TEXAS MUNICIPAL RETIREMENT SYSTEM

ANNUAL TRAINING SEMINAR

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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)**

<u>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</u>.

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)

<u>Retirement system is not considered a "citizen" for purposes of federal court jurisdiction</u>.

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)

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

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. Investment/Securities Cases

Recent venue disputes in investment cases.

The choice of venue and applicable law has become of increased importance in an increasing number of suits arising from events connected with the capital market decline in 2008. In a pair of recent cases, the issue of state versus federal court as the proper forum was decided with diametrically opposed results.

In *General Retirement System of the City of Detroit v. UBS*, 2010 WL 5296957 (E.D. Mich. 2010), the retirement system sued UBS alleging that the latter fraudulently induced both the general and public safety pension funds into buying an equity position in collateralized loan obligations and for breach of fiduciary duty. The suit was filed in Wayne County, Michigan state court. UBS removed the case to federal court on the basis of diversity of citizenship. The retirement plans sought to remand the cases back to state court claiming that each had retiree participants residing in Delaware and Connecticut. The federal court declined to remand the case finding that the residency of the pension funds, as the legal owners of the assets, controlled rather than the citizenship of individual participants.

By contrast, in May 2011, the United States Court of Appeals for the 8th Circuit remanded a securities fraud case back to state court in *Public School Retirement System v. State Street Bank and Trust*, 640 F.3d 821 (8th Cir. 2011). As State Street was a citizen of Massachusetts, it removed the case to federal court from the state court in Cole County, Missouri, the county where the retirement plan was headquartered. The retirement plan moved to remand the case back to state court claiming it was immune under the diversity of citizenship statute. The appeals court found that the retirement plan was an arm of the state of Missouri. As such, the system was not a "citizen" within the definition of the federal law providing for jurisdiction between citizens of different states. Apparently, the deciding factor was the state treasury's exposure to costs of the retirement system.

<u>Court refuses to dismiss securities lending claims since factual questions exist, including whether warning signs should have caused a reasonably prudent fiduciary standing in Northern Trust's shoes to act differently</u>.

The Louisiana Firefighters' Retirement System, the Public School Teachers' Pension & Retirement Fund of Chicago and other lead plaintiffs brought a class action suit against Northern Trust alleging breach of fiduciary duties and breach of contract arising out of Northern Trust's securities lending program. Through that program, Northern Trust arranged loans of securities owned by its customers to pre-approved borrowers. Borrowers pledged collateral equal to 102% of the market value of the loaned securities. Northern Trust then invested in fixed-income securities, generating revenue for the participants in the program. Plaintiffs claimed that Northern Trust, in pursuit of higher lending fees and in breach of fiduciary and contractual duties, ignored the investment objectives of the Collateral Pools and imprudently invested hundreds of millions of dollars in exotic, unregistered securities, such as structural investment vehicles ("SIVs"). Plaintiffs alleged that these and other securities were inappropriately long term and high risk and therefore unsuitable to properly serve as short term collateral. For example, by mid–2007 more than half of the securities in the Short Term Extendable Portfolio ("STEP") Collateral Pool were not due to mature for at least two years, and 18% of those securities were not due to mature for at least 20 years. At the height of the financial crisis in October 2008, a third of the securities in the Core USA Collateral Pool were not due to mature for over two years.

Because they carried greater risk, the longer-term securities yielded higher returns. This provided Northern with enhanced securities lending fees which exceeded the fees that would have been earned on shorter-term notes. Plaintiffs further alleged that the Collateral Pools were inappropriately structured with high levels of exposure to the housing market.

According to the complaint, Northern ignored warning signs, including warnings by its own Chief Economist that a housing bubble and recession would severely impact the United States banking industry because of unprecedented exposure to housing loans. Northern argued that it took appropriate steps following the bankruptcy of Lehman Brothers in 2008, which triggered a financial crisis. Northern also argued that the investment guidelines for the pools expressly allowed these types of investments.

The court refused to dismiss the case, recognizing that "the fact that a pool's guidelines would allow a type of investment does not per se indicate that such an investment would be prudent given a particular set of financial circumstances." As the lawsuit progresses to summary judgment or trial, plaintiffs will need to establish that warning signs would have caused a reasonably prudent fiduciary to act differently. The court held nonetheless that plaintiffs' claim for breach of good faith and fair dealing was properly dismissed since it was subsumed in plaintiffs' breach of contract claim.

Louisiana Firefighters' Retirement System v. Northern Trust Investments, 2011 WL 1770266 (N.D.Ill. 2011)

<u>In continuation of securities lending litigation case, federal district court dismisses third party complaint and all 31 affirmative defenses, refusing to permit "blame the victim" defensive strategy</u>.

This case is the continuation of the ongoing class action against Northern Trust for breach of fiduciary duty involving securities lending losses. After the court denied Northern Trust's motion to dismiss, Northern raised 31 separate affirmative defenses with its answer. Northern also brought a third-party complaint asserting claims for contribution and indemnification against plaintiff Boards. The Boards moved to dismiss on a number of grounds, including that Northern's claims were not properly brought in a third-party complaint, and that neither indemnification nor contribution is available for claims of breach of fiduciary duty.

Northern Trust asserted that if plaintiffs are right that the collateral investment strategies were imprudent, then plaintiffs bear sole responsibility "because they made the *choice* to accept a certain level of risk in return for the potential investment rewards." The Boards successfully argued that defendants' third-party complaint pursues a "blame the victim strategy." Northern Trust was essentially alleging that if it is liable to plaintiffs for imprudently investing, then the Boards are more liable for hiring Northern and not stopping it from breaching its fiduciary duty. According to the court, if Northern was found liable to plaintiffs, it can be based only on Northern's own breaches of fiduciary duties, not on any legal principle that makes it liable for the Boards' actions. Northern can be liable to plaintiffs based only on its own guilt. Because it cannot be both blameless and liable, Northern could not claim for implied indemnity. The court also dismissed Northern's third-party complaint and granted the plaintiffs' motion to strike all 31 of Northern's defenses.

Louisiana Firefighters' Retirement System v. Northern Trust Investments, 2012 WL 601861 (N.D.Ill. 2012)

New Mexico Teachers lack standing to recover 2008 investment losses.

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

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

State governmental entities, including public employees/trustees acting within the scope of their duties, are immune from liability for any tort, except as waived by law. The court held that breach of fiduciary duty is not one of the tort claims for which the New Mexico legislature chose to waive governmental immunity under New Mexico's Tort Claims Act. After granting the motion to dismiss in part, the federal district court remanded the case to New Mexico state court given a lack of subject matter jurisdiction.

This is consistent with a Texas decision involving TRS, decided the year before, dismissing claims by members due to plan losses.

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

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

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

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

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

Nevertheless, where the duties breached do not arise under the contract, an action for an independent tort may exist even though the parties are in contractual privity. Accepting all factual allegations in the complaint as true and construing them in the light most favorable to plaintiffs, the court held that the complaint alleged facts which are distinct from a breach of contract claim. At this stage in the case, the court determined that the claim was both adequately pled and not barred by the economic loss rule.

Ultimately the case settled. The underlying issue of the application of the economic loss rule in fiduciary duty cases is currently pending on appeal at the Florida Supreme Court in an unrelated case.

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

F. Benefits Cases

Settlement payment from class action regarding unpaid wages qualify as pensionable earnings.

A county and Retirement System appealed a lower court's ruling that class action settlement payments are "compensation earnable." The class action case at issue involved allegations of underpayment by the county. Under the retirement plan, "compensation earnable" is defined as "salaries or wages earned during a payroll period for personal services." The court concluded that because "the awards were paid in lieu of wages and salary that the plaintiffs claimed should have been paid in the past[,]" the settlement payment properly constitute compensation earnable.

Serres v. Washington Dept. of Ret. Sys., 2011 WL 4090414 (Wash. Ct. App. 2011)

Under the plain language of collective bargaining agreements, retirees were only entitled to health insurance benefits to the same extent as current employees.

A group of retired public employees brought a class action lawsuit when a city began providing them with less favorable health care benefits received by current employees rather than the benefits they received at retirement. The "CBAs guaranteed retired City employees health insurance benefits 'to the same extent as active employees.'" At issue was whether, under the language of the CBAs, the retirees were entitled to health insurance benefits at the same level that was provided to city employees when they retired or whether the city could permissibly lower retiree health insurance benefits to the level received by current employees. The retirees argued that they are entitled to health insurance benefits to the same extent as employees who were active at the time of the retirees' departure, rather than benefits to the same extent as current employees. However, the court ruled that under the plain language of the CBAs, the retirees were only entitled to benefits to the same extent as current employees.

Savela v. City of Duluth, 806 N.W.2d 793 (Minn. 2011)
Requiring repayment of pension benefits received by employee who was ineligible for benefits due to a part-time job is too harsh of a remedy.

A pension fund determined that a public employee's "retirement was not bona fide because he did not observe the required thirty-day break in service before commencing . . . [a] part-time temporary teaching job" covered by the same retirement system. As a result, the pension board ordered the employee to return benefits paid to him while he maintained the part-time temporary job and to make contributions for the same period. The employee appealed the pension board's decision. After a detailed discussion of relevant plan provisions, the court ultimately found that even though the employee technically violated the plan by accepting the part-time employment within the thirty-day period following retirement, "the imposed remedy was excessive, given the circumstances of [the] case, and that equitable considerations require a diminution in the amount that he must refund."

Chiappini v. Bd. of Trustees, Public Employees' Retirement System, 2011 WL 3207959 (N.J.Super.A.D. 2011)

Federal court may decline to accept jurisdiction over a case when the only federal subject matter alleged are ERISA violations by a governmental pension plan.

A former state employee filed a federal lawsuit against a governmental retirement plan for its alleged refusal to return her employee contributions. In the lawsuit, the plaintiff alleged breach of contract, breach of fiduciary duty, trespass, misrepresentation, and ERISA violations. In her suit, the plaintiff sought damages in the amount of "$366.1 Quadrillion Dollars." The court recognized that ERISA does not apply to governmental plans. Therefore, there were no other Federal law claims and the court declined to exercise jurisdiction over the case.

Slade v. California Public Employees' Retirement Service, 2011 WL 4374994 (E.D.Cal. 2011)

<u>City committed unfair labor practice when it unilaterally terminated partial lump sum distribution option</u>.

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

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

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

The Court held that the parties are required to bargain over mandatory subjects of bargaining before a party may unilaterally change such benefits. The fact that a city changes benefits through the enactment or repeal of an ordinance does not alter this calculus. Indeed, if this were the case, a public employer could grant benefits through ordinances and simply unilaterally repeal them at will. Accordingly, the city committed an unfair labor practice when it, by ordinance, unilaterally eliminated firefighters' PLSDO pension benefit without first collectively bargaining with union.

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

<u>Retirement system was not contributorily negligent and thus actuary was liable for $72,000,000 in lost contributions and lost interest</u>.

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

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

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

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

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

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

> ***Raby v. Bd. of Trustees of the Police and Fire Retirement System of the City of Detroit***, 2011 WL 921645 (Mich. App. 2011)
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> <u>Intended beneficiary is entitled to benefits calculated based upon the life expectancy of a former beneficiary who was fraudulently designated a beneficiary</u>.
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> A former state employee's son was appointed her guardian due to her disabling drug addiction. On her behalf, the son submitted an application for disability retirement benefits, naming himself as beneficiary. A few years later, a court removed the guardianship over the former employee. At that time, she requested that her beneficiary designation be changed to another son. However, the retirement system denied the request and the son who formerly served as guardian began receiving benefits. The employee's estate sued the retirement system and the son receiving benefits, arguing that the son was guilty of "fraudulent and unauthorized misconduct" and that the system should have honored the employee's request to change her beneficiary. The court recognized that the pension
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>> plan "prohibits a change in beneficiary after the retired member received his first payment because [the system] bases the amount of benefits on the actuarial computation of the life of the retired member and, depending on which option the member chose, the life of the designated beneficiary." The court further stated that it "understands that to allow any changes to the beneficiary after benefits have been calculated and disbursement has commenced would create an administrative nightmare for [the system]." However, the court concluded that there is "no reason why the benefit payments based upon the [fraudulent beneficiary's] lifetime may not continue to be paid to the beneficiary(ies) designated" by the court as the proper beneficiaries.
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> ***Peterson v. Public Employees' Retirement System of Mississippi***, 77 So. 3d 554 (Miss. Ct. App. 2012)

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

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

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

G. Forfeiture Cases

Conviction for possession of child pornography not a forfeitable offense because it was not directly linked to library employment.

The Plaintiff was formerly a Director of Community Service at a library. After police searched his home and found incriminating evidence, the Plaintiff resigned from his library position. He was later convicted of two counts of possession of child pornography. As a result of his conviction, the retirement board revoked his retirement benefits. The lower court affirmed the retirement board's revocation of the Plaintiff's benefits. However, the appellate court reversed the trial court and retirement board's ruling. In reversing, the court found that the Plaintiff's convictions were not "directly linked" to his former employment and therefore his retirement benefits were not subject to forfeiture.

Scully v. Ret. Bd. of Beverly, 80 Mass.App.Ct. 538 (Mass. App. Ct. 2011)

Involuntary termination for conviction of causing injuries to others while driving under the influence of alcohol is not a forfeitable offense.

A pension board denied an application for deferred retirement benefits because the employee was involuntarily terminated based upon criminal convictions. The applicant was involuntarily terminated from her position as a Geographic Information Specialist because she was convicted of causing serious injuries to another whiledriving under the influence of alcohol. On appeal, the court found that the conviction was unrelated to the applicant's official duties and reversed the Board's decision denying deferred retirement benefits.

In re Hess, 422 N.J. Super. 27 (App. Div. 2011)

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

After a pension fund ordered a benefit forfeiture of a judge convicted of felonies that violated his oath of office, the judge and his wife sought judicial review. The judge was convicted of indecent exposure committed during the performance of his duties. Rejecting the former judge's argument that his benefit forfeiture was inappropriate, the court held that the judgment and sentence in the criminal matter against the former judge is sufficient to establish the fact that the judge had committed a forfeitable offense. The burden then shifted to the former judge, who failed to introduce sufficient evidence as to why his benefits should not be forfeited. He "presented as his defense that the felonies he committed did not disrupt the trials." The court found that "[w]hile that is an attempt to rebut the prima facie case, it is not a successful defense." Additionally, the court ruled that the former judge's spouse did not have a vested interest in the judge's retirement benefits so as to trigger any procedural due process rights.

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

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.