SUNCOAST LEAGUE OF CITIES

January 12, 2013
Clearwater, Florida

****

From Tallahassee to Naples and Back Again[1]

****

Presented by: Robert D. Klausner, Esquire

I. THE EPIC AND EVOLVING QUEST TO COME TO GRIPS WITH COST VERSUS CLARITY FOR PUBLIC SAFETY OFFICERS AND PENSION PLAN SPONSORS

The August 14, 2012 Naples interpretation by the Division of Retirement regarding Chapter 175 and Chapter 185 pension plans and the committee bill by the Florida Senate Governmental Oversight and Accountability Committee.

Introduction:

The purpose of this memo is to provide a high level summary of the "Naples interpretation" by the Division of Retirement, along with the recently released draft "committee bill" that is set for a workshop on January 17, 2013 before the Senate Governmental Oversight and Accountability Committee. A full explanation of the Naples interpretation and its specific impact on particular

---

[1] This past year J. R. R. Tolkien's *The Hobbit: An Unexpected Journey* opened in theaters. The subtitle to the 1937 novel is "*There and Back Again.*" In the story of the *Hobbit,* Bilbo Baggins finds the "One Ring" and returns it to the Shire. At the conclusion of the *Lord of the Rings* trilogy, the One Ring is destroyed by Frodo Baggins and Gollum in the volcanic Mount Doom.

plans is beyond the scope this memo. Readers are encouraged to consult with their local pension plan attorney, actuary and Chapter 175 - Chapter 185 pension trustees. Likewise, this memo does not provide a comprehensive explanation of the committee bill, which necessarily attempts to address a complex subject that cannot fully be set forth in this summary memo.

Naples interpretation:

The Naples interpretation arises out of an August 14, 2012 letter from Keith Brinkman, Chief of the Bureau of Local Retirement Systems at the Division of Retirement, to Naples Mayor John F. Sorey III. Subsequent versions of the Naples letter have since been issued by the Division of Retirement across the state on a case by case basis.

By way of background, Naples Mayor Sorey had written to Governor Rick Scott in a letter dated March 16, 2012 petitioning the Governor and his staff to review the Division of Retirement's position with respect to the operation of Chapters 175 and 185. According to Mayor Sorey, he had been advised by his attorneys that the Division of Retirement's interpretation "is not in state statute or rule, but is 'non-rule policy' invented by the Division." In particular, Mayor Sorey objected that if any pension benefit for police officers is reduced below the level in place on March 12, 1999, the pension plan would no longer be in compliance with Chapter 185, resulting in the loss of premium tax revenues. Mayor Sorey explained that the City of Naples and the Naples police, as represented by the FOP, had entered into a **voluntary** agreement to reduce benefit levels. The Mayor thus petitioned the Governor, who was a Naples resident before he was elected Governor, to prevent the loss of future premium tax revenue and to "right this wrong and allow cities and public safety employees reaching voluntary agreement on sustainable pension benefits to continue to use premium tax revenue" to fund Chapter 185 pension plans.

By all accounts, very close cooperation between the League of Cities and the Governor's office resulted in the August 14, 2012 Naples letter. The Naples letter not only fully accomplished Mayor Sorey's objective of preserving the receipt of premium tax revenue, it resulted in what many have called a wholesale reinterpretation of the Chapter 175 - 185 pension regime, which had been in effect since 1999. Some have observed that the League's criticism of "non-rule policy" by the Division of Retirement ironically resulted in even more "non-rule policies." Yet, the Naples letter achieved the League of Cities' desired outcome, cost savings and flexibility. To the extent that the Division of Retirement's longstanding interpretation was objectionable to the League, some have pointed out that it had the advantage of being clear and consistent. By contrast, many have complained that the new Naples

interpretation lacks clarity and internal consistency, while it undoubtedly advances the cause of "pension relief."

According to the Naples letter:

- Previously, the Department had interpreted this law to mean that in order for Naples to receive any state premium tax revenues it must provide chapter minimum benefits and must preserve benefits in place on March 12, 1999. However, upon receiving your letter and reviewing the law again, this interpretation appears inaccurate.

- The law actually states that local law plans in effect on October 1, 1998, like the City of Naples Police Officers' Retirement Plan, "must comply with the minimum benefit provisions of this chapter *only to the extent that* additional premium tax revenues become available to incrementally fund the cost of such compliance." The phrase "only to the extent that" qualifies the law's requirement that local law plans "comply with the minimum benefit provisions" of chapter 185.

- This qualification means that, for local law plans in effect on October 1, 1998, the law compels them to provide chapter minimum benefits *only to the extent that* such benefits can be funded with "additional premium tax revenues." Thus, for local law plans in effect on October 1, 1998, the law states that chapter minimum benefits must be provided only to the extent that they can be funded with premium tax revenues received in excess of the amount received for calendar year 1997.

- Because the City of Naples Police Officers' Retirement Plan was in effect on October 1, 1998, the law allows Naples to provide benefits below the chapter minimums and below those in effect on March 12, 1999, if there is insufficient "additional premium tax revenues" to fund chapter minimum benefits and insufficient "subsequent additional tax revenue" to fund extra benefits.

- In order for the Department to determine if these proposed changes can be approved, the plan actuary must demonstrate that there are not enough "additional premium tax revenues" to fund the minimum chapter benefits.

<u>Draft Committee Bill</u>:

The draft committee bill set for discussion before the Senate Governmental Oversight and Accountability Committee on July 17 reflects a laudable effort to address the new and evolving non-rule policy by the Division of Retirement

resulting from the Naples interpretation. The committee bill attempts to put in place a structure that allows premium taxes to be used exclusively for their intended purpose of funding Chapter 175 and 185 pension benefits. The committee bill also focuses on improving the funding of Chapter 175 and 185 pension plans, while retaining much of the flexibility created by the Naples letter for **voluntary** agreement between unions and cities.

The committee bill provides in material part as follows:

- Cleans-up and makes conforming changes to the definitions in Sections 175.032 and 185.02;

- Deletes the requirement that no less than 300 hours of overtime per calendar year be pensionable for local law police pension plans, as a minimum benefit from Section 185.02;

- Creates a new Section 175.091(1)(e) and Section 185.07(1)(e) providing that cities remain obligated to continue making mandatory payments of annual normal cost and amortized unfunded liability, in addition to a new future funding "floor"[2];

- Substantially revises Section 175.351 and 185.35 to require that plans and their sponsors: 1) meet newly re-defined minimum benefit levels, 2) meet minimum standards, and 3) make mandatory contributions that "at a minimum" continue at the March 1, 2013 level (the new funding floor[3]);

- Premium tax revenue shall be used in its entirety to provide pension benefits in the following specified order and procedure:

  After using all other revenues, including "mandatory payments," employee contributions, and investment earnings, annual premium tax revenue shall be used 1st) to meet "annual costs" of minimum benefit,

---

[2] While the committee bill never uses the term funding "floor," it is clear that Sections 175.091(1)(e), 175.351(2), 185.02(1)(e) and 185.35(2) create a new "minimum" contribution floor based on the contributions "for the most recent plan year ending before March 1, 2013." For the vast majority of plans, this translates into the valuation for the year ending 9/30/12. As a technical matter, the committee bill does not indicate whether this new funding floor is calculated based on a percentage of pay or fixed dollar amount.

[3] The March 1, 2013 contribution floor may be reduced if a plan has no actuarial deficiency. Section 175.091(1)(e) & 185.02(1)(e).

2nd) to meet annual costs associated with additional benefits, 3rd) 50% of the premium tax revenue shall be allocated as additional contributions to fund any actuarial deficiency if the plan has an actuarial unfunded liability, and last) any remaining annual premium tax revenue shall be used to provide supplemental benefits.

- Premium tax revenues may not be used to fund (DB) defined benefits that were not part of the plan as of March 1, 2013[4]. After March 1, 2013, "additional pension benefits" may only be paid as "supplemental benefits" in a (DC) "defined contribution" plan, otherwise called a share plan;

- Existing language is deleted from Sections 175.351 and 185.35;

- New definitions are created for the terms "additional pension benefits", "annual costs", "minimum benefits" and "supplemental benefits." The prior terms "additional premium tax revenue" and "extra benefits" are deleted.

In sum, the draft committee bill attempts to formalize new procedures and definitions to enhance the funding of pension plans while providing flexibility to unions and cities. As is the case with the One Ring from the *Hobbit*, the Naples interpretation engenders great power. With this power comes great responsibility requiring clarity and oversight to continue insuring that pension plans are properly funded.

II. MUNICIPAL BANKRUPTCY

Several high profile bankruptcy cases filed by municipal governments have sharply focused the effect of Chapter 9 of the Bankruptcy Code on pension obligations.

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

---

[4] March 1, 2013 thus become the new funding floor and the new base year for purposes of limiting future defined benefits to be funded with premium tax revenue.

dismissed as not meeting the state law test under Chapter 9 and the City has since made some partial pension payments since the automatic stay was dissolved. Later, the Alabama Supreme court held that Prichard was able to declare bankruptcy under state law and the bankruptcy case was refiled. Active employees who lost everything have filed a claim in that latest proceeding.

Vallejo, California received judicial approval to abrogate its collective bargaining agreements in its on-going bankruptcy proceedings. As Vallejo is a participant in the California Public Employees Retirement System (CalPERS), it has local retirement plan. The unanswered question from the Vallejo decision is whether a city that rejects a collective bargaining agreement under the *Bildisco* standard can also avoid its pension obligations. *Bildisco* was a private sector case setting the standards for an employer covered by the National Labor Relations Acts to avoid contract obligations through bankruptcy. Given the factual intensity of such examinations, the question is likely to be addressed on a case by case basis.

In 2011, Central Falls, Rhode Island retirees agreed to take a cut in their retirement benefits as a part of that city's bankruptcy proceedings. It is believed to be the first voluntary reduction of retiree benefits in this circumstances, but may act as an example for other troubled cities to use.

In 2012, the Cities of Stockton and San Bernardino filed for bankruptcy protection. These cases are focused on whether bankruptcy can relieve a city of its contribution obligations to the California state retirement system, CalPERS. The focus will be on the federal law which controls bankruptcy and state's reserved rights under the federalism protections of the 10th Amendment to run its own retirement programs. The insurer for the municipal bond holders and CalPERS are battling to see who will bear the brunt of the loss. This stands a high likelihood of setting nationwide precedent.

A Florida trial court will hear arguments in 2013 concerning that stat's financial urgency law. This is a provision in the state public bargaining law which allows a city with a "financially urgent situation" to unilaterally alter labor agreements. The term "financial urgency" is not defined in the law and appears to run counter to the state constitutional provision which makes public bargaining, except for the right to strike, a fundamental constitutional right.

III. HIGHLIGHTS OF THE LEGISLATIVE ACTIONS AROUND THE COUNTRY[5]

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.

---

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

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; FAC from 3 years to 5 years.

IV. AS IF THAT WASN'T ENOUGH ....

The following matters are currently pending around the country:

A. **Ft. Worth Pension Litigation** - In late October, the City of Ft. Worth cut pension benefits for all employees and retirees, except firefighters (who have one more year on their collective bargaining agreement). At the same time, the City sued the Board of Trustees of the Retirement Fund to ask for a judicial declaration that the ordinance was constitutional. On November 19, a federal suit was filed by police employees and retirees seeking to strike down the ordinance as being in violation of the U.S. and Texas Constitutions as applied to vested and retired members.

B. **Cincinnati Pension Litigation** - In 2012, the City of Cincinnati cut pension benefits for active employees. In addition, the balance of representation on the Board of Trustees was altered to place the City in effective control. A federal class action has been filed by vested members of the plan challenging the benefit cuts, including the alteration of the retirement board.

C. **Omaha Pension Litigation** - The Board of Trustees of the Omaha Police and Fire Retirement System has sued the City of Omaha in state court over the City's failure to observe the fiduciary independence of the Board. We are working with the local counsel for the Board. At the same time, the Police Association may sue the Board and the City to remedy the City's longtime underfunding of the plan.

D. **Florida Retirement System** - The speaker-designate of the Florida House of Representatives has stated his intention to file legislation closing the Florida Retirement System to new members, all of whom will be placed in a DC plan. This will have effect, among other things, of exacerbating the State's recent practice of intentional underfunding the plan. NCPERS may wish to assist in organizing opposition to the bill and in providing expert testimony and educational assistance as to ill-advised nature of this proposal. A state supreme court consideration of a constitutional challenge to the last pension reform law remains pending a decision.

E. **Michigan Class Action for Breach of Fiduciary Duty** - In September of 2009, the trial court certified a class action consisting of participants and beneficiaries of the Detroit Plan who are seeking to recover millions of dollars resulting from investments which "in hindsight should not have been made" (quoting from the Defendants' brief). Eight cases were consolidated for appeal.

NCPERS argued in its amicus brief that 1) Plaintiffs lack of standing flowed from the design of governmental DB plans; 2) Plaintiffs possessed neither a direct nor particularized injury-in-fact for constitutional standing purposes; and 3) the improper granting of standing would chill the taking of prudent investment risks, while opening the floodgates to improper litigation.

The Appeals Court issued a lengthy opinion on November 15, 2012. The Michigan Court of Appeals held as follows:

1) The Court agreed with Defendants and reversed the trial court as to governmental immunity/lack of PERISA standing for claims against the trustee defendants;

2) The Court affirmed the trial court's ruling that plaintiffs have standing to pursue their PERISA claims against the investment advisor defendants;

3) Plaintiffs do not have standing to pursue a declaratory judgment action against either the trustee defendants or investment advisor defendants with regard to PERISA claims;

4) Plaintiffs have standing to assert their (i) common-law and statutory conversion claims; (ii) causes of action grounded in the trustee defendants' "extravagant, unnecessary and improper trips", and (iii) constitutional claims against trustee defendants and investment advisor defendants for violation of Art 9, Section 24 which protects "accrued financial benefits";

5) Defendants' motion for summary disposition was inappropriate at the early stage of the litigation;

6) The lower court correctly denied defendants' motions for summary disposition on the basis that plaintiffs lacked standing. There is at least some independent evidence in support of the bad investment and self dealing allegations supporting their breach of fiduciary duty and gross negligence claims;

7) The lower court properly dismissed the spoilation and waste counts;

8) The order granting class certification is affirmed. *Estes v. Adrian Anderson,* Michigan Court of Appeals (unpublished)(11/15/2012)

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