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CURRENT ISSUES FACING PUBLIC EMPLOYEE RETIREMENT SYSTEMS, THEIR MEMBERS, AND PLAN SPONSORS

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RECENT TRENDS IN PENSION LITIGATION

A. What Happened in the past Year?

In 2010 and 2011, a number of states lowered or eliminated cost-of-living provisions in an effort to improve the funding level of financially-stressed retirement systems. The reductions were challenged by members and retirees as impairing the obligation of contract and depriving members of their property rights without due process of law. In a pair of detailed trial court decisions issued in June 2011, courts in Minnesota and Colorado rejected the constitutional challenge. The third challenge in South Dakota

met the same fate in 2012.

The Minnesota case, *Swanson v. PERA*, was decided using an analysis of Minnesota's promissory estoppel theory which calls for a balancing of legitimate state interests and the rights and expectations of retired plan members. In finding that the reduction of the COLA was not unconstitutional, the court noted that the legislative history of the COLA provisions indicated that it was intended to be a variable and, therefore, amendable provision. At the same time, however, the court made it clear that the base benefit was not subject to alteration based on constitutional contract and property principles.

Reaching the same result for surprisingly similar reasons, a Colorado trial court rejected a challenge to a Colorado law altering the COLA provisions of the state retirement system. The court found that the COLA had been an ever-changing process, unlike the base retirement which the court found to be protected from diminution or impairment.

In the 2011 Legislature, at least 18 states considered similar reductions in COLA benefits alone. The most highly publicized were reductions by the Rhode Island, New Jersey and Florida Legislatures. The New Jersey and Rhode Island provisions are particularly controversial in that it creates a committee to decide if the COLA should be reinstated once the retirement plan meets a certain funding benchmark. Challenges in New Jersey have thus far been unsuccessful, with a federal court refusing to hear constitutional claims because it viewed the matter as an action for damages against a state, which is forbidden by individuals in a federal court under the 11th Amendment of the U.S. Constitution.

In December, 2011, a Florida trial court joined sister courts, Arizona and New Hampshire, in striking down changes to employee contribution rates and reductions in COLAs. The Florida Legislature appealed and the case, *Scott v. Williams*, was argued on September 7th, having been "fast tracked" past the middle level appeals court as a question of great public importance. The Florida Retirement System, which lacks an independent board of trustees, is taking no role in the litigation.

In May, a California appellate court upheld dismissal of a case which voided a pension benefit which was not enacted in accordance with the City Charter. Because the benefit was not properly enacted, it was held not to create any contract rights and retroactive invalidation of the benefit did not violate the constitutional rights of participants, nor did it create a grounds for estoppel and detrimental reliance. *San Diego City Firefighters Local 145 v. Board of Administration*, 141 Cal. Rptr. 3d 860 (Cal. App. 2012).

In mid-August, 2012, the Michigan Court of Appeals in *AFT Michigan v. State*, ___N.W.2d___, 2012 WL 3537789 (Mich. App. 2012), determined that a Michigan law requiring that public school districts withhold 3% of employee wages as an employer contribution was unconstitutional. The court found that the law violated the contracts clause, was a taking of private property without just compensation, and a violation of substantive due process. Essentially, the court held that the employees had a property right in the salary that had been earned which the state wrongly took to pay its own obligations. The state has asked the Michigan Supreme Court to review the matter.

Louisiana Retired Employees Association is currently challenging the recently enacted cash balance tiers of LASERS and TRSL based on the failure of the Legislature to adopt the measures by the constitutionally required 2/3 vote. The issue at litigation will likely address the meaning of "cost" and whether the Legislature may ignore its statutorily-designated auditor's report in favor of an actuarial report which provides the desired result.

California enacted wide ranging changes to retirement benefits for future employees. The law presents as many questions as it does answers and possess significant challenges for systems which now must manage an additional tier of benefits.

Most recently, a federal court in Baltimore struck down a City ordinance reducing benefits for both active and retired members of the police and fire pension plan. The court found that the city could prospectively alter benefits for active members, as long as they were not yet eligible to retire (which in Baltimore is when members vest). The court disapproved the elimination of a COLA based on reserved earnings which was replaced by

a COLA from 0% to 2% depending on age. The court found that change was not “reasonable and necessary” to preserve public welfare. But, because the court found the provisions of the ordinance could be treated separately, the entire ordinance was struck down. *Cherry v. Baltimore*, U.S. District Court, September 20, 2012.

B. What’s on the Horizon?

1. ***City of Houston v. Houston Firefighters’ Pension Fund***

The City has sued the Board of Trustees to obtain access to membership data to prepare a competing actuarial valuation to support efforts to reduce retirement benefits and close the current defined benefit plan. The Board has refused citing state confidentiality laws. Pending cross motions for summary judgment.

2. ***FOP v. City of Miami***

Florida recognizes employee collective bargaining as a fundamental constitutional right. A provision of the state public employee bargaining law allows a unilateral alteration of contract rights when a financially urgent situation exists. Financial urgency is not statutorily defined. Police union challenging both facial and “as applied” constitutionality.

3. ***Alabama Suits***

State judges filed a challenge to a 40% increase in employee contributions in state court. City employees in Gadsden filed a comparable suit in federal court.

4. ***Miami Beach pension***

Under the City Charter, a referendum is required to change pension benefits. The city imposed a collective bargaining agreement resulting in adverse changes. The Florida appeals court held that the bargaining law trumped the earlier requirement for a

referendum. *City of Miami Beach v. Board of Trustees*, 91 So.3d 237 (Fla. 3d DCA 2012)

5. ***Idaho Education Ass'n v. State***

Challenge filed in state court to repeal of early retirement incentive and shortening of all collective bargaining agreements.

6. ***Maine Ass'n of Retirees v. Board of Trustees***

Federal suit filed challenging reduction in COLA benefits.

7. ***Ohio pension cases***

Suits filed in both state and federal courts challenging massive reduction in pension and COLA benefits in Cincinnati.

8. ***Rhode Island Retirees Ass'n v. Chaffee***

State court challenge filed to reductions on final average salary, extended retirement age, suspension of COLA and movement of current workers to hybrid plan.

9. ***Duncan v. TVA Retirement System***

Federal court challenge filed to pension accumulation.

10. ***Texas Pension reform - Second Battle of the Alamo***

Texas legislators and municipal officials have vowed to take decisive action to cut retirement benefits. DROP and benefit spiking are key issues. Likely to bring first interpretation of 2003 constitutional guarantee of vested benefits provision in Article XVI, Section 66 of State Constitution.

11. ***Stockton Bankruptcy***

In a preliminary decision, a California federal bankruptcy court ruled that Stockton's retirees and employees must take a reduction

in accrued post-retirement health care benefits as part of the bankruptcy reorganization plan. The court has yet to reach the larger battle between the insurer for the municipal bonds and CalPERS, which provides retirement benefits to employees. The insurer is claiming that CalPERS must suffer a loss on the same basis as any other creditor. CalPERS responded that it has no authority to lower required contributions or to unilaterally reduced benefits. This will most assuredly create a significant state law versus federal issue.

C. Constitutional Cases

Recoupment of overpayments by Oregon PERS upheld after protracted litigation.

Members of the Oregon Public Employees Retirement System (PERS) brought suit against the PERS Board challenging the recoupment of overpayments to retirees. The overpayments arose from a 20 percent earnings credit for calendar year 1999 that the Board erroneously approved, without properly funding a contingency reserve account. The City of Eugene challenged the earnings credit a year later, when it successfully disputed the employer contribution rates set by the Board. A court agreed that the Board had abused its discretion by allocating excessive earnings to member accounts while not allocating funds to the contingency reserve.

As a result, the Board sought to recoup the overpayments through a two step recovery mechanism. First, the Board established a general procedure for the recovery of overpayments. Subsequently, the Board made individualized recovery determinations based on the individual circumstances of each affected PERS member. Retirees were offered the option of a lump sum repayment of approximately \$9,000 for the average member, or retirees could elect an actuarial reduction of approximately \$30 per month.

The retirees objected to the recoupment based on four theories, including breach of contract, promissory estoppel, wage claims, and declaratory and injunctive relief under the state's Administrative Procedures Act (APA).

In an en banc ruling, the Oregon Supreme Court held that the Board did not unconstitutionally impair contract rights or violate procedural due process. According to the Court, the Board did not unconstitutionally impair contract rights because it lacked statutory authority to promise the 20% earnings credit in the first place. Moreover, the court held that retirees did not have a protected property interest in earnings credits at a rate that the Board lacked statutory authority to grant.

In a companion case, Arken v. City of Portland, the Court determined that legislation did not create enforceable contractual rights. Rather, recoupment of excessive retirement benefits was permitted by withholding of COLA increases otherwise payable to retirees.

Goodson v. Public Employees Retirement System, 264 P.3d 148 (Or. 2011)(en banc)

Bill reducing required employer contributions does not violate the Contracts Clause of the state or federal constitution.

A multi-employer retirement system was funded by both employee and employer contributions. In 2003, the state legislature passed a bill that changed the contribution requirements for certain employers, and allowed them to make contributions equal to a specified percentage of actuarial liability. The police and fire unions filed suit, alleging that the bill violated their rights under the Contracts Clauses of both the state and federal constitutions. The court held that the state “constitution does not expressly create a contractual right to retirement benefits.” While noting that vested members of the plan have non-forfeitable rights to receive benefits, the court found that “the statute grants the Legislature discretion to maintain the Plan’s funds as it sees fit.”

Professional Firefighters Association of New Jersey v. State of New Jersey, 2011 WL 3667721 (N.J.Super.A.D. 2011)

Statute requiring the payment of voluntary healthcare premiums from retiree pension payments does not violate constitutional protections.

A Union and individual retirees brought suit against the state and the state pension system seeking a declaration that a statute mandating that the system deduct premiums for voluntary healthcare coverage is unconstitutional. Healthcare benefits and pension benefits are administered through separate systems under separate statutory authority. The statute at issue provided that the retirement system was required to deduct a specified insurance premium for all members receiving such healthcare benefits. The Plaintiffs argued that the statute violated the state's constitutional protection against impairment of contract. The lower court found no constitutional violations. On appeal, the court found that there was impairment to a vested contractual right, but the impairment was not substantial, and thus did not violate the constitutional prohibition on impairment of contract.

The New Hampshire Supreme Court affirmed. The court reasoned that the retirees would have been required to pay insurance premiums regardless of whether the premiums were deducted from pension benefit payments or whether the retirees were separately billed. Therefore, the New Hampshire Supreme Court agreed that any contractual impairment was not substantial and did not violate any constitutional protection. "The plaintiffs acknowledged at oral argument that the crux of this dispute is not whether the State may charge retirees a premium toward their healthcare, but how the State can collect that premium. Given that the retirees who are covered must pay the premium in one manner or another, we cannot say that any alleged alteration of contractual obligations is anything other than minimal."

State Employees' Ass'n of New Hampshire v. State of New Hampshire, 161 N.H. 730 (2011)

Due process rights are not violated when a city unilaterally reduces insurance coverage that is not specifically provided for by the applicable collective bargaining agreement.

A police officer was killed in line of duty when he was struck by a vehicle. For several years prior to the officer's death, the city had purchased a policy for \$1 million in underinsured motorist insurance coverage. However, the year the officer was killed, the city unilaterally decreased

the coverage to \$35,000. The officer's widow alleged that the officer did not receive any notice regarding the change in coverage, nor did other officers, and therefore was denied the opportunity to purchase necessary supplemental coverage. The court noted that the applicable collective bargaining agreement required certain insurance coverage, but was silent as to underinsured motorist insurance. The officer's widow argued that the officer's due process rights were violated when the city unilaterally reduced the insurance coverage. The court further noted that courts "have generally declined to find a protectible property interest in ancillary financial benefits associated with employment, such as sick leave, health care and pension benefits, where those benefits do not rise to the level of extreme dependence or permanence, despite their financial value, and where the benefit can be discontinued for reasons other than cause." For that reason, the court dismissed the widow's lawsuit.

Jones v. Township of Middletown, 2011 WL 3157143 (E.D. Pa. 2011)

Retirement system is not considered a "citizen" for purposes of federal court jurisdiction.

After a dispute arose between two public retirement systems and an investment manager regarding whether the funds were permitted to withdraw money from the manager, the funds filed suit for breach of contract and breach of fiduciary duty in state court. The investment manager, on multiple occasions, attempted to remove the case to federal court. The retirement systems, however, convinced the federal trial court that the cases were properly brought before the state court. The investment manager appealed the trial court's ruling, arguing that it had the right to remove the cases to federal court. At issue on appeal was whether the retirement systems were considered "citizens" for purposes of conferring jurisdiction on a federal court. The court conducted an inquiry into whether the retirement systems were considered "arms of the state," which would lead to the legal conclusion that they are not

“citizens.” The court ultimately found that the retirement systems and the state were closely related and that the state “is a real party in interest in [the] case.” Thus, the court found that the retirement systems are not “citizens” for the purposes of conferring federal jurisdiction and therefore the remand to state court was proper.

Public School Retirement System of Missouri v. State Street Bank & Trust Co., 640 F.3d 821 (8th Cir. 2011)

D. Administrative Cases

Employer found to have breached settlement agreement when it paid required pension contributions that were rejected by the pension fund because it did not find an alternative to making pension contributions.

A public employee was terminated from his job and entered into a settlement agreement with his former employer. Under the agreement, the employer was required to continue making pension contributions “for the benefit of” the employee for a specified period of time. However, the pension fund refused to accept the employer’s contributions. Even though the employer “paid” the contributions, the court agreed with the plaintiff’s argument that “the intent of the settlement agreement was for him to receive a benefit from the contributions and because that did not happen, the agreement was breached.”

The court ruled that once the employer realized the pension fund was not accepting its contributions, the employer should have found “an acceptable alternative to fulfill its contractual obligations[.]”

Daggett v. Bd. of Public Utilities of the Unified Gov’t of Wyandotte County/Kansas City, Kansas, 263 P.3d 847 (Kan. Ct. App. 2011)

If a public employer’s unilateral action sufficiently affects, either directly or derivatively, the status quo with respect to mandatory bargaining subjects, the employer has a duty to bargain.

A fire union brought an unfair labor practice charge against the city. The union argued that the city's implementation of a pilot return-to-work program for permanently restricted firefighters violated statutorily mandated collective bargaining. The Employment Relations Board (ERB) found that the program challenged the status quo and that the city was therefore required to bargain about the numerous mandatory impacts of the program. "However, in reasoning that the status quo had been changed and that mandatory subjects of bargaining, including salary, workload, promotional opportunities, and job security, had been affected by the city's unilateral decision to implement the return-to-work police, ERB did not construe the CBA for the purpose of determining whether it provided for or authorized those changes and impacts." The city argued that "existing CBA provisions authorized the city's actions and that no change occurred to mandatory bargaining subjects so as to trigger the city's duty to bargain." The court ultimately ruled that the ERB must interpret the provisions within the CBA to determine whether the city's argument had merit.

Portland Fire Fighters' Ass'n, Local 43, IAFF v. City of Portland, 263 P.3d 1040 (Or. Ct. App. 2011)

Police and firefighter relief associations not required to amend bylaws before adding items to benefits calculation.

A recently adopted state statute requires police and firefighter relief associations to obtain city ratification of bylaw amendments that "increase or otherwise affect the retirement coverage provided by or the service pensions or retirement benefits payable from [the associations]." However, the statute does not define when such bylaw amendments must be made. The trial court found that "the associations had improperly calculated benefits, and it granted injunctive relief to the city, requiring the associations to recalculate benefits and resulting levy requests, and to recoup overpaid benefits from association members." On appeal, however, the court found that the trial court erred in interpreting the statute "to require bylaw amendments before certain items were added to the benefits calculation, but [found] no error in the determinations that the associations improperly calculated certain benefits."

City of Minneapolis v. Minneapolis Police Relief Ass'n., 800 N.W.2d 165 (Minn. Ct. App. 2011)

Trial court lacked authority to add a class action claim to a widower's administrative appeal of the denial of survivor benefits.

Following a dispute as to whether a public employee's widower was entitled to survivor benefits, an administrative hearing officer ruled that the widower was not entitled to survivor benefits because his spouse had not selected the applicable option during her employment. The widower appealed the hearing officer's decision. While that case was pending, the widower and the employer agreed to hold the appeal in abeyance for a period of time while the legislature was allegedly considering a bill that would favorably impact the widower's claim. After the legislative session ended without such a bill being passed, the widower amended his petition to include himself "and on behalf of all others similarly situated." The court allowed the case to continue as a class action. On further appeal, the court ruled that the lower court improperly allowed the widower to amend his petition to make it a class action. The court held that if the lower court disagreed with the administrative decision, the proper course of action would have been reversal.

Fitzpatrick v. Public School Employees Retirement System, 2011 WL 1902000 (Mich. Ct. App. 2011)

Cause of action for payment of missed pension contributions accrues when invoice becomes past due.

A public employer failed to make its employer contributions to a pension fund on behalf of an employee for several months in 1972 and 1973. In 2007, once the mistake was realized, the pension fund sent the employer its annual invoice, including a demand for the missed contributions plus interest. When the city refused to make the payment, the state's comptroller filed suit against the city. The city argued that the claim was barred by a 6 year statute of limitations. The applicable state statute permits a pension fund to send an invoice for past due amounts, regardless

of how long ago the payment was due. The court ruled that the 6 year statute of limitations began running once payment became due on the pension fund's invoice.

DiNapoli v. Town of New Scotland, 90 A.D.3d 1401 (N.Y. Ct. App. 2011)

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

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. 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.

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

E. Highlights of the Legislative Actions Around the Country¹

¹ Material for this Section was drawn from Snell, "Highlights of State Pension Reform," National Conference of State Legislatures and from various system websites.

Alabama Act 377

Created a new tier for employees hired after 1/1/13 with lower employee contributions; highest 5 year average rather than highest 3 years; extended retirement age by 2 years; eliminated 25 year normal retirement; and lowered multipliers for both safety and non-safety employees by 15%.

California AB 340

New tier for persons hired on or after 1/1/13. Employees will pay 50% of normal cost; Changes retirement age by 2 years; requires highest 3 year AFC; limits benefits to 415 limit; limits benefits to base pay; limits post retirement employment; prohibits purchase of airtime and retroactive application of benefit increases. Prohibits employers from taking contribution holidays. Contributions may not be less than full normal cost. Added a felony forfeiture provision.

Kansas Chapter 171, laws of 2012

Closed DB plans to new members and created a hybrid cash balance DB plan. Guaranteed investment return; no risk of member to the market; lifetime annuity based on account balance.

Louisiana Chapter 483, Laws of 2012

Closed certain classes of LASERS and TRSL to current plan. Created a Hybrid cash balance DB tier with guaranteed investment return; no market risk to members; and lifetime annuity based on account balance or partial lump sum with reduced annuity.

New York Chapter 18, Laws of 2012

Created a new tier for state and New York City retirement plans effective 1/1/13. Tiered contributions of 3%-6% depending on salary. Multiplier

tiered to encourage 30 years of service; 5 year AFC; increased retirement age by one year.

South Carolina Act 278

Increased current member contributions; Extended retirement ages for new hires; eliminated service only retirement; increased vesting to 8 years; Caps COLA at \$500 per year.

Virginia Act 702

Establishes hybrid DB-DC plan for new hires (except public safety). 1% DB multiplier and 5% employee contribution to DC plan with partial employer match. Age and other plan factor for retirement are unchanged.

Virginia Act 822

Requires increase in employee contributions, to be offset by mandated salary increases equal to the amount of the contribution increase.

Wyoming Chapter 107, Laws of 2012

Prohibits COLA until System fully funded. Current COLA discretionary.

Wyoming Chapter 108, Laws of 2012

Applies to person hired on or after 9/1/2012; increases retirement age; lowers multiplier by 10% for all except firefighters; increases FAC from 3 years to 5 years.

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

