

Arizona Supreme Court Upholds Constitutional Pension Rights

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In a recent information message, NCPERS advised its members of the entry of a landmark decision favoring retiree rights in Arizona. This article is an in-depth look at the decision and its reasoning.

In a closely watched decision, *Fields v. Elected Officers Retirement Plan*, 2014 WL 644467 (Ariz. 2/20/14), the Arizona Supreme Court issued a unanimous opinion on February 20, 2014 upholding a trial court decision finding that a reduction in post retirement benefits to retired judges and other elected officials violated the Pensions Clause of the Arizona Constitution.

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

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

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

As a threshold matter, the Court noted that the sitting Justices are not members of the class of retired judges who brought suit. Nevertheless, the Court acknowledged that the Justices are members of the Elected Officials' Retirement Plan and will be eligible for benefits upon their retirement. The Court further observed that no party

had asked for their recusal. Even if recusal had been requested, the Court reasoned that the rule of necessity would apply because disqualification would result in denial of the litigants' constitutional right to have a properly presented question adjudicated.

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

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

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

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

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

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

After concluding that the benefit formula was constitutionally protected, the Court proceeded with its analysis of whether S.B. 1609’s amendments impaired retirement system benefits. By retroactively preventing the transfer of \$31 million to the Plan’s COLA reserve, only a 2.47% benefit increase was paid in 2011 instead of the expected 4% increase. Moreover, no benefit increase was paid in 2012 or 2013, when a 4% increase would otherwise have been payable.

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

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

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

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