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15TH ANNUAL CLIENT CONFERENCE

**HYATT PIER 66
FORT LAUDERDALE, FLORIDA**

MARCH 10-13, 2013

NATIONAL CASE LAW UPDATE

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CONSTITUTIONAL CASES

Law changing pension fund from non-contributory to contributory held constitutional.

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

Scott v. Williams, ___ So. 3d ___, 2013 WL 173955 (Fla. Jan. 17, 2013)

Law requiring withholding of pension contributions declared unconstitutional.

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

AFT Michigan v. State, ___ N.W.2d ___, 825 N.W.2d 595 (Mich. Ct. App. 2012)

Ordinance reducing benefits struck down by court.

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 plans. 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 the 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, Case No. 1:10-CV-01447 (D.Md. September 20, 2012)

ADMINISTRATIVE CASES

Municipal pension fund required to reimburse statewide pension for employer contributions received for member who was erroneously enrolled in the fund.

A public employee was mistakenly enrolled in a municipal pension fund when he should have been enrolled in the statewide teachers' retirement system. Once the error was discovered, the employee was transferred into the statewide teachers' retirement system, but the municipal system refused to transfer employer contributions for the employee to the statewide fund. The court determined that the statute governing the transfer of funds was ambiguous. The court relied upon legislative intent in ruling that the municipal fund must transfer the employer contributions to the state fund. The court found that "[f]ailing to require full funding of the retirement system that provides the pension benefit would defeat the statutory purpose of financial stability, would visit a windfall on the system that received contributions in error, and would discourage the detection and correction of errors in administration."

Haverhill Retirement System v. Contributory Retirement Appeal Bd., 971 N.E.2d 330 (Mass. Ct. App. 2012)

INVESTMENT/SECURITIES CASES

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.

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 inadequate disclosure. The suit alleged a single count for breach of

fiduciary duty. Plaintiffs asserted that Merrill sought and created a relationship of trust and confidence while serving as a gatekeeper. 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 are in contractual privity 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. To the extent that discovery demonstrated that the duties allegedly breached by Merrill Lynch are in fact based on or inextricably intertwined with the parties' written agreements, the court indicated that it would revisit the issue.

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)

BENEFITS CASES

City committed unfair labor practice when it unilaterally terminated partial lump sum distribution option.

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)

DISABILITY CASES

Board's action in refusing to allow employee to amend application for disability retirement was arbitrary and capricious.

After suffering a heart attack, a public employee filed an application for disability retirement benefits and was denied. It appears that the board denied the employee's application because the employee was not diagnosed until after he had retired. However, at the time the employee filed his application for disability retirement, he had already suffered a heart attack and was incapacitated. The court found that even though the employee was not diagnosed until after he retired, the board's refusal to allow the employee to amend his application was arbitrary and capricious, and was therefore reversed.

Diaz v. Kelly, 98 A.D.3d 425 (N.Y. App. Div. 2012)

Pension board's denial of disability application upheld when pension board stated with particularity its reasons for disregarding medical opinion.

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

At the administrative hearing, the officer presented three fact witnesses, including the chief of police, who testified that over the past ten years they had noticed a deterioration of the officer's memory, cognitive abilities, and ability to keep focused. The police chief specifically testified that the officer is unable to perform the duties of a police officer due to her memory problems. The officer also presented reports by doctors she had previously seen stating that she was unable to perform the duties of a police officer due to memory problems. However, the board's medical witness testified that in his medical opinion, the officer's problems were not caused by neurological issues. Rather, the board's medical expert believed that the officer's

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

Bailey v. Police and Firemen's Retirement System, 2013 WL 11705 (N.J. Ct. App. Jan. 2, 2013) (Unpublished)

FORFEITURE CASES

Assaulting fellow police officer constitutes forfeitable offense.

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

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

Forfeiture requires return of benefit payments made prior to conviction.

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

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

Off-duty sexual abuse of another firefighter's child found not to be a forfeitable offense.

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

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

Even if there is a money judgment against a public employee for a bribery conviction, pension board cannot refuse to return employee's contributions.

A federal grand jury indicted a public employee on multiple felony counts related to accepting bribes. After pleading guilty to the charges, the employee was ordered by the criminal court to forfeit to the government the funds he illegally obtained. About one month prior to entering his guilty plea, the employee resigned and requested a return of his pension contributions. The pension board refused to return the employee's contributions based upon the fact that a money judgment for restitution had been entered against the employee. The employee filed suit, arguing that the board wrongfully refused to return his pension contributions. The trial court agreed with the employee that the pension board cannot lawfully refuse to return his contributions. The pension board appealed. On appeal, the court analyzed applicable law and concluded that the board could refuse to return the employee's contributions if there was a "restitution" order against the employee. However, the court determined that the judgment at issue did not constitute a restitution order, but was rather a forfeiture order, because the debt was not owed to the victim of the employee's crimes. Therefore, the court held that the pension board could not lawfully refuse to return the employee's contributions.

Zambarano v. Retirement Bd. of Employees' Retirement System of the State of Rhode Island, ___ A.3d ___, 2013 WL 772656 (R.I. March 1, 2013)

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