Montana Legislative Services Division
Office of Research and Policy Analysis

PO BOX 201706
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

December 9, 2013

TO: Legislative Finance Committee

FROM: Sheri S. Scurr, Legislative Research Analyst

RE: Update on Public Employee Pension Plan Activity

This memorandum provides and update on public employee pension plan activity since your September 26-27, 2013, meeting.

The FY 2013 actuarial valuations for the systems were completed. The key points with respect to the valuations for TRS and PERS are summarized below.

TRS	Funded Ratio	Amortization Period
With GABA reduction in HB 377	67 %	20 years
Without GABA reduction	62%	29 years

PERS	Funded Ratio	Amortization Period
With GABA reduction in HB 454	80%	14.5 years
Without GABA reduction	70%	43.7 years

An issue with respect to HB 454 and PERS is the statutory trigger that terminates the 1% increase in the employer and employee contribution rate. The trigger becomes effective if the contribution increases may be terminated without causing the amortization schedule to exceed 25 years. Based on the FY 2013 valuation, the contributions would terminate January 1, 2015, assuming the GABA reduction is not overturned.

A lawsuit to overturn the GABA reduction for TRS was filed on October 11, 2013. A request for a preliminary injunction was filed and a hearing was held on December 4. District Court Judge Mike Menahan has indicated he would try to issue a determination on the injunction before January 1, 2014, which is the date that the GABA reduction would go into effect.

A lawsuit to overturn the GABA reduction for PERS was filed on October 30, 2013. A request for a preliminary injunction was filed and hear will be held on December 12 before District Court Judge Reynolds.

A third lawsuit was filed on October 25, 2013, concerning the plan choice rate for the PERS-DC plan. The lawsuit alleges an unconstitutional violation of the equal protection clause because a portion of the employer contribution to the DC plan that is allocated to the PERS-DB plan as the plan choice rate. The grounds for the complaint is that DC plan members do not derive any

benefit from the DB plan. The complaint also alleges that the 1% additional employer contribution enacted in HB 454 for DC plan members should have been allocated to DC plan members and not to pay DB plan liabilities.

A summary table of the FY 2013 actuarial valuations for each of the public employee DB plans along with a December 3, 2013, staff memorandum by K. Virginia Aldrich summarizing the lawsuits is attached.

Attach:
Summary of FY 2013 Actuarial Valuations
Dec. 3, 2013, memo from K. Virginia Aldrich

Cl0134 3343shqa.

Summary of FY 2013 Actuarial Valuations

Compiled by Sheri Scurr, Legislative Services Division
From FY 2013 Actuarial Valuations

System	Funded Ratio (percentage)	Covered Payroll	ARC Shortfall (% payroll)	ARC Shortfall (covered payroll x ARC shortfall)	Amortization period (years)
TRS					
w/ GABA change	67%	$ 742,609,000	0	0	20
w/out GABA change	62%		0	0	29
PERS-DB					
w/ GABA change	80%	$1,098,340,791	0	0	14.5
w/out GABA change	70%		1.41%	$ 15,486,605	43.7
SRS	77%	$ 60,947,547	5.00%	$ 3,047,377	24.37
GWPORS	80.1%	$ 39,154,521	2.95%	$ 1,155,058	22.51
HPORS	60.2%	$ 13,000,215	4.93%	$ 640,911	44.6
MPORS	70.8%	$ 42,323,994	0	0	23.8
FURS	66.4%	$ 37,727,304	0	0	13.9
JRS	142.8%	$ 6,212,209	0	0	0

TOTAL
Including PERS
w/ GABA change $ 4,843,346
w/out GABA change $ 20,329,951

Notes:

1. The ARC shortfall as a percent of payroll is the total additional contribution rate needed to amortize the system's unfunded liabilities in 30 years.

2. The ARC shortfall as a dollar amount is the amount of money required in the first year of the biennial budget in addition to current contributions. To amortize the system's unfunded liabilities in 30 years, this amount must be deposited each year until the liability is completely paid off and will increase each year at the same rate as the payroll increases. **This dollar amount is provided for general purposes. It will need to be updated because it is based FY 2013 salary information.**

3. The amounts shown in this table are based on several actuarial assumptions, including an investment return assumption of an average 7.75% over the next 30 years.

Cl0134 3343shqb.

PO BOX 201706
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

State Administration and Veterans' Affairs Interim Committee

63rd Montana Legislature

SENATE MEMBERS
DEE BROWN--Chair
LARRY JENT
DAVE LEWIS
SUE MALEK

HOUSE MEMBERS
BRYCE BENNETT--Vice Chair
JOANNE BLYTON
DOUG KARY
KATHY SWANSON

COMMITTEE STAFF
SHERI SCURR, Lead Staff
GINGER ALDRICH, Staff Attorney
KRISTINA LIMING, Secretary

TO: Sheri Scurr on behalf of the State Administration and Veterans' Affairs Committee

FROM: K. Virginia Aldrich, Staff Attorney

RE: Status of Retirement System Lawsuits

DATE: December 3, 2013

I. Public Employee Retirement System Lawsuit -- GABA

Plaintiffs: Association of Montana Retired Public Employees, Russell Wrigg, Marlys Hurlbert, Carole Carey, Edward Sondeno
Attorneys for Plaintiffs: Leo Berry, Chad Adams, Jessie Luther

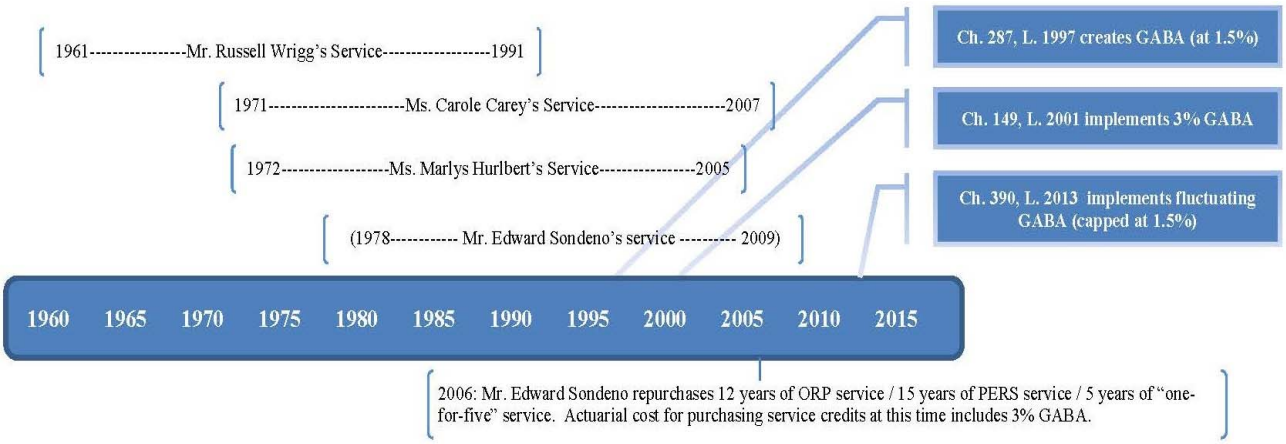
Defendants: State of Montana, Montana Public Employee Retirement Administration, Public Employees' Retirement Board, Gov. Steve Bullock
Attorneys for Defendants: Tim Fox, Michael Black, Stuart Segrest

On October 30, 2013, multiple plaintiffs representing Montana retired public employees filed a lawsuit over Guaranteed Annual Benefit Adjustment (GABA) reductions in the Public Employees' Retirement System. The case was originally assigned to Judge Kathy Seeley, who recused herself, and she was replaced by Judge James Reynolds.

The complaint alleges that the recent changes to the GABA during the 2013 session are an illegal impairment of a contract and the taking of property (without just compensation) under the state and federal constitutions. House Bill No. 454 reduced the GABA for all defined benefit retirees under the Public Employee Retirement System from 3% to a fluctuating percentage capped at 1.5%. The complaint also alleges that the reduction violated the state and federal constitutions' contract clauses and takings clauses with respect to service credit purchases made under the 3% GABA. The plaintiffs have requested both a preliminary and a permanent injunction to prevent the state from decreasing the GABA under the provisions of HB 454 to 1.0% on January 1, 2014.

The complaint was filed on behalf of the Association of Montana Retired Public Employees and four individual plaintiffs on behalf of themselves and similarly situated retirees. Individual plaintiffs include an individual who completed his state service before the GABA was originally enacted in 1997 and three individuals who retired after the 3% GABA was enacted in 2001.

MONTANA LEGISLATIVE SERVICES DIVISION STAFF: SUSAN BYORTH FOX, EXECUTIVE DIRECTOR • DAVID D. BOHYER, DIRECTOR, OFFICE OF RESEARCH AND POLICY ANALYSIS • TODD EVERTS, DIRECTOR, LEGAL SERVICES OFFICE • HENRY TRENK, DIRECTOR, OFFICE OF LEGISLATIVE INFORMATION TECHNOLOGY • JOE KOLMAN, DIRECTOR, LEGISLATIVE ENVIRONMENTAL POLICY OFFICE



The plaintiffs state that the 1997 GABA was introduced to enforce a "stable standard of living for retirees" and to combat inflationary erosion of pension benefits. Plaintiffs' Br. at 4. The plaintiffs argue that retirement benefits are a contract between the state and members who were retired at the time of the increase as well as employees working during the time of the increase. They argue that the GABA reduction is a substantial impairment of the contract and that there was not a significant and legitimate purpose for the GABA reduction in HB 454, maintaining that reducing the amortization period from "Does Not Amortize" to 36.7 years was "a huge positive shift in the actuarial soundness of PERS." *Id*. at 12. Plaintiffs point out that there were reasonable alternatives to reducing the GABA, including deleting the provision that eliminates the additional 1% employer contributions, further increasing employer contributions, using the state's budget surplus, or allocating state trust fund balances toward the retirement system. The plaintiffs argue that implementing HB 454's GABA reduction will cause retirees irreparable harm due to financial hardship.

The state responded to the plaintiffs' complaint by presenting two alternative defenses. First, the state notes that there is a difference between an unconstitutional impairment of a state contract and an ordinary breach of a contract. In the former case, the state's action removes a contracting party's remedies, and in the latter case, existing remedies remain available. In this case, the state points out that HB 454 did not remove any existing remedies; thus, if the court found a contractual breach, damages would be the appropriate remedy (rather than an injunction).

Second, the state notes that courts will uphold legislation that impairs contracts if 1) the law is a substantial impairment to the contractual relationship; 2) the state had a significant and legitimate purpose for the law; and 3) the law imposes reasonable conditions that are reasonably related to achieving the legitimate and public purpose. The state contends that the law was not a substantial impairment to a contract because retirement statutes allow the Legislature to alter retirement terms for both current employees and retirees. This argument relies heavily on section 19-2-502(2), MCA, which states:

> Benefits and refunds to eligible recipients are payable pursuant to a contract as contained in statute. The contract is entered into on the first day of a member's covered employment and may be enhanced by the legislature. **Unless specifically provided for by statute**, the contract does not contain revisions to statutes after the time of retirement or termination of membership (emphasis added).

Furthermore, the state argues that because of substantial historical regulation of retirement benefits by the Legislature, the extent of any impairment was diminished. The state argues that even if a substantial impairment existed, HB 454's comprehensive response to an economic crisis was a significant and legitimate purpose, especially in light of the constitutional requirement of funding the public retirement systems on an actuarially sound basis. The state also argues that HB 454 is reasonably related to the state's purpose of protecting retirement benefits for future retirees, but pointed out a lower level of review was appropriate because "the State's self-interest is not at stake." Def. Br. at 18. Lastly, it notes that the plaintiffs had impermissibly shifted the burden of proving reasonable necessity to the state and that they had not proven a prima facie case of contract impairment.

A hearing concerning the preliminary injunction will take place at 2 p.m. on December 12, 2013, in Judge Reynolds' courtroom at 228 Broadway, Helena, MT.

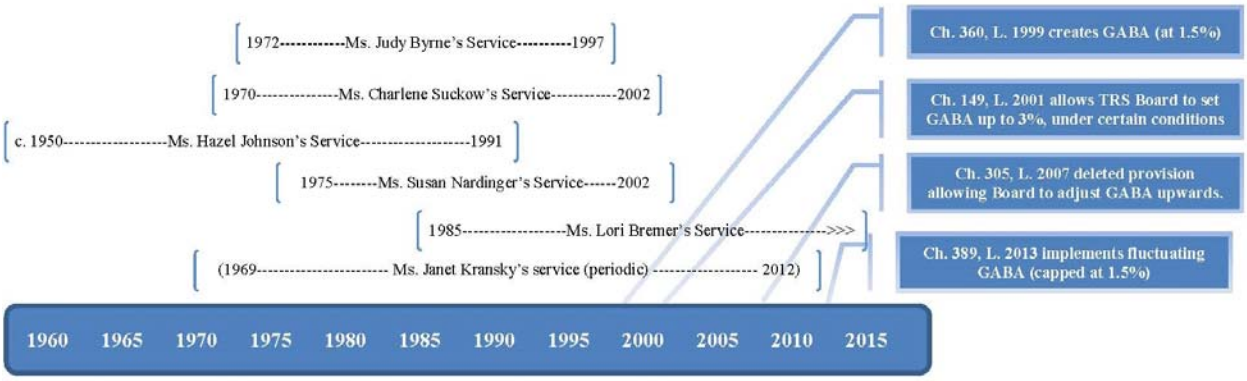
II. Teachers' Retirement System Lawsuit -- GABA

Plaintiffs: Judy Byrne, Janet Kransky, Susan Nardinger, Hazel Johnson, Lori Bremer, Charlene Suckow, MEA-MFT
Attorneys for Plaintiffs: Karl J. Englund, Jonathan McDonald, Jay Sushelsky

Defendants: State of Montana, Teachers' Retirement System of the State of Montana, Teachers' Retirement Board
Attorneys for Defendants: Michael Black, Matt Cochenour

On October 11, 2013, MEA-MFT and several other plaintiffs filed a lawsuit over House Bill No. 377's GABA reductions in the Teachers' Retirement System (TRS). The case was brought on behalf of members who joined the TRS system before July 1, 2013, and it is assigned to Judge Mike Menahan.

The complaint was filed on behalf of MEA-MFT and includes individual plaintiffs who retired before the 1999 GABA implementation, individuals who retired after the GABA was implemented at 1.5% but before it was adjusted upward to 3%, a recent retiree who is not yet eligible for GABA, and a teacher who is eligible for retirement based on years in service but who has not yet retired.



Although acknowledging that HB 377 made "significant and necessary changes" to TRS to ensure its actuarial soundness, the complaint alleges that HB 377 also illegally reduced retirement benefits for teachers, violating the contract clause of the Montana Constitution. In addition, it alleges the reduction in the GABA constitutes a taking of property without just compensation. Prior to HB 377, the TRS GABA was set at 1.5%. HB 377 modified the TRS GABA provision to reduce the GABA to 0.5% if the most recent actuarial valuation showed that the TRS retirement system liabilities were less than 90% funded. If the most recent actuarial valuation showed that liabilities were more than 90% funded, the TRS Board would be authorized to set the GABA between 0.5% and 1.5%, as long as the increase did not reduce the system's liabilities to under 85% funded. After the 2013 valuation, the system's liabilities were found to be under 90% funded, so the GABA will be reduced to 0.5%.

Plaintiffs argue that the violation of a constitutional right is an irreparable injury and have asked for a preliminary injunction pending trial. Plaintiffs further contend that a heightened level of scrutiny is necessary whenever a governmental entity is a party to the contract. They argue that the state impermissibly impaired teachers' retirement benefits by altering the financial terms of those benefits. Plaintiffs argue that the burden of proof showing that the impairment was reasonable rested with the state and that there were other "more moderate course[s] of action" that would have served the state's purpose equally well. Def. Br. at 13. Last, the plaintiffs argued that actuarial soundness is not a sufficient justification for pension plan alterations.

The state responded to the plaintiffs' claims with substantially similar arguments to those made in the PERS lawsuit, arguing any violation of contractual retirement rights would potentially be a breach of contract but not a constitutional impairment. The plaintiffs respond that in this case, the state is relying on the new law as a defense to pay the full 1.5% GABA to the plaintiffs; therefore, they argue that HB 377 is an impairment and not a breach. The state further argues that even under a contract-impairment theory, the contract was not impaired because 1) current employees were subject to retirement benefits in statute at the time of retirement (therefore allowing changes until the employee retires), and 2) the Legislature intended for the GABA reduction to apply to retirees. Both arguments rely heavily on section 19-20-501(6), MCA, which is substantially similar to the PERS provision, above. However, the plaintiffs point out

case law that has held "[t]he terms of the teachers' retirement benefit contract in Montana are determined by the controlling provisions of the teachers' retirement system statute in effect at the time the teacher becomes a member." *State ex rel. Sullivan v. State Teachers' Retirement Bd.*, 174 Mont. 482, 571 P.2d 793 (1977). Plaintiffs also dispute that the GABA reduction could apply to retirees, noting that the statute upon which the state relies has never been interpreted to apply to benefit reductions and that if it did, it would also impermissibly violate the contracts clause. The state also argues that because of substantial historical regulation of retirement benefits by the Legislature, the extent of any impairment was diminished and there was a reasonable expectation of further changes to the GABA.

The state also argues that even if a substantial impairment existed, HB 377's comprehensive response to an economic crisis was a significant and legitimate purpose, and the GABA provision should not be viewed separate from the other provisions of that bill. Further, they note that actuarial soundness is a constitutional edict; therefore, it is a sufficient justification for pension plan alterations. However, plaintiffs note that as of the most recent actuarial valuation, actuarial soundness is achieved without the GABA implementation. The state points out the Legislature built in a mechanism to return the GABA provision to 1.5%, balancing retirees' needs with the needs of the state. Last, the state argues that heightened scrutiny is not appropriate for the contract clause analysis because the state's interests were diminished by the contractual change, not increased, and the plaintiffs had not proven a prima facie case of contract impairment. However, the plaintiffs argue that the contract provision is found in Article II of the Montana Constitution (Declaration of Rights), affording it the highest level of scrutiny.

A hearing concerning the preliminary injunction will take place at 10 a.m. on December 4, 2013, in Judge Menahan's courtroom at 228 Broadway, Helena, MT.

III. Public Employees' Retirement System Lawsuit -- Plan Choice Rate

Plaintiffs: Edward Wrzesien, Megan Ashton, Lacey Van Grinsven
Attorneys for Plaintiffs: Travis Dye

Defendants: State of Montana, Montana Public Employee Retirement Administration
Attorneys for Defendants: Tim Fox, Michael Black, Stuart Segrest

On October 25, 2012, a lawsuit was filed by three plaintiffs: one active, vested member in the University System Retirement Program (USRP) and two active, vested members in the Public Employees' Retirement System Defined Contribution Plan (PERS DC Plan). They filed on behalf of all potential class members, including current and former employees of the USRP and the PERS DC Plan. The case is assigned to Judge James Reynolds.

The complaint alleges that the plan choice rate paid by employers for PERS DC and USRP members reduces the employer-paid retirement benefits of those members by treating them unequally from similarly situated defined benefit plan members. The complaint states that PERS "DC Plan and ORP participants receive an employer-paid contribution of 4.80% while DB Plan participants receive an employer-paid contribution of 8.17%." Complaint at 7. The complaint

alleges that this treatment is an unconstitutional violation of the Equal Protection clause of the Montana Constitution. The plaintiffs amended the complaint in October, 2013, to add the additional 1% employer contributions allocated to the defined benefit plan, found in section 19-3-2117(2)(c), MCA, by Chapter 390, L. 2013.

The complaint also alleges that the requirement for PERS DC and USRP members to contribute to the defined benefit plan (the plan choice rate and the 1% additional employer contributions) when they are statutorily prohibited from receiving benefits from the defined benefit plan violates the Due Process and Equal Protection clauses of the Montana Constitution.

A scheduling conference will take place at 10 a.m. on December 20, 2013, in Judge Reynolds' courtroom at 228 Broadway, Helena, MT.

Cl0429 3338gafa.