received his first payment because [the system] bases the amount of benefits on the actuarial computation of the life of the retired member and, depending on which option the member chose, the life of the designated beneficiary." The court further stated that it "understands that to allow any changes to the beneficiary after benefits have been calculated and disbursement has commenced would create an administrative

nightmare for [the system]." However, the court concluded that there is "no reason why the benefit payments based upon the [fraudulent beneficiary's] lifetime may not continue to be paid to the beneficiary(ies) designated" by the court as the proper beneficiaries.

Peterson v. Public Employees' Retirement System of Mississippi, 77 So. 3d 554 (Miss. Ct. App. 2012)

9. **Pension Board properly determined that applicant's retirement benefits from two periods of employment should be calculated separately.**

A long-time public employee left public service for approximately two years and then returned to work for his former public employer. Upon applying for retirement benefits, the Pension Board ruled that the applicant's public service should be calculated using two separate periods of service, rather than one continuous period. In arguing that the Pension Board should be equitably estopped from using two separate periods of service, the applicant testified that he called the retirement system's office three times and asked detailed questions about the impact on his retirement benefits. He further testified that he was told that if he left public service for two years and then returned to service, that his "retirement benefit would be calculated using one continuous period of time." In upholding the Pension Board's ruling, the court found that the plain language of the statute required calculating benefits using two different periods of time and that the applicant failed to demonstrate the "high evidentiary standard required to establish that [the pension system] misrepresented this point to him in telephone conversations before his original retirement."

McLeod v. Ret. Bd., 257 P.3d 1090 (Utah Ct. App. 2011)

10. **Partially complete disability application properly denied upon member's death.**

A police officer applied for disability retirement benefits after being diagnosed with cancer. The retirement system advised the officer that he needed to submit additional information in order for his application to be considered. The officer died shortly thereafter, without ever submitting the additional documents. The Board denied the application because all required documents were not received. The officer's wife challenged the denial of disability retirement benefits. The court upheld the denial of disability retirement benefits by holding that "decedent's death terminated his membership in the Retirement System, warranting the denial of his pending application for disability retirement benefits under most circumstances."

Goldberg v. DiNapoli, 2011 WL 4484447 (N.Y. App. Div. 2011)

IF YOU HAVE ANY QUESTIONS OR COMMENTS CONCERNING THIS PRESENTATION, CONTACT KLAUSNER, KAUFMAN, JENSEN & LEVINSON, 10059 NW 1ST COURT, PLANTATION, FLORIDA 33324, (954) 916-1202, FAX (954) 916-1232, WEBSITE, www.robertdklausner.com.