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NATIONAL CASE LAW UPDATE

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CONSTITUTIONAL CASES

Arizona Supreme Court Upholds Constitutional Pension Rights.

In a closely watched decision, the Arizona Supreme Court issued a unanimous opinion on February 20, 2014 upholding a trial court decision finding that a reduction in post-retirement benefits to retired judges and other elected officials violated the Pensions Clause of the Arizona Constitution.

In 1998, the electors of Arizona adopted constitutional protection for retirement benefits against impairment or diminution. Notwithstanding that public referendum, the Legislature altered the guaranteed post retirement benefit formula in 2011, causing a substantial reduction in the gain sharing formula. In response, a group of retired judges filed suit claiming that the legislation was an unconstitutional impairment of the pension contract. An Arizona trial court agreed and struck down the law, holding that the post retirement benefit was a vested financial benefit that was directly and adversely affected by the S.B. 1609.

On appeal to the Supreme Court of Arizona, the Retirement System argued that the impairment was financially necessary, applying a traditional federal impairment of contract test which balances the contract against public necessity. The Supreme Court rejected that argument finding that the Pension Clause in the Arizona Constitution was intended to add an additional measure of protection to pension benefits. Perhaps even more important is the Court's finding that the term "benefit" includes the formula by which future payments will be calculated. Otherwise stated, the "benefit increase formula" is itself a protected "benefit."

The Arizona Pension Clause, Article 29(C) of the Arizona Constitution, provides that membership in a public retirement system is a "contractual relationship." The pension clause further specifies that "public retirement system benefits shall not be diminished or impaired."

As a threshold matter, the Court noted that the sitting Justices are not members of the class of retired judges who brought suit. Nevertheless, the Court acknowledged that the Justices are members of the Elected Officials' Retirement Plan and will be eligible for benefits upon their retirement. The Court further observed that no party had asked for their recusal. Even if recusal had been requested, the Court reasoned that the rule of necessity would apply because disqualification would result in denial of the litigants' constitutional right to have a properly presented question adjudicated.

Next, the Court explained that it would apply a *de novo* standard to review S.B. 1609. The Court began by presuming that the amendment was constitutional, recognizing that the plaintiffs bear the burden of overcoming the presumption of constitutionality.

On the merits, the Court began by addressing the argument that the case should be resolved by using only a federal Contract Clause analysis used by the U.S. Supreme Court in *Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400 (1983). "But accepting this argument would render superfluous the latter portion of §1(C), the Pension Clause, which prohibits diminishing or impairing public retirement benefits." Accordingly, the Court refused to apply the lower federal standard, which would treat the Arizona Pension Clause as "essentially meaningless." Similarly, the

Court reasoned that the Pension Clause "confers additional, independent protection for public retirement benefits separate and distinct from the protection afforded by the Contract Clause."

Turning to the benefit formula used to calculate future benefit increases, the Court agreed with plaintiffs that the term "benefit" includes the "benefit-increase formula." The State and the Plan had argued that the term "benefit" only includes "the right to receive payments in the amount determined by the most recent calculation." Looking to the history of the Pension Clause, the Court observed that the benefit formula predated the Pension Clause. When the original version sunsetted in 1994, the legislature removed the sunset in 1996 "unqualifiedly extending benefit increases in perpetuity." Two years later, the legislature reinstated the 4% cap and the voters approved the Pension Clause, affording public retirement benefits constitutional protection in 1998.

The Court also rejected the argument that the Pension Clause only protected liquidated amounts, rather than the statutory formula. Of course, monthly benefits are determined using a statutory formula. The legislature has "never promised to pay a specific dollar amount; rather, it has provided a formula by which the promised amount is calculated." As the legislature itself demonstrated when it passed S.B. 1609, lowering the benefit requires changing the formula. A contrary interpretation would place the "base benefit" outside the scope of Pension Clause protection because the base benefit is the direct product of a formula. Thus, the promised "benefit" necessarily includes the right to use the promised statutory formula.

In reaching this conclusion, the Court confirmed that its interpretation of the Pension Clause was consistent with prior Arizona cases. In particular, in *Yeazell v. Copins*, 402 P.2d 541 (Az. 1965), the Arizona Supreme Court held that an employee was entitled to have their retirement benefits calculated based on the formula in effect when employment began, rather than a less-favorable formula adopted during employment. Effectively affirming *Yeazell*, the Court held that plaintiffs had a right to "the existing formula by which his benefits are calculated as of the time he began employment and any beneficial modifications made during the course of his employment."

For additional guidance, the Court looked to the use of the term "benefit" in other states that have similar constitutional protections. For example, New York and Illinois have also determined that benefit calculation formulas are constitutionally protected. Additionally, the Court recognized that unlike the narrowly protections in some states, the Arizona Pension Clause extends broadly and unqualifiedly to "public retirement system benefits," not merely "accrued" benefits.

After concluding that the benefit formula was constitutionally protected, the Court proceeded with its analysis of whether S.B. 1609's amendments impaired retirement

system benefits. By retroactively preventing the transfer of $31 million to the Plan's COLA reserve, only a 2.47% benefit increase was paid in 2011 instead of the expected 4% increase. Moreover, no benefit increase was paid in 2012 or 2013, when a 4% increase would otherwise have been payable.

The Court further observed that S.B. 1609 makes it more difficult for retirees to receive future benefit increases by raising the rate of return required to fund a benefit increase from 9% to 10.5%. By tying benefit increases to the funding ratio, the likelihood of receiving the maximum 4% benefit was further diminished.

It is noteworthy that the unanimous decision was authored by perhaps the most conservative Justice on the Arizona Supreme Court. Ultimately, the Court refused to award statutory attorneys' fees or to apply the "common fund doctrine" to award fees. Fees for a successful mandamus action were not available since the complaint alleged that the Board did not use the correct formula, not that it refused to calculate the benefits at all. Because the common fund doctrine is capable of great abuse, it is exercised only in exceptional circumstances. The Court thus declined to exercise its discretion to award common fund fees. The entirety of the lower court's order was affirmed, however, which included an award of trial level fees.

While other Arizona class action cases involving other retirement systems remain pending, it is expected that the Court's broad language would generally apply to litigation against all state retirement systems.

This decision represents a major victory for the protection of public employment retirement benefits, particularly in jurisdictions with constitutionally protected pension contract rights. NCPERS filed a friend of the court brief on behalf of the retirees authored by NCPERS General Counsel Bob Klausner and Adam Levinson.

Fields v. Elected Officers Retirement Plan, 2014 WL 644467 (2/20/14).

Pension Change Deemed Unconstitutional for Lack of Required Vote.

Retired state employees association and taxpayers brought suit challenging the newly created cash balance plans for new hires that would allow certain active members to opt into the new plans. The cash balance plan was intended to be a hybrid plan, yet had a higher cost than the existing DC plan.

The Louisiana Constitution requires that any pension bill with an actuarial cost be adopted by 2/3 vote. The bill failed to pass by the requisite super majority. The Governor argued that he could disregard the legislative actuary's cost determination by hiring an outside actuary who produced a "no cost" valuation. The Supreme

Court said that the legislature itself set the role of the legislative actuary and could not ignore undesirable valuation results.

A state trial court struck down the law for failing to meet the constitutional requirements for passage. The decision was affirmed by a unanimous Supreme Court.

Retired State Employees Association v. State of Louisiana, 119 So.3d 568 (La. 2013)

Law Changing Pension Fund From Non-Contributory to Contributory Held Constitutional.

In 2011, the Florida Legislature enacted legislation that converted the statewide Florida Retirement System from a non-contributory to a contributory system, requiring all current members to contribute 3% of their salaries and eliminated future cost-of-living adjustments. The Legislature also prospectively eliminated the plan's COLA for all active members. Members of the system challenged the legislation and prevailed at the trial court. The trial court found that the legislation violated Florida's constitutional right to collectively bargain, the constitutional protection against impairment of contract, and the constitutional prohibition on taking private property for public use without just compensation. The state appealed and the case was certified as a question of great public importance, fast tracking the case to the Florida Supreme Court. In January 2013, the Florida Supreme Court issued its ruling and reversed the trial court. The Florida Supreme Court ruled that because the changes to the plan were prospective, they did not violate constitutional protections. The court held that "the preservation of rights statute was not intended to bind future legislatures from prospectively altering benefits for future service performed by all members of the FRS."

Scott v. Williams, 107 So. 3d 379 (Fla. 2013)

Law Requiring Withholding of Pension Contributions Declared Unconstitutional; but Later Law Making Participating Voluntary Did Not Create Constitutionally Protected Benefit Level.

In mid-August, 2012, the Michigan Court of Appeals determined that a 2010 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 court found that "[t]he prohibition against governmental impairment of contracts is violated because the statute requires that school employees be paid three percent less than the amount they and their employers freely agreed on in contracts."

In 2012, a revised statute made the contributions at issue in 2010 voluntary, but lowered health and pension benefit levels prospectively. A number of employee groups challenged the law on the basis of the 2012 court of appeal opinion on the *mandatory* contribution. This time, the appeals court ruled for the state, finding that health care benefits are not constitutionally protected retirement benefits under the state pensions clause. It also ruled that future accruals of retirement benefits were not diminished as increased contributions to keep the current benefit was not an impairment. As members had the choice to keep the current benefit and pay more or keep the current contribution and accrue less, the pensions clause was not violated.

AFT Michigan v. State, 825 N.W.2d 595 (Mich. Ct. App. 2012)
AFT Michigan v. State, ___N.W.2d___, 2014 WL 128086 (Mich. Ct. App. 2014)

Colorado Appeals Court Reinstates COLA Challenge

The Colorado Court of Appeals has reversed an order dismissing a state court action challenging the elimination of a variable COLA in the Colorado PERA. The appeals court found that under Colorado law, pension benefits are a contract and that contract included the COLA. The court returned the case to the trial court to determine in light of its finding that the state law impaired the pension contract, whether the state's action should be allowed as being "reasonable and necessary" to protect the public welfare. The Supreme Court of Colorado granted review in August, 2013.

Justus v. State, 2012 COA 169 (Colo. App. 2012); cert granted 2013 WL 4008216 (Co. 2013)

Washington Trial Court Upholds Pension Law Change

In an order dated November 9, 2012, a state trial court in Olympia issued an order striking down a 2011 law repealing COLA in the state employees' and teachers' retirement plans. The court held that a state cannot reserve the right to repeal vested benefits. Once granted, such a repeal can only be permitted if replaced with a substantially equal new benefit.

On appeal to the Washington Supreme Court, however, the trial court decision was reversed and the statutory change upheld. The Court held that the 1988 gain sharing statute contained a reservation of rights by the Legislature to alter the benefit in the future. As a result, employees consented to the reservation of rights as a condition of participating in the gain sharing program. Where a statute contains an express reservation of rights, the "contract" also includes the reservation.

Washington Education Ass'n v. State Retirement Systems, 332P.3d 428 (Wash. 2014).

Constitutional Protection of Health Care Benefits

A more recent trend in establishing a right to guaranteed retiree health care on the same basis as pension benefits has been a claim of implied contract. The theory is that governmental behavior and assurances over an extended period of time have created an implied right of contract. Courts which have recognized the theory have cautioned plaintiffs of their heavy burden in establishing a constitutionally protected right.

After a county passed a resolution that limits the amount of money that could be spent on retiree healthcare, an association representing the retirees filed suit. The association alleged various causes of action, including breach of express and implied contract. The association argued that the county's course of conduct over many years created an implied contract. Because the association was unable to identify any resolutions or ordinances that created a contractual relationship, the trial court dismissed the association's claims, with leave to amend. The association proceeded to file an amended complaint, which attached copies of numerous resolutions, memoranda of understanding, and ordinances upon which it relied. However, the trial court determined that none of these documents contained the county's express agreement not to reduce retiree healthcare benefits and dismissed the case with prejudice. On appeal, the court ruled that the association should have been given another chance to amend its complaint. In so holding, the court recognized recent judicial decisions holding that "a court can infer contractual rights from legislation when the legislature's intent is clear . . . ." In light of recent jurisprudence allowing a court to infer contractual rights from legislation, the court ruled that the association should have been given another opportunity to amend its complaint. However, the court noted that "a plaintiff claiming the existence of a contract with implied terms carries the heavy burden of establishing, from statutory language or relevant circumstances, that the public entity intended to create a compensation contract by ordinance or resolution. It also bears the equally heavy burden of establishing that implied terms in that contract provide vested healthcare benefits."

Following the decision in *Sonoma County*, a similar suit in another federal court survived a motion to dismiss.

In both of the cased discussed, the issue was the ability to present the claim; not whether the claim will succeed. Time and more litigation will ultimately settle the question.

Sonoma County Ass'n of Retired Employees v. Sonoma County, 708 F.3d 1109 (9th Cir. 2013)

Retiree Support Group v. Contra Costa County, ___F.Supp.2d___, 2013 WL 1915661 (N.D. Cal. May 8, 2013)

In New Mexico, No Constitutional Right to an Annual Cost-of-Living Adjustment to Retiree Benefits Based Upon the Cola Calculation in Effect at the Time of Retirement.

In 2013, the New Mexico legislature passed a bill that reduced the annual COLA; in some cases up to a 20%. Retired teachers sued, claiming a vested property right in the COLA calculation in effect at the time of their retirement. Their argument was based upon a constitutional provision that states public employees, "shall acquire a vested property right with due process protections" in a retirement plan. N.M. Const., Art. XX, § 22. The question before the New Mexico Supreme Court was whether the COLA is part of the retirement benefit. The Court answered this in the negative. The Court noted that the COLA benefit was created in a separate section of the statute creating the pension plan and that the COLA was provided independently from the obligation and payment of retirement benefits. The Court further stated that unless the legislature intended to create a property right, the legislature was crafting public policy which it can change prospectively and reducing the COLA did not reduce the underlying retirement benefit. The Act creating the reduction, therefore was not unconstitutional.

Bartlett v. Cameron, 316 P.3d 889 (N.M. 2013)

Illinois Appeals Court Upholds Health Care Claim.

Former and current employees of city of Chicago transit authority filed class action law suit against transit authority following changes to health care benefits, alleging breach of collective bargaining agreements, unconstitutional impairment of contract, and breach of fiduciary duty. The plaintiffs' contentions, in essence, were that after years fully paid health insurance benefits for retired CTA (Chicago Transit Authority) employees, retirees are now asked to pay for a portion of their health care. The

plaintiffs' claims were dismissed at the trial level because the trial court concluded that since the plaintiffs had no vested right to retiree health care benefits, plaintiffs could not state a cause of action under any theory of recovery. The court determined that under Illinois law, there was a presumption in favor of retirement health care benefits being vested in the form they exist, at the time of the members' retirement. The court further held that the next step was to examine the language of the retirement plan and determine whether the retirement plan unambiguously provides that retiree health care benefits were not intended to be vested. After examining the retirement plan, the court determined that the agreement was clear that, at the very least, benefits up to the level of the language of the plan, which capped benefits at the level provided on December 31, 2003.

Mathews, et al. v. Chicago Transit Authority, et al., 2014 IL App (1st) 123348 (Feb 7, 2014)

ADMINISTRATIVE CASES

Claim of Fiduciary Breach Does Not Excuse Required Employer Contributions.

Trustees brought mandamus action to require city to budget, appropriate and pay actuarially-required contributions to municipal firefighter pension fund. The Trustees alleged that beginning in 2010, the City of New Orleans unilaterally reduced its contributions and continually failed to pay the actuarially-calculated contributions resulting in a shortfall of $34,000,000 by 2012.

The City argued that mandamus was not the proper procedure for enforcement of funding obligations since the pension statute is vague. Ordinarily mandamus only applies strictly to ministerial acts. The City also argued that the Trustees had mismanaged the investments and the City sought the right to "take over management of the Fund." The trial court agreed with the Trustees that the applicable statutes, when read together, provide that the City shall contribute the required "normal contribution" and "accrued liability contribution." The use of the term "shall" rather than "may" supports this conclusion. Moreover, the Court reasoned that related statutory language would otherwise be meaningless under the City's proposed interpretation. Although the statute does not contain any provision allowing the City to challenge the actuary's determination, the Court recognized that its function was not to legislate or rewrite the law.

This conclusion was affirmed by the appellate court which agreed that funding obligations were ministerial in nature. The alleged mismanagement by the Trustees

was irrelevant as the statute obligated the City to make the required contributions. The court refused to rewrite the statute to circumvent the City's funding obligation.

New Orleans Fire Fighters Pension and Relief Fund v. City of New Orleans, 2013 WL 6923719 (La. App. 4th Cir. Dec. 18, 2013).

Colorado Court Denied Records Access for Non-fiduciary Purpose.

In a recent decision, the Colorado Court of Appeals upheld the state retirement system's board of trustees refusal to give the state treasurer, himself a co-trustee, unfettered access to member records otherwise made confidential by statute.

The state treasurer requested information concerning the top 20% of pension beneficiaries, including place of employment, salary, and Zip Code of residence. No purpose related to the efficient administration of the system or any other identifiable fiduciary purpose was articulated as a basis for the information request. As a result, the Board of Trustees denied the request. Even after outside counsel opined that release of the information would be a breach of fiduciary duty, the treasurer persisted in his request by filing suit against the Board for breach of fiduciary duty. The Board counter claimed for a declaration that its records policy was consistent with its fiduciary duty.

A state trial court ruled against the treasurer. On appeal, the Colorado Court of Appeals affirmed the decision, finding that unfettered access to member financial records for reasons unrelated to the members' best interests was contrary to the duty of a fiduciary and the Board correctly acted to preserve the statutory privacy rights of members. This decision is an important analysis of the often conflicting interests of statutory ex officio trustees who may view their political offices as taking precedence over their duties as trustees to the retirement plan. In ruling for the Board, the Court made it clear that pension trustees must act in all instances in the best interests of plan participants to the exclusion of any other office or political goal. In August 2014, the Supreme court of Colorado denied review.

Stapleton v. PERA,___P. 3d___, 2013 WL 3943272 (Colo. App. 2013).

Trustee Discretion on Investment of COLA Proceeds Upheld

Under the terms of the City of Tampa Fire and Police Pension Plan, a 13th check may be issued if certain earnings benchmarks are met. The Fund was defending an unrelated claim by retirees which if unsuccessful for the Fund would have lowered net earnings below the benchmark. In an abundance of caution, the Board of trustees placed the 13th check proceeds in a separate account with little or no market

risk, but which earned less than the over-all portfolio. The Fund prevailed in the retiree suit and paid the 13th check. A different group of retirees sued the Fund claiming it breached its fiduciary duty by reserving the 13th check proceeds in a safer investment and wanted what would have been the additional interest had the trustees left the proceeds at risk to the market. A state trial judge dismissed the case and the retirees appealed. The Florida appeals court affirmed finding that the decision to hold the proceeds of the 13th check in a safer investment environment was a sound exercise of the Board's fiduciary duty.

Pena v. Board of Trustees, ____So.3d____, 2014 WL 4086821 (Fla. 2d DCA 8/20/14)

BENEFITS CASES

Retiree Benefits Tied to Labor Contract Can Be Reduced if Active Member Benefits Reduced

A group of retired firefighters were receiving disability benefits for line-of-duty injuries. Pursuant to local law, the city was required to pay the firefighters "the difference between such benefits and their 'regular salary and wages.'" During the course of their retirement, the city and union entered into a new collective bargaining agreement, which included a 5% salary reduction applicable to "all 'bargaining unit members,' except as otherwise 'required by law.'" After the collective bargaining agreement was ratified, the city notified the firefighters receiving disability benefits that their benefits would be reduced accordingly. The firefighters filed suit, arguing that they are not "bargaining unit members" within the meaning of the collective bargaining agreement and that they have a vested interest in the higher salaries which cannot be reduced. The city argued that the retirees would receive the benefit of any salary increases and therefore must be subject to any salary reductions. Noting that this was a case of first impression, the court ruled that because the payments owed to the retired firefighters is directly tied to the salaries of active firefighters, the retirees are subject to any reduction in salary paid to active firefighters.

Whitted v. City of Newburgh, 961 N.Y.S.2d 727 (N.Y. App. 2013)

Member Bears Burden to Insure System Has Accurate Records.

Charter school employee sought review of decision of Public School Retirement Board's decision to deny employee' request for credited service for particular years. During a three year span of time the employee worked in a full time capacity as administrator, simultaneously, at two different charter schools and was shown as

performing services for three other charter schools. The schools did not provide proper documentation to the board that employee "actually engaged in work for the school district" the requisite number of days in each school to be given retirement credit for both charter schools. The Board asserted the employee bore the burden of proof of providing evidence of the actual number of hours she worked for the two charter schools. The employee admitted in cross-examination that she had no idea how many hours she worked at each school and presented no documentation on the issue. The appellate court held that the burden was upon a member to prove the retirement system records are accurate before the member retires.

Hairston-Brown v. Public School Employees' Retirement Board, 78 A.3d 720 (Pa. 2013)

Liberal Construction of Plan Language Cannot Extend Benefits.

Former city council member challenged determination of the Public Employees' Retirement System Board of Administration calculation of member's retirement benefit. The board, pursuant to statute, bifurcated the member's benefit calculation and calculated the member's service as a state employee at a different rate than his service as an elected official, which yielded a benefit lower than member calculated. The court held that pension benefits are to be broadly construed in favor of those who were intended to be benefitted, but they are cannot be construed so as to confer benefits a member is not entitle thereto.

Chaidez, et al. v. Board of Administration of California Public Employees' Retirement, 167 Cal.Rptr.3d 587 (Cal. App. 2014)

Surviving Spouse Allowed to Receive Deceased Husband's Pension After Husband Left Service Early But Had Not Yet Obtained the Age of Retirement.

The City of Altoona, Pennsylvania Paid Firemen's Pension Fund provides for a 20 year retirement, but allows members to vest after 12 years and receive their pro-rated pension at what would have been their normal retirement age. The husband left service with the department at 13 years, and filed documents to receive his pension at the time he would have normally retired. During that interim, husband passed, so at the normal retirement time, the surviving spouse applied for spousal death benefits. The City filed suit for declaratory relief claiming that the ordinance does not allow for the wife to receive a benefit as the member was not actively working and not yet "on pension" as the code describes, at the time of his death. The question before the Court was to interpret the meaning of the phrase "retired on pension." The Court began its discussion, noting the object of statutory construction was to give effect to the intention of the legislature and that pension statutes are to be liberally construed. The Court then held that because the member had filed the

proper documentation to receive a pension at the appropriate time, that fulfilled the intent behind the phrase, "retired on pension." The Court noted that had the legislature intended that the member actually be receiving benefits, as the City argued, the legislature would have used the terms, "retired and receiving a pension."

City of Altoona Paid Firemen's Pension Fund Assoc. v. Dale-Dambeck, 83 A.2d 279 (Pa. 2014)

SURVIVORSHIP CASES

Failure to Inform Does Not Revive Untimely Death Benefit Application.

The widow of a public employee contacted the pension fund shortly after the member's death requesting information regarding benefits. The pension fund sent the widow the application for survivor benefits, but did not inform her that there was a one year deadline to apply for the benefits. After the widow failed to submit her application within one year of her spouse's death, her claim for benefits was denied. The widow sued, claiming a host of constitutional violations. However, the court agreed with the pension fund that the widow was precluding from receiving any survivor benefit due to her failure to timely file an application. The court concluded that "her right to survivor benefits was governed by the terms of the Act and it terminated when she failed to comply with the Act's application requirements within one year of her husband's death."

Martinez v. Public Employees Retirement Ass'n of New Mexico, 286 P.3d 613 (N.M. Ct. App. 2012); review granted, 296 P.3d 1207 (N.M. 2012); review denied, 300 P.3d 1182 (N.M. 2013)

Right to Elect Benefit Option Cannot be Assigned.

Administrator of estate of decedent who was receiving a firefighter's widow's annuity at time of her death brought suit against the Retirement Board of the Firemen's Annuity and Pension Benefit Fund of Chicago, alleging that widow would have been entitled to receive a higher death annuity benefit, and seeking to recover for the estate additional payments that widow would have been entitled to receive but did not during her lifetime. Illinois Appellate court held that it against public policy to allow an estate to receive as assignee, the right to apply for enhanced widow's benefit that the widow was notified of and never applied for during her lifetime.

Pursuant to statute, the widow was barred from assigning her right to any benefit while alive, therefore the law prohibits the same through an estate.

Reynolds v. Retirement Board of the Firemen's Annuity and Benefit Fund of Chicago, 990 N.E.2d 337 (Ill. App. 1st Dist. 2013)

Estate is a Necessary Party in Death Benefit Claim.

Ex-wife appealed denial of awarding ex-husband's pension benefits following his death. Appellate court held that under NY law, decedent's estate was a necessary party to the proceedings and ordered joinder of the estate prior to resolution where both ex-wife and estate claim entitlement to ex-husband's death benefit.

McCauley v. New York State and Local Employees' Retirement System, 112 A.D.3d 1211 (N.Y. App. Div. 2013).

DISABILITY CASES

Pension Board's Denial of Disability Application Upheld When Pension Board Stated with Particularity its Reasons for Disregarding Medical Opinion.

A pension board denied a police officer's application for disability benefits and the officer appealed. The officer's application for disability benefits was based upon injuries suffered as a result of two separate accidents. In one incident, the officer was hit in the head by the side mirror of a passing car. In the other incident, the officer fell out of her chair and hit her head on a metal cabinet. The pension board, relying on an independent medical examination conducted by a neurologist, determined that the officer was not totally and permanently disabled. The officer requested an administrative appeal of the board's decision. At the time of the administrative appeal, the neurologist who performed the independent medical examination became unavailable to testify. Therefore, the board sent the officer for another independent medical examination. This second independent medical examination, also performed by a neurologist, concluded that the officer was not totally and permanently disabled.

At the administrative hearing, the officer presented three fact witnesses, including the chief of police, who testified that over the past ten years they had noticed a deterioration of the officer's memory, cognitive abilities, and ability to keep focused. The police chief specifically testified that the officer is unable to perform the duties of a police officer due to her memory problems. The officer also presented reports by doctors she had previously seen stating that she was unable to perform the duties of a police officer due to memory problems. However, the board's medical witness

testified that in his medical opinion, the officer's problems were not caused by neurological issues. Rather, the board's medical expert believed that the officer's issues may be caused by depression, which is treatable and not permanent. The administrative law judge recommended that the officer's application for service-connected disability be denied, but that her application for non-duty disability be granted. The board, however, again voted to deny any disability benefits to the officer. The officer proceeded to appeal the board's denial. The appellate court recognized that "[a]gency decisions are given a strong presumption of reasonableness, and we will generally not reverse such a decision unless it is arbitrary, capricious, or unreasonable, or it is not supported by evidence in the record." Because the pension board stated with particularity its reasons for rejecting certain medical opinions and accepting others, the appellate court found that the board's decision was reasonable and supported by substantial evidence.

Bailey v. Police and Firemen's Retirement System, 2013 WL 11705 (N.J. Ct. App. 2013) (Unpublished)

Board Cannot Ignore Record Evidence in Favor of Speculation.

Police officer challenged denial of disability benefits because of post-traumatic stress disorder and depression after service after September 11th events at World Trade Center. The appellate court held that although the Medical Board is empowered to weigh conflicting evidence, it may not ignore medical evidence and speculate as to other causes of disabling medical conditions in order to rebut statutory presumptions.

Ginther v. Kelly, 109 A.D.3d 738 (N.Y. App. Div. 2013)

Collapsing Stretcher Sufficiently Unusual to Constitute an "Accident."

Police officer challenged denial of application for disability retirement benefits. Appellate court held that when applying for disability pension because of accident, the petitioner has burden of proving the underlying incident constituted a "sudden, fortuitous, out of the ordinary and unexpected event that does not result from an activity undertaken in the performance of regular or routine employment duties." In this case, a stretcher carrying a patient collapsed, which had not happened in 20 years, so the event was sufficient to meet burden.

Scharp v. DiNapoli, 104 A.D.3d 1041 (N.Y. App. Div. 2013)

FORFEITURE CASES

Assaulting Fellow Police Officer Constitutes Forfeitable Offense.

A municipal police pension board forfeited a police officer's pension benefit after the officer was convicted of assaulting a fellow officer. The officer appealed the forfeiture and the appellate court ultimately upheld the forfeiture. The officer was off-duty, wearing civilian clothing, and carrying his department-issued firearm in his off-duty holster. After consuming numerous alcoholic beverages, a fellow officer invited to drive the officer and suggested that he sleep at his house. The officer agreed, but when they arrived at the fellow officer's house, he began walking away from the house. The fellow officer followed the officer on foot and asked him to come back to his house. From a distance of five to six feet, the officer drew his firearm, shot his fellow officer once near his hip, and left the scene. The officer subsequently pleaded guilty to assault and battery with a dangerous weapon. The nexus required for pension forfeiture under state law "is not that the crime was committed while the member was working, or in a place of work, but only that the criminal behavior be connected with the member's position." The court found that the officer "engaged in the very type of criminal behavior he was required by law to prevent." The court upheld the forfeiture, finding that "this violation was directly related to his position as a police officer as it demonstrated a violation of the public's trust as well as a repudiation of his official duties."

Durkin v. Boston Ret. Bd., 83 Mass. App. Ct. 116, 981 N.E.2d 763 (Mass. Ct. App. 2013)

Forfeiture Requires Return of Benefit Payments Made Prior to Conviction.

After being convicted for larceny for stealing paving supplies from the city's highway department, a municipal pension board ordered the forfeiture of the employee's pension. In the first level judicial review, the court ruled that the pension forfeiture did not constitute an excessive fine, but that the employee could keep any benefit payments he received prior to the date of his conviction. Upon further judicial review, the next level court affirmed the forfeiture and held that the employee could not keep any benefits in excess of his actual contributions. The employee appealed, and effectively obtained a third appellate review. Upon further review, the court ultimately held that the forfeiture was proper, rejecting the employee's argument that the forfeiture violated the Excessive Fines Clause of the Eighth Amendment to the United States Constitution. Further, the court also ruled that the pension statute

required that the former employee repay all pension benefits that he received in excess of his actual contributions, even those funds received prior to his conviction.

Flaherty v. Justices of the Haverhill Div. of the Dist. Ct. Dept. of the Trial Ct., 83 Mass. App. Ct. 120, 981 N.W.2d 745 (Mass. Ct. App. 2013)

Off-duty Sexual Abuse of Another Firefighter's Child Found Not to Be a Forfeitable Offense.

A former firefighter pled guilty to numerous counts involving sexual abuse of minors. One of the firefighter's victim's was another firefighter's son. Following his initial indictment, the firefighter applied for retirement benefits, which were granted. However, after he was convicted of various related offenses, the pension board decided to forfeit his pension benefits. The firefighter appealed the board's decision. On the first level of appellate review, the court reversed the board's decision and found that there was not a significant nexus between the firefighter's offenses and his position as a firefighter. The pension board proceeded to appeal that decision. Upon further review, the court analyzed numerous forfeiture cases and found that the firefighter's pension was improperly forfeited. The court reasoned that the crimes did not occur at the fire station, the firefighter was never on duty when the crimes occurred, and he never used his position, uniform, or equipment in the commission of his crimes. While noting that the firefighter's crimes were reprehensible, the court found that they were personal in nature and not sufficiently connected to his duties as a firefighter to warrant forfeiture of his pension benefits.

Retirement Bd. of Maynard v. Tyler, 981 N.E. 2d 740 (Mass. Ct. App. 2013)

Even If There Is a Money Judgment Against a Public Employee for a Bribery Conviction, Pension Board Cannot Refuse to Return Employee's Contributions.

A federal grand jury indicted a public employee on multiple felony counts related to accepting bribes. After pleading guilty to the charges, the employee was ordered by the criminal court to forfeit to the government the funds he illegally obtained. About one month prior to entering his guilty plea, the employee resigned and requested a return of his pension contributions. The pension board refused to return the employee's contributions based upon the fact that a money judgment for restitution had been entered against the employee. The employee filed suit, arguing that the board wrongfully refused to return his pension contributions. The trial court agreed with the employee that the pension board cannot lawfully refuse to return his contributions. The pension board appealed. On appeal, the court analyzed applicable law and concluded that the board could refuse to return the employee's

contributions if there was a "restitution" order against the employee. However, the court determined that the judgment at issue did not constitute a restitution order, but was rather a forfeiture order, because the debt was not owed to the victim of the employee's crimes. Therefore, the court held that the pension board could not lawfully refuse to return the employee's contributions.

Zambarano v. Retirement Bd. of Employees' Retirement System of the State of Rhode Island, 61 A.3d 432 (R.I. 2013)

Former Judge's Pension Properly Forfeited Where Statute Providing for Forfeiture Did Not Allow for Weighing Underlying Facts of Case Removing Judge from Bench.

After the Pennsylvania Court of Judicial Discipline removed a district judge from his office for directing improper language to staff, some of which included sexual innuendo. The Board of the State Employees' Retirement System forfeited the former judge's pension, and he appealed, asserting the Pennsylvania Constitution and Judicial Code precluded forfeiting the entire pension and the magnitude of forfeiting his entire pension was extremely unfair based upon the conduct alleged. The appellate court held state law did not provide the Board with the discretion to weigh the magnitude of the conduct alleged, in that the state constitution and judicial code provided that any jurist removed from officer for misconduct was precluded from receiving a pension in retirement. Former judge also asserted the rules regarding forfeiture were instituted after he was elected to office, but the court held that the former judge was twice re-elected, thus creating a new contract with the state in regards to his pension, and that each new contract placed at risk everything he had earned. The court finally held that it was error to forfeit that portion of the former judge's pension that he was purchased through prior military service.

Berkhimer v. State Employees' Retirement Board, 60 A.3d 873 (Pa. 2013)

Court Upholds Forfeiture Based on Federal Crime.

A former school superintendent petitioned for review of order of Public School Employees' Retirement Board, determining that his retirement benefits were forfeited as a result of his guilty plea to the federal criminal offense of corrupt receipt of reward for official action concerning a program receiving federal funds. The appellate court held that the Board properly rejected a hearing officer's order which held the federal offense not to be the same as the state offense which would cause the former school superintendent to forfeit pension. The hearing officer incorrectly focused on the phrase "substantially the same as" in comparing the federal and state offenses, instead of the test previously established by the courts of Pennsylvania,

the court must compare the elements of the two crimes, the burden of proof and the required *mens rea*. After conducting that test in comparing the two crimes, the appellate court found the federal crime to be a qualifying crime to forfeit the pension. The court next dealt with the former superintendent's argument that the forfeiture act was an improper delegation of legislative power to the pension board. The court held the statute provided a standard by which the board could properly act and was therefore constitutional. Finally, the court held that forfeiting a pension was not a fine, which might render it excessive in violation of the Eighth Amendment to the US Constitution, but was the result of a breach of contract.

Scaratino v. Public School Employees' Retirement Board, 68 A.3d 375 (Pa. 2013).

SAME GENDER MARRIAGE AND SURVIVORSHIP

As of January 2014, seventeen states and the District of Columbia had legalized same gender marriage. What will be the effect on the definition of "marriage" when members marry in states where same gender marriage is legal, but participate in a public employee retirement system in a state where such marriages are still prohibited?

Many states have expressly defined marriage as being only between persons of opposite genders. For example, marriage in Texas is defined as a union between a man and a woman. Texas Family Code, Section 2.001. Article I, Section 32 of the Texas Constitution provides in pertinent part "... the state or a political subdivision of this state may not create or recognize any legal status identical or similar to marriage." A similar provision was added to the Utah Constitution in 2004. Similar provisions exist in thirty-one other states, by statute or constitution.

The recent decision of the United States Supreme Court in *U.S. v. Windsor*[1] effectively requires recognition by pension funds of same gender marriages which were lawful in the state where made, even if the state where the fund is located prohibits same gender marriages. In *Windsor*, the Supreme Court struck down the provisions of the Federal Defense of Marriage Act which purported to allow states to refuse to honor same gender marriages from other states. Article IV, Section 1 of the U.S. Constitution requires each state to give "full faith and credit" to the laws and judicial decisions of every other state. The Supreme Court in *Windsor* recognized that marriage is a purely state law concern and Congress could not adopt a law which had the effect of invalidating a state marriage law.[2]

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[1] 133 S.Ct. 2675 (2013)

[2] Id.

The holding in *Windsor* has since been extended to the states by a federal court in Ohio. In *Obergefell v. Kasich*,[3] the U.S. District Court issued a temporary injunction requiring Ohio, which like 32 other states does not permit same gender marriage, to honor a lawful same gender marriage made in Maryland.

On February 26, 2014, a federal court in the Western District of Texas found that Texas must recognize a lawful marriage of a same gender couple entered into in Massachusetts.[4] The Court found that the state's premise that same gender couples would not be good parents did not survive an equal protection analysis. Similar results were achieved on due process grounds in Virginia[5] and Oklahoma[6].

The Treasury Department and the Internal Revenue Service similarly honor lawful state same gender marriages. IRS Notice 2013-61, IRS Notice 2014-1, and Revenue Ruling 2013-17 make it clear that the IRS recognizes "marriage" to include a same gender marriage created in those jurisdictions which recognize them. In light of the *Windsor* decision and the interpretations which have followed, failure to recognize a same gender marriage which was lawfully made in a different state may jeopardize the qualified status of a plan.[7]

Pension plans themselves, however, may not define marriage. An attempt by the Atlanta City Council to provide legal benefits to domestic partners on the same basis of marriage was rejected by the Georgia Supreme Court as invading the state legislature's exclusive authority to regulate marriage. A later ordinance defining benefit eligibility on the basis of "dependency" was held valid because it did not seek to define "marriage."[8]

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3 ___F.Supp.2d___, 2013 WL 3814262 (S.D. Ohio 7/22/2013). Final judgment was granted invalidating the statute in Obergfell v. Wymslo, 962 F. Supp.2d 968 (S.D. Ohio 2013).

4 De Leon v. Perry, 975 F. Supp.2d 632 (W.D. Tex. 2014)

5 Bostic v. Rainey, 970 F.Supp.2d 456 (E.D. Va. 2014), aff'd, ___F.3d___, 2014 WL 3702493

6 Bishop v. U.S., 962 F.Supp2d 1252 (N.D. Okla. 2104), aff'd, ___F.3d___,2014 WL 3537847 (10th Cir. 2014)

7 IRS Notice 2014-19

8 City of Atlanta v. Morgan, 492 S.E.2d 193 (Ga. 1997)

Laws regulating marriage have been recognized by the U.S. Supreme Court for more than a century as strictly a function of state legislatures. In an 1890 decision[9] it was held that the "whole subject of domestic relations" belongs to the laws of the states and not the laws of the United States.

Similarly, a lawful marriage is a requirement for death benefits which are only payable to a "spouse." After the decision in *Windsor*, the Supreme Court of Missouri considered the case of a state trooper killed in the line of duty. The deceased trooper had been in a long-term relationship with a person of the same gender for nearly 15 years prior to his death. Although same gender marriage was lawful in the neighboring state of Iowa, the trooper and his life partner never married. The survivor's claim for spousal benefits was rejected by the Board of Trustees. On review, the Supreme Court of Missouri declined to address the constitutional questions of whether equal protection of the law had been violated.[10] Instead, the Court simply found that because the trooper and his partner were not married, the survivor could not challenge a spousal survivorship law where having a marriage was an essential element of entitlement.

Nothing in the *Windsor* decision requires a state to alter its marriage laws. If the plan statute or ordinance permits benefit payments to a "spouse," however, that should be interpreted to give "full faith and credit" to a marriage formed in any state which was valid in that state. Thirty-nine states no longer permit the creation of a common law marriage; but every state is required to recognize a common law marriage that was valid in the state where formed. In light of the growing body of federal case law, the better legal view is that same gender marriage should receive the same treatment.

This view is further supported by the IRS qualification requirements under Section 401 of the Code that will necessitate recognition of same gender marriage as a condition of continued tax qualification.[11]

Yet, just as the issue seemed settled among the federal judiciary, a U.S. District Court in Louisiana upheld that state's ban on same gender marriage.[12] There the Court viewed same gender marriage as on a rational basis versus a fundamental right analysis and concluded that the state had a rational basis for denying same gender marital rights holding that fundamental social change should be determined

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9 In re Burrus, 136 U.S. 586 (1890)

10 Glossip v. MoDOT Retirement System, 411 S.W.3d 796 (Mo. 2013)

11 IRS Notice 2014-19, Rev. Rule 2013-17

12 Robicheau v. Caldwell, ___F.Supp.2d____, 2014 WL 4347099 (E.D. La. 2014)

through democratic consensus. That decision is currently pending review in the U.S. Court of Appeals for the 5th Circuit.

WHAT IS HAPPENING IN BANKRUPTCY COURT?

A. What Are the Facts?

On July 17, 2013, the City of Detroit filed a petition for protection from creditors under Chapter 9 of the Bankruptcy Code, making it the largest municipal bankruptcy filing in U.S. history. The filing, like those in Stockton and San Bernardino has implications most notably for bond holders and participants in the two city retirement systems.

To date, there is little history regarding the application of the bankruptcy law to municipal pensions. Two high profile bankruptcy cases filed by municipal governments have sharply focused the effect of Chapter 9 of the Bankruptcy Code on pension obligations.

B. A Discussion of the Cases.

The City of Prichard, Alabama became the first city in American history to completely default on its employee pension obligations. Prichard sought protection under Chapter 9 of the Bankruptcy Code relating to municipal debt obligations. The automatic stay prevented pursuit of a number of actions by the city's creditors including its employees. The bankruptcy petition was dismissed as not meeting the test under Chapter 9 and has since made some partial pension payments since the automatic stay was dissolved. The petition was later reinstated after the Alabama Supreme Court ruled that the City had authorization under state law to file. Proceedings in 2013 continued to center on whether the petition should again be dismissed.

Vallejo, California received judicial approval to break its collective bargaining agreements in its bankruptcy proceedings. As Vallejo is a participant in the California Public Employees Retirement System (CalPERS), it has no local retirement plan. The unanswered question from the Vallejo decision is whether a city that rejects a collective bargaining agreement also is relieved of its obligations under a pension plan. Vallejo settled its bankruptcy without impairing its pension obligations.

At issue in both Stockton and San Bernardino is whether the Supremacy Clause of the U.S. Constitution will permit a bankruptcy court to disregard state constitutional pension protections. In Stockton, the court has already relieved the City of certain post-retirement health care obligations.

The City of Stockton reached an agreement in October 2013 with other creditors and will continue in CalPERS with no change in benefits. The City was able to convince the bond holders that the loss of pension benefits would so disrupt the remaining workforce that recovery of the City would be impossible.

Central Falls, Rhode Island was sued in an adversarial proceeding by its teachers' union over the effect of that city's bankruptcy proceedings on retirement benefits when municipal bondholders were protected in the bankruptcy plan at the expense of retired and active employees. Bond holders suffered no loss, while retirees took pension cuts of up to 55%. By contrast, a bankruptcy plan by Stockton, California placed the onus on bondholders and no recommended changes to the City's obligations to the California Public Employees Retirement System.

In San Bernardino, the bondholders are demanding that the pension system "share in the pain" endured by all creditors in bankruptcy who receive less than full compensation. This set the stage for a legal challenge by the bond insurer for a pension obligation bond issue as to the relative rights of bondholders versus pensioners in Detroit as well. The Bankruptcy Judge in October 2013 ruled that San Bernardino was "eligible" to proceed in bankruptcy and lumped CalPERS in with other creditors despite claims by the State that it was immune to such claims. That eligibility issue as it relates to pensions is already on appeal to the U.S. Court of Appeals for the 9th Circuit.

WHAT IS DIFFERENT ABOUT DETROIT?

A. The Detroit case is of particular significance in that, unlike California, Michigan has an express provision in its state constitution which makes pensions a contract between the employee and public employer. The City and the bondholders contend that the federal law overcomes this state constitutional provision. On July 18, 2013, a state judge in Lansing, the state capital, held that the constitutional provision expressly prevents the Governor from authorizing Detroit's emergency financial manager from seeking bankruptcy protection.

B. The Ruling.

The federal bankruptcy judge held a lengthy trial to determine if Detroit was "eligible" to file for bankruptcy. The issue is whether the State Legislature in Michigan could authorize a bankruptcy that could affect pensions if the Pensions Clause in Michigan prohibits any law impairing pensions. A ruling on eligibility took place on December 3, 2013.

The Bankruptcy Judge held that despite the constitutional provision, the Supremacy Clause of the U.S. Constitution allowed the Court to treat the pension contract the same as any other contract in bankruptcy - it can be impaired in a plan of adjustment.

C. The Plan of Adjustment and the Pending Appeal.

On February 21, 2014 the City filed a 440 page plan of adjustment outlining in detail the treatment proposed for all creditors, including pensioners.

In summary, the plan proposes reducing general employee benefits between 26% and 30%, which would push nearly a quarter of all retirees below the poverty line. The current plan for existing employees would be replaced with a hybrid plan.

Police and fire retirees, who do not have Social Security, would receive approximately 94% of pension benefits. Current workers would also be placed in a hybrid plan.

No COLAs would be paid for 10 years and a restructuring of the respective boards of trustees' investment authority would be required. In addition the plans would have assumed rates of return of 6.5% for PFRS and 6.25% for the GRS.

On Friday, February 21, 2014, the United States Court of Appeals for the 6th Circuit agreed to hear the legal question of whether Detroit was eligible to file for Chapter 9 with the ability to impair the pension contract.

In March, a revised POA was filed seeking cuts of up to 49% for general retirees and 32% for public safety. In addition, efforts continue to restructure the boards to remove stake holders from having an effective voice in their retirement systems.

Mediation efforts have proposed a substantially less draconian result of 6% cuts for general retirees and loss of the COLA for a period of time and no

reduction for public safety, also with a period of COLA loss. Contained within that proposal, however, is a "hard freeze" of accrued benefits.

As of the date of this outline discussions continue while at the same time the appeal in the 6th Circuit of the eligibility questions will continue. The retirement system, the retiree committee and the unions filed briefs on April 24th and amicus briefs in support of the constitutional protections were filed on May 1 by AARP, TEXPERS, NCPERS, CalPERS, the AFT, and the IPFA.

In early July, the participants in the Detroit pension systems approved the most recent version of the Plan of Adjustment. Police and fire kept 100% of their base benefits and lost most of their COLA benefits, subject to restoration at a future date. General members lost 4% of the base benefit and the suffered the same future COLA reduction.

The appeal of the eligibility argument was stayed by the Court of Appeals in late July, 2014 pending completion of the approval of the Plan of Adjustment by the Bankruptcy Court. An appeal by the insurance company for the City's bonds against the City concerning whether certain revenues were part of the bankruptcy estate continued but was settled in September 2014.

D. The Real Constitutional Issue.

The real constitutional issue was not a state versus federal sovereignty issue. Instead it had to do with the plain reading of the Michigan Constitution. If the state constitution prohibits laws which impair contract and the bankruptcy law allows a bankruptcy only if state law allows it, then how could Michigan pass a state law which violates its own constitution by allowing the pension contract to be impaired?

WHAT DOES THIS MEAN FOR THE NEW BATTLE IN ILLINOIS?

A. Like Michigan, the Illinois Constitution prohibits any impairment of the Pension Contract. The Illinois Pensions Clause is actually broader than the Michigan clause which addresses "accrued benefits." While that term is subject to debate as to whether it means benefits earned to date or the formula in effect when a member vests, that is not open to debate in Illinois. The benefit structure in effect when a firefighter is hired is the base benefit which cannot be reduced.

A state cannot file for bankruptcy in Chapter 9 of the Federal Bankruptcy Code. A city cannot file for bankruptcy unless the state government where it

is located has passed a law authorizing the filing. Illinois and 26 other states do not have a general bankruptcy filing law for cities. A petition by Washington Park, Illinois was denied in 2010 because Illinois did not have a state law authorizing bankruptcy.

Illinois does have a law for cities in financial distress. The Local Government Financial Planning and Supervision Act, 50 ILCS 320 provides a means for addressing municipal insolvency. 50 ILCS 320/9 (b)(4) allows a commission established under the law to recommend filing a petition. The Bankruptcy Court in the case of *In re Slocum Lake Drainage District of Lake County*, 336 B.R. 387 (Bkrtcy. N.D. Ill 2006) dismissed a bankruptcy proceeding due to the absence of a commission under the Financial Planning and Supervision Act recommending such a filing and the absence of a general state law authorizing a Chapter 9 petition. Even if the law was found to constitute legislative authorization, the law must still otherwise comport with the rest of the state constitution.

B. The Battle in Illinois.

The Illinois Legislature made an important change in state law when it reduced pension benefits in 2013. It effectively overturned an earlier state Supreme Court decision which said that pension plan members could sue over underfunding. The new law allows suits to force funding if the state fails to meet the statutory funding requirements. Will this new right be a sufficient quid pro quo for the dramatic benefit reductions? The lawsuits have already begun and consolidated into a class action affecting more than 600,000 workers and retirees. In challenges to alteration of retirement benefits, the issue is whether the change is a "diminution." The theory behind the new legislation is that providing a right to sue for the funding is a "new and offsetting advantage." The current state of the law in Illinois is that a court cannot order funding. See, *Sklodowski v. State*, 695 N.E.2d 374 (Ill. 1988). Is the judicial right of enforcement a benefit? Is it a lawful surrender of legislative independence to set fiscal policy?

C. The *Kanerva* Decision and its Import

In a very important decision of first impression reached on July 3, the Illinois Supreme Court held that the General Assembly was precluded from impairing or diminishing health insurance subsidies provided to state retirees.

Effective July 1, 2012, Public Act 97-695 eliminated the statutory standards[13] for the mandatory state contribution to health insurance premiums for members of the three state retirement systems. Instead, Act 97-695 required the Director of the Illinois Department of Central Management Services to administratively determine, annually, the amount of health insurance premiums that will be charged. To facilitate the implementation of the new system, Act 97-695 permits the new contributions to be altered through emergency rules. This amendment "fundamentally altered" the state's obligation to contribute toward the cost of health insurance coverage.

Members of the State Employees Retirement System (SERS), the State Universities Retirement System (SURS) and the Teacher Retirement System (TRS) brought four class actions challenging the constitutionality of the health insurance reduction under various theories including: violation of the Illinois Constitution pension protection clause (Article XIII, Section 5), contracts clause, separation of powers, along with common law claims based on contract and promissory estoppel theories.

The defendants, including the Governor, and State Treasurer moved to dismiss. The trial court granted the motion dismissing all of the complaints. The Supreme Court agreed to allow direct review, permitting the case to proceed straight to the state's highest court. The Supreme Court also allowed members of the City of Chicago's healthcare programs to file an amicus brief on behalf of the plaintiffs. The City of Chicago filed an amicus brief on behalf of the defendants.

Plaintiffs argued that the prior law requiring the state to make specified contributions toward health insurance premiums constitutes a benefit of membership in the retirement systems. Plaintiffs further argued that the amendments diminished and impaired membership benefits in violation of the pension protection clause.

The state argued that its contributions to retiree health premiums are not codified in the pension code and are not paid from the assets of the retirement system. According to the state, health insurance premiums are fundamentally different from pension annuities and therefore not covered by the protections of the pension protection clause.

As framed by the Court, the question presented was whether a health insurance subsidy provided in retirement qualifies as a benefit of membership.

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[13] The health care subsidy differs depending on when employees retiree, including in some cases a 5% contribution for each year of creditable service upon which the pension benefit is based.

Holding that it does, the Court observed that health benefits were provided in 1970 when the pension protection clause was adopted by the voters.

While some of the health benefits are governed by group health insurance statues and others are covered by the pension code, "eligibility for all of the benefits is limited to, conditioned on, and *flows directly from membership* in one of the State's various public pension systems." (emphasis added).

The Court gave the pension protection clause its plain and ordinary meaning that all retirement benefits, including subsidized health care are considered benefits of membership in the retirement system and covered by the pension protection clause. If the drafters of the constitutional provision had intended to only protect "core" pension annuity benefits they could have so specified. The Court refused to rewrite the clause to include restrictions that the drafters did not express and the voters did not approve. Because the Court was able to decide the case based on the plain language of the pension protection clause, it did not need to rely on the underlying debates, which nevertheless support the Court's conclusion. A single Justice dissented reasoning that the subsidized health insurance benefits are not "pension benefits" based on a narrow reading of the pension protection clause.

Kanerva v. Weems, 13 N.E.3d 1228 (Ill.2014)

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