VERMONT COMMISSION ON DESIGN AND FUNDING OF RETIREMENT AND RETIREE HEALTH BENEFITS

LEGAL ADVISORY REPORT

Preliminary Draft

Attorney-Client Communications

PREPARED BY:

Mary Beth Braitman
Terry A.M. Mumford
ICE MILLER LLP
One American Square, 29th Fl.
Indianapolis, IN 46282-0200

REVIEW OF VERMONT LAW AND ANALYSIS:

Beth Pearce
VERMONT STATE TREASURER'S OFFICE

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I. INTRODUCTION

Pursuant to a Request for Proposals ("RFP"), Ice Miller LLP ("Ice Miller") was retained by the Vermont Commission on Design and Funding of Retirement and Retiree Health Benefits Plans for State Employees and Teachers ("Commission") to perform the following services: (a) Review constitutional, legal, and contractual issues relative to the provision of, and revision thereto, of governmental pension and retiree health benefits; (b) Advise the Commission on the legality, under state and federal law, of options to modify existing Vermont State benefit design, structure, and contribution levels consistent with the charge of the Commission; (c) Review proposed pension benefit, design, or contribution level revisions to assure compliance with IRS and other regulatory compliance for governmental plans; and (d) Provide other legal consultation services as requested by the Commission.

This report addresses (a) and (b) described in that RFP.

Ice Miller works with retirement systems in 32 states and has had the opportunity to review the constitutional and state law protections in most of those states. The purpose of this report is to provide you with an overview of those constitutional and state law protections, and then to identify how Vermont fits into that overview. A detailed summary of state constitutional provisions and cases is attached as Appendix A to this report.

Vermont state employees participate in the Vermont State Retirement System ("VSRS"). Vermont public school teachers participate in the Vermont State Teachers' Retirement System ("VSTRS"). The Vermont municipal employers and their employees may participate in the Vermont Municipal Employees' Retirement System ("VMERS"). We will address solely the VSRS and VSTRS in this report.

The purpose of this report is not to recommend or suggest any particular changes to the benefit structure, but rather to provide background on the legal issues associated with changes. Of course, any decisions on benefit changes would also require consideration of many other ramifications, to identify but a few:

- sufficiency of benefits,
- competitiveness of total benefit package for public employees,
- effects of changes on retirement decisions, retention, recruitment, and workforce demographics,
- effects on funded status, and
- employee and employer contribution needs.

This report cannot predict the outcome of any particular litigation. The outcome of litigation depends on the specific facts and issues that are presented, how the litigants argue their respective cases, and how a court applies the law. The Vermont Attorney General's office is responsible for advising state agencies directly on these matters.

II. FRAMEWORK FOR ANALYSIS

A. Federal Constitutional and Common Law

1. The Contract Clause

Article I, section 10, clause 1 of the United States Constitution states: "No State shall … pass any … Law impairing the Obligation of Contracts." ("Contract Clause"). This clause applies only to the States (the Due Process Clause applies to the federal government and provides similar protection). There is no specific definition of what constitutes a contract or whether pension obligations are covered.

The Contract Clause was drafted to prevent states from enacting debtor relief laws, but under Chief Justice Marshall the Contract Clause was given an expansive reading to prohibit states from impairing agreements to which the state was a party. Ronald D. Rotunda and John E. Nowak, Treatise on Constitutional Law § 15.8 (4th ed. 2007) ("Rotunda and Nowak").

2. The U.S. Trust Case

In 1977 the United States Supreme Court issued United States Trust Co. v. New Jersey, 431 U.S. 1 (1977). In this case the New Jersey legislature sought to repeal legislation implementing a limitation agreement which was designed to reassure Port Authority bondholders regarding the financial security of the bonds. The Court found that because the legislation was seeking to relieve the state of its own obligations, deference to legislative judgment was not appropriate. Therefore, the Court assessed whether the state's action was "necessary and reasonable." The Court found the law to be neither, because alternative means were available to promote the goals of the legislation.

Any analysis of state action needs to consider the possible applicability of the Contract Clause. If federal courts were to treat governmental pensions as constituting contracts (to whatever degree), the courts could follow basic three-step analysis for determining whether legislation which impairs the contractual obligations of a governmental unit violates the Contract Clause:

a. Step One: Contractual Relationship: Does a contractual relationship exist? The Supreme Court has stated that "[i]n general, a statute is itself treated as a contract when the language and circumstances evince a legislative intent to create private rights of a contractual nature enforceable against the State." United States Trust Co., 431 U.S. at 17, n.14. Additionally, "the obligations of a contract long have been regarded as including not only the express terms but also the contemporaneous state law pertaining to interpretation and enforcement." Id. at 19, n.17.

b. Step Two: Substantial Impairment: Does the legislation constitute a substantial impairment of a contractual relationship?

(i) Rights v. Remedies. There is no clear distinction between rights and remedies, but laws regulating only the form of remedies to enforce state obligations may be considered an insubstantial impairment of the contract.

(ii) Reservation of Right to Modify. From the beginning, the Supreme Court has held that, if a state reserved the right to modify the terms of the contract, either by a provision in the contract or a general statutory scheme, the state could subsequently modify the contract without violating the Contract Clause. See, e.g., Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, 666 (1819) (Story, J. concurring opinion). However, later cases have required a very explicit reservation to allow modification if a third party has accrued rights under the contract—a general reservation is insufficient. If a state explicitly reserves the right to modify benefit levels, any subsequent modification may be considered an insubstantial impairment. See Rotunda and Nowak.

c. Step Three: Narrowly Tailored to Serve a Public Purpose: Is the law that impairs the obligation justified by a significant and legitimate public purpose? Is the method used to advance the public purpose reasonable and necessary?

(i) Police Powers v. Economic Obligations. A state cannot bargain away its police powers, which are necessary for the protection of the health and safety of its citizens. However, states will be held to their economic obligations if unrelated to a police power. See Rotunda and Nowak.

(ii) Reasonable. Whether a method is reasonable should be judged in light of whether the effects which the legislation is seeking to remedy "were unforeseen and unintended by the legislature" when the statute creating those obligations and rights was adopted. United States Trust Co., 431 U.S. at 27.

(iii) Necessary. To be considered necessary, two conditions must be satisfied. First, no less drastic modification could have been implemented. Second, the state could not have achieved its stated goals without the modification. Id. at 29-30.

B. Overview of Other State Laws

We have attached to this report a multi-state survey of constitutional provisions and case law, concerning pension and retiree health benefit protections. See Appendix A.

1. Constitutional Provisions

As is indicated in Appendix A, states fall into three categories with respect to state constitutional protections for pension and retirement benefits:

a. No constitutional provision. This would the category in which Vermont would fall.

b. General constitutional protection of contracts.

c. Specific constitutional protection of pension and retirement benefits.

2. Court Interpretation of Constitutional Provisions

a. For states with no constitutional provision, a limited number of state courts have found that pensions are a gratuity to which no protection applies. Other states in this category have applied the federal Contract Clause.

b. For states where a general constitutional contract clause protection is applied to pension and retirement benefits, there is a wide variation among state courts as to when that contract clause protection vests:

(i) Upon commencement of employment

(ii) Upon commencement of participation in the plan.

(iii) After fulfilling service requirements

(iv) Upon eligibility for a pension

(v) Upon retirement.

c. For states with specific constitutional protection of pension and retirement benefits, the cases are more apt to find an earlier vesting of the contract than in those states with only a general contract clause.

d. Courts in states which recognize a constitutional protection of pension and/or retirement benefits have also recognized that benefits may be subject to modifications in limited circumstances. These limited circumstances include:

(i) Where a disadvantage is offset by an advantage.

(ii) Where a change is reasonable and necessary to preserve the pension system.

(iii) Where a change is reasonable and necessary to maintain the integrity of the pension system.

(iv) Where the creator of the plan has reserved the right to amend the plan.

We believe that preservation of the pension system may be a different concept from maintaining the integrity of the pension system. Although this difference is not fully developed in the cases, we believe that the sustainability of the pension system (funding, contribution levels, benefit levels, cash flows) is clearly the key concept in maintaining a pension system. On the other hand, integrity may encompass benefit design and benefit administration issues, such as avoiding benefit spiking, compliance with federal laws, and achieving the goals of the pension system.

3. What Generalizations are Found from Other States?

From Appendix A, there seems to be little variation among the state law decisions on the following points:

a. Those individuals who are hired after a change occurs cannot claim that their rights have been impaired.

b. On the other hand, in most states employees who are actually retired and receiving benefits are protected as to the benefit being paid (barring erroneous benefit payments, and perhaps not as to any prospective changes (e.g., COLAs) to the benefit).

c. In most states, employees who are currently eligible for an immediate benefit have protected rights to that benefit.

d. In contrast, in most states, when constitutional or statutory language specifies vesting requirements, individuals who have not satisfied those requirements probably have lesser or no protection.

As to the remaining population, there are numerous cases across the country that explore all these issues, and they reach different conclusions. We realize this is not a "bright line" situation, but rather, a complex and nuanced one.

4. Questions Left Unanswered by Court Cases

What is often left unanswered by the general holdings of existing court cases is what is the exact nature of the protection afforded by the Constitution:

a. If an employee started employment when benefits were X and benefits over time have been increased to 2X, is the employee who is still working vested in X or 2X?

b. Does the protection cover solely the "core" retirement benefit, e.g., X% times years of service times final average salary?

c. Does the protection cover any other benefits, e.g., post-retirement benefit increases, employee/employer contribution levels?

d. Does the protection extend only to benefits accrued to the date of the impairment, or to the completion of the person's career?

III. VERMONT AUTHORITY

A. Vermont Constitution

We understand from the Treasurer's office that there is nothing in the Vermont Constitution concerning contract or pension rights. This would place Vermont in the "company" of Connecticut, Delaware, Kansas, and Maryland. However, in each of these states, state courts

have established certain protections for contractual rights. Therefore, in the next section of this report, we summarize existing Vermont cases and indicate how they compare to other state law cases and the U.S. Trust case.

B. Vermont Case Law

1. Burlington Case

The first Vermont case to consider contractual rights with respect to public pensions appears to be the Burlington Fire Fighters' Association v. the City of Burlington, 543 A.2d 686 (Vt. Sup. Ct. 1988). This case involved a City retirement ordinance amendment enacted on October 29, 1984, made retroactively effective to July 1, 1983. The plaintiffs (the Burlington Fire Fighters' Association and the Burlington Fire Fighters' Officers Association) challenged the validity of the retroactive application of the ordinance. The ordinance itself contained a number of benefit improvements, but did increase both the amount (4½% to 6%) and the period (25 to 35 years) of employee contributions. The challenge was not to the City's authority to change pension benefits, but rather to apply changes retroactively. The Vermont Supreme Court found that the City had the power to enact retroactive provisions since "absent express statutory constitutional language to the contrary, the ability to enact retroactive provisions to the pension ordinance may be necessarily fairly implied from the powers which have been expressly granted . . .", citing 24 V.S.A. 1121, 1122 and Senter, 72 Vt. at 113, as well as 6 McQullin Mun. Corp. § 20.70 (3rd ed. 1988) since "(in the absence of constitutional prohibition, retroactive municipal legislation is permissible unless it interferes with contract obligations or vested rights)." The Burlington case did not consider benefit changes to VSRS or VSTRS. However, we believe that analyzing the case gives some indication of the Court's thinking on the question of what legal approach would be applied if the Vermont legislature modifies benefits for VSRS and VSTRS.

In considering contract impairment, the court found

> . . . where an employee makes mandatory contributions to a pension plan, that pension plan becomes part of the employment contract as a form of deferred compensation, the right to which is vested upon the employee's making a contribution to the pension plan. See *Snow v. Abernathy,* 331 S.2d 626, 631 (Ala.1976) (pension is vested contract right upon acceptance of plan); *Olson v. Cory,* 27 Cal.3d 532, 540, 636 P.2d 532, 537, 178 Cal.Rptr. 568, 573 (1980) (pension plans create vested contract rights accruing upon acceptance of employment); *In re State Employees' Pension Plan*, 364 A.2d 1228, 1235 (Del.1976) (pension is vested contract right for employees who fulfill pension's eligibility requirements); *Halpin v. Nebraska State Patrolmen's Retirement System*, 211 Neb. 892, 898, 320 N.W.2d 910, 914 (1982) (public employee pensions are deferred compensation and create "'reasonable expectations which are protected by the law of contracts'") (quoting *Pineman v. Oechslin*, 494 F.Supp. 525, 538 (D.Conn.1980)).

Having found a contract right, the Vermont Supreme Court then considered the Contract Clause of the United States Constitution. U.S. Const., Art. I, § 10, Cl. 1:

> To trigger the constitutional protection of the Contract Clause, there must first be an impairment of a contract. *Id.* [*United States Trust Co. v New Jersey*, 431 U.S. 1, 17, 97 S.Ct. 1505, 1515, 52 L.Ed.2d 92 (1977)]. Assuming plaintiffs establish the existence of an impairment, such impairment only violates the clause if it is not reasonable and necessary to achieve an important public purpose. *Id.* at 25, 97 S.Ct. at 1519. The United States Supreme Court has suggested that an overall determination of reasonableness be used to evaluate challenged legislation under the Contract Clause. *Id.* at 22 n. 19, 97 S.Ct. at 1517 n. 19 (citing *Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 445-47, 54 S.Ct. 231, 242-43, 78 L.Ed. 413 (1934)). An employee's vested pension rights may, therefore, be modified prior to retirement if such modifications are reasonable, since it allows the pension system to adapt to changing conditions. See *Olson*, 27 Cal.3d at 541, 636 P.2d at 537, 178 Cal.Rptr. at 573; *Singer v. City of Topeka*, 227 Kan. 356, 366, 607 P.2d 467, 475 (1980); *Bakenhus*, 48 Wash.2d at 701-02, 296 P.2d at 540.
>
> [7] To be sustained as reasonable, "'alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation . . .'" *Bakenhus*, 48 Wash.2d at 702, 296 P.2d at 540 (quoting *Allen v. City of Long Beach*, 45 Cal.2d 128, 131, 287 P.2d 765, 767 (1955)); see *Singer*, 227 Kan. at 366, 607 P.2d at 475. Furthermore, any changes in the plan which result in disadvantage to the employees must be accompanied by comparable new advantages. *Bakenhus*, 48 Wash.2d at 702, 296 P.2d at 540 (citing *Allen*, 45 Cal.2d at 131, 287 P.2d at 767).
>
> The court found that:
>
> In the instant case, the amendments to the pension plan bear close relationship to the continued success of the pension system to meet the changing needs of municipal employees. Plaintiffs agree that the City had the power to amend the pension ordinance and that the changes made by the new ordinance are beneficial. Although the amendments have a retroactive effect, the fact that legislation is retroactive is not by itself sufficient to establish a violation of the contract clause. *United States Trust Co.*, 431 U.S. at 17, 97 S.Ct. at 1515. In this case the retroactive effect of the increased benefits is simply being offset by the requirement of retroactive contributions. In effect, we find that plaintiffs have not shown that the ordinance amendments created a constitutional impairment of their contract.
>
> The court also rejected an equitable estoppel argument.

2. Cases Cited by Burlington Case

The Vermont Supreme Court cited a number of cases in the Burlington case from other states.

First, for the proposition that a right becomes vested "upon the employee's making a contribution to the pension plan" four cases were cited. This section gives additional details on those cases:

- Snow v. Abernathy, 331 So.2d 626 (Alabama Sup. Ct. 1976): Largely based on voluntary participation and employee election, case concluded that there had been a vesting of contract rights, citing Smith v. City of Dothan, 279 Ala. 571 (Alabama Sup. Ct. _____).

- Olson v. Cory, 636 P.2d 532 (Calif. Sup. Ct., 1980: Case concluded that limits on cost-of-living salary increases cannot be applied to judges who are mid-term if the judge served prior to January 1, 1977. It also discussed the rights of those in pension payment status. The court relied on "a long line" of California cases holding that a "public employee's pension rights are an integral element of compensation and a vested contractual right accruing upon acceptance of employment" citing Betto v. Board of Administration, 582 P.2d 614 (Calif. Sup. Ct.) and Kern v. City of Long Beach, 179 P.2d 799 (Calif. Sup. Ct.). The court summarized the position that while an employee does not obtain any absolute right to fixed or specific benefits, there are strict limitations on the conditions which may modify the pension system in effect during employment. Modifications must be reasonable and disadvantageous changes should be accompanied by comparable new advantages. The case did not seem to rely on voluntary contributions as a crucial factor.

- In re State Employees' Pension Plan, 364 A.2d 1228 (Del Sup. Ct. 1976): Delaware has a mandatory contribution structure. The court found that vested pension rights exist at least as to individuals who have statutory vested rights or who have otherwise fulfilled eligibility requirements for a pension.

- Halpin v. Nebraska State Patrolmen's Retirement System, 320 N.W.2d 910 (Nebraska Sup. Ct., 1982): This case involved a change to the calculation of the benefit for state police. The court found that the Nebraska statutes at issue contained no provisions preventing vesting until a certain time, thus legitimate expectations were raised that the amounts in issue would be included in the calculation.

Second, in order for the Contract Clause to apply, the Vermont Supreme Court found there must be an impairment of the contract which is not reasonable and necessary to achieve an important public purpose, such as allowing the pension system to adapt to changing conditions. The court cited three cases:

- Olson (see above).

- Bakenhus v. City of Seattle, 296 P.2d 536 (Supreme Court of Washington, 1956): Washington Supreme Court found a pension is deferred

compensation for services rendered, as a gratuity would be prohibited under the Washington Constitution as a gift of public funds, and further found that the contractual promise arises at employment. The court found this contract was for a "substantial pension" at the time of fulfillment of the prescribed conditions. The court recognized that the pension rights could be modified prior to retirement, "but only for the purpose of keeping the pension system flexible and maintaining its integrity."

- See also Allen v. City of Long Beach, 287 P.2d 765 (California Supreme Court, 1955)

- Singer v. City of Topeka, 607 P.2d 467 (_____, 1980) See Brazleton v. Kansas Public Employees Retirement System, 607 P.2d 510 (Kansas Supreme Court) court rejected a "hard and fast rule" of no change, since there "may be times when changes are necessary to protect the financial integrity of the system or for some other compelling reason which would mandate and justify some unilateral changes."

3. Summary of Burlington Approach

The Vermont Supreme Court in the Burlington case upheld a retroactive contribution increase for a municipal plan under the theory that the ability to retroactively amend is implied from the ability to enact. However, the court placed limits on retroactive legislation in an instance where the legislation interfered with contract obligations or vested rights.

Because there is no Vermont constitutional provision on contract obligations or vested rights, the Vermont Supreme Court looked at the contract clause of the U.S. Constitution and the U.S. Trust case. Under the U.S. Trust case, there are three questions to be analyzed:

- Does a contract exist?
- Has the contract been impaired?
- Is the impairment reasonable and necessary to achieve an important public purpose?

Applying the U.S. Trust case to the facts in Burlington, the Vermont Supreme Court found that the amendments bore a close relationship to the continued success of the pension option and that the impact of the retroactive contributions was offset by enhanced benefits. In this situation, no constitutional impairment was found.

4. How Does the Burlington Approach Compare to the U.S. Trust Case and Other State Cases?

a. If/When a Contract Arises.

The cases that were cited by the Vermont Supreme Court with regard to if/when a contract arises for pension benefits do not necessarily present a consistent picture, demonstrating the challenge in reconciling cases with different facts and different underlying statutes. If the

Burlington decision indicates that all four cases should be applied, then one way to achieve that would be to use the following interpretations from the cases:

(i) A voluntary participation system creates vested contract rights when the election to participate or contribute is made by the employee.

(ii) In a mandatory system, an employee who has met statutory requirements for vesting or for a pension has contractual rights to that vested amount or that pension.

(iii) In a mandatory contribution system, an employee has the right to participate in the pension system upon employment, but has no absolute or fixed right to a benefit until the employee meets the statutory requirement for vesting or for a pension.

(iv) An impairment does not exist if there is a balance between disadvantageous and advantageous changes.

The above interpretation would be consistent with what we have previously characterized as the generally accepted position in many states and with the U.S. Trust case.

b. Whether an Impairment is Reasonable and Necessary.

The cases that were cited by the court with regard to whether an impairment was reasonable and necessary to achieve an important public purpose present a consistent picture. The cases cited would permit an impairment in the following circumstances:

(i) When the impairment is reasonable and necessary to achieve an important public pursuit such as to protect the financial integrity of the system or to keep the pension system flexible, or

(ii) When there is a compelling reason that justified unilateral actions.

This interpretation would also be consistent with the position in many states and with the U.S. Trust case.

5. Jacobs Case

The next case to consider is Jacobs v. State Teachers' Retirement System, 816 A.2d 517 (Vermont Supreme Court 2000). In this case Ms. Jacobs brought a class action suit against VSTRS to recover the amount of a service purchase plus interest, claiming the system had breached statutory and fiduciary duties to her. The question presented to the Court was whether VSTRS was protected by sovereign immunity so that Jacobs and other class members could not recover. The Court concluded that (1) the State of Vermont would ultimately be responsible for the payment of any money judgment paid to the plaintiffs and (2) the system was an arm of the state. As a result, the Court held that sovereign immunity prevents a suit for money damages absent a waiver. Ms. Jacobs took the position that under a contract theory the state had waived its immunity. Her specific claim was that VSTRS had not provided her with accurate

information and that constituted a contract breach. The Court considered this argument but did not decide whether Ms. Jacobs had established that a contract existed. Instead the Court issued a very narrow decision on the issue that a failure to provide accurate information was not a breach of contract. In its discussion of this decision, the Court stated the following:

> State-created contract rights may be entitled to constitutional protection. See Halpin, 320 N.W.2d at 914. As a result "before governmental action will be held to grant a constitutionally protected contract right, the intent to do this must be expressed in clear and unmistakable language." Robert T. Foley Co. v. Wash. Suburban Sanitary Comm'n, 289 A.2d 350, 358 (Md. 1978). Thus there is a "recognized presumption that statutory enactments do not create contractual obligations in the absence of an 'unmistakable' intent on the legislature's part to do so." McGrath, 88 F.3d at 19.

6. Summary of Jacobs Reasoning

The Jacobs case is a narrowly drawn decision. However, it is very important in the following respects:

1. At least with respect to VSTRS, it makes available the argument of sovereign immunity as a defense to legal action, although there could possibly be a waiver of that immunity for a contract breach.

2. It seems to stand for the proposition that a contract is only created through government action if the intent to create a contract is clearly and unmistakably expressed.

7. How Does the Jacobs Case Compare to Other States Case Law?

The Jacobs case addresses an issue that is an important part of the U.S. Trust analysis – has the state created a contract. The Jacobs case is very helpful in providing direction to look specifically at state legislative action to determine if a contract has been created.

8. Kaplan Case

In July, 2009, the Vermont Superior Court issued a decision in Kaplan v. Morgan Stanley & Co., 47 EBC 1891 (Vermont Sup. Ct., 2009). This case involved the Town of Stowe and its police pension programs. It was decided on a statute of limitations basis, but the court discussed equitable estoppel ("which requires a showing that a defendant's conduct in some way induced the plaintiff to delay bringing suit") and equitable tolling (which applies "either where the defendant is shown to have actively misled or prevented the plaintiff in some extraordinary way from discovering the facts essential to the filing of a timely lawsuit, or where the plaintiff has timely raised the same claim in the wrong forum").

C. Vermont Attorney General

We were supplied by the Treasurer's Office with a number of Attorney General letters and memoranda. These were not official opinions of the Attorney General. This section contains a discussion of the ones we thought would be most relevant to the Commission 's work.

1. 2002 McShane Memorandum

On January 10, 2002, a memorandum was issued by Mike McShane, as Assistant Attorney General, regarding the potential for legal challenge if legislation was passed to establish a year of service requirement for the retiree medical state subsidy and to establish a minimum number of years of service to be eligible for a retirement benefit. The memorandum stated that:

> The Contract Clause of the United States Constitution limits the ability of states to pass laws that impair contractual obligations. The Contract Clause does not absolutely prohibit laws, which impair contractual obligations. Rather the United States Supreme Court has held that laws, which result in substantial impairment of contractual relationships, are prohibited unless the impairment is reasonable and necessary to serve an important public purposes. General Motors v. Romein, 503 U.S. 181 (1992).
>
> This memorandum also addressed the status of Vermont state law as follows:
>
> I am aware of no decision from the Vermont Supreme Court that holds that the Vermont State Employees Retirement System creates contractual rights. [Footnoting that "There is a case suggesting that the municipal retirement system is contractual in nature. Burlington Fire Fighters v. City of Burlington, 149 Vt. 293."] However, most courts that have addressed this question in other states have held that public pension plans do create contractual rights.

This memorandum went on to emphasize that "[I]f it is assumed that the Retirement System creates contractual rights, the more difficult question is to whom do those rights apply." Mr. McShane then reviewed a Maine case finding that contractual rights of members not yet receiving pension benefits were not violated by changes in the system. He also commented that some state cases (not Vermont cases) suggest "there is a substantial risk in applying benefit reductions to existing employees, particularly employees who have vested."

The memorandum identified the following legal analysis, which follows the U.S. Trust approach:

> In order to successfully challenge the proposed legislative changes any plaintiff would have to establish the following:
>
> 1. That the Retirement System creates contractual rights and benefits.
>
> 2. That the plaintiff has rights which are protected under the contract and that those rights are impaired by the amendments.
>
> 3. That the impairment of rights are not reasonable and necessary to serve an important public purpose.

2. 2003 and 2005 Asay Memoranda

On June 2, 2003 [also dated May 29, 2003], a memorandum was issued by Ms. Bridget Asay, an Assistant Attorney General concerning changes to teachers' retiree health benefits. This memorandum stated that:

> The Vermont Supreme Court has not directly considered whether state retirement benefits are constitutionally protected. But the Court has recognized, in the retirement context, that "[s]tate-created contract rights may be entitled to constitutional protection." Jacobs v. State Teachers' Retirement Sys., ____ Vt. ____, 816 A.2d 517, 526 (2002). To find a constitutionally protected contract right, the State's intent to create such a right 'must be expressed in clear and unmistakable terms.' Id. The Court in Jacobs stated further that 'statutory enactments do not create contractual obligations in the absence of an 'unmistakable' intent on the legislature's part to do so.' Id.

(Note: The same language as immediately above was also used in a November 14, 2005 memorandum from Ms. Asay, again on health benefit rights.) The ultimate conclusion in both the 2003 Asay memorandum and the 2005 Asay memorandum was:

> At most, members who retired after May 22, 1996, may have constitutionally protected rights to (1) access health and medical benefits through plans approved by the Board, with the Board retaining discretion to determine the terms of those plans; and (2) have the System pay some portion of the cost of health and medical benefits, with the Board retaining discretion to determine the System's share of the cost. It is not clear whether a court would find these rights enforceable. Because the amount and scope of the benefit is left to the Board's discretion, a court might find that the Legislature did not intend to create enforceable rights. On the other hand, a court might conclude that the right to access health and medical benefits in some form is clear, and that right is valuable enough, even if retirees must pay most of the cost, to be constitutionally protected.

3. 2005 McShane and Griffin Emails

Earlier in 2005 there was an exchange of emails between the Attorney General's Office and Cynthia Webster. The original question from Ms. Webster was whether anything in the state retirement statutes directly states that it is not possible to reduce retirement benefits. Mr. McShane's response (dated March 31, 2005) was:

> There is not a specific statutory provision that so states. However, U.S. Constitution contains what is referred to as the Contract Clause. The Contract clause has been interpreted to invalidate legislation which impairs vested contract rights. The Vermont Supreme Court has discussed the contracts clause in situations which are not exactly on point. The clause is found at Article I, Section 10 of the Constitution. It is an enumeration of the powers denied to the states and quit [sic] directly states that no state shall pass a law "impairing the obligation of

contracts." Of course it is possible to change benefits for new hires but vested contract rights cannot be retroactively altered.

Mr. Griffin responded that same date that:

I agree with Mike that 'vested contract rights cannot be retroactively altered.' The more interesting question in the context of a public retirement system is what contract rights have 'vested' and what changes might be characterized as 'retroactive.' The answers to these questions would depend on the nature of the benefits (for example, cash or insurance), the specific statutory language that governs those benefits, any statutory and plan changes over time, the extent of those changes, the circumstances of particular retirees and other factors.

Mr. Griffin then cited the Asay 2003 Memorandum and concluded:

It is difficult to predict how the courts will ultimately decide these issues, and the outcomes may be very fact specific. To my knowledge the AG's Office has not done the research and analysis that would be needed to provide legal advice on any proposals to alter any retirement benefits other than that reflected in the Asay memorandum.

4. 2006 Rice Memorandum

We note that there is also a June 5, 2006 memorandum from William H. Rice, Office of State Treasurer, reviewing whether the State Employee Retirement Board has the same discretion to change state retiree medical benefits as the Asay memoranda reflects for teachers' retiree medical benefits. The memorandum reviewed the statutory provisions regarding modifications of retiree medical benefits for state employees and then reviews the Burlington standard:

"where an employee makes mandatory contributions to a pension plan, that pension plan becomes part of the employment contract as a form of deferred compensation, the right to which is vested upon the employee's making a contribution to the pension plan." Burlington Fire Fighters Association v. City of Burlington.

The memorandum further observed that the Vermont Supreme Court had determined that vested pension rights may be modified prior to retirement if such modifications are reasonable "since it allows the pension system to adopt to changing conditions." Id. at A.2d at 690. The memorandum also observed that the Vermont Supreme Court had:

established a two part test of reasonability: 1) "[t]o be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation" and 2) "any changes in the plan which result in disadvantage to the employees must be accompanied by comparable new advantages." Id. 149 Vt. at 298, 543 A.2d at 690.

5. Summary of Attorney General Analyses

The memoranda from the Assistant Attorneys General have reviewed the Burlington case and found that it would have limited application to the question of whether state pension benefits can be modified. The memoranda have generally followed the U.S. Trust case in that a three part analysis must be followed:

1. Is there a contract and what are the terms of that contract?

2. Has that contract been impaired?

3. Is there a legally acceptable reason for that impairment?

With respect to retiree health benefits, the memoranda have not concluded whether there is state law protection for retiree health benefits, although there may be some protected rights to access.

These memoranda are very consistent with general state law principles and the U.S. Trust case. We will consider these memoranda in more detail as we consider the Commission's specific questions.

IV. APPLICATION OF CONSTITUTIONAL AND STATE LAW PRINCIPLES

A. Pension Benefits

Following the rationale in the Vermont cases (primarily Burlington and Jacobs), we have reviewed the statutes governing VSRS and VSTRS to identify statutory provisions that could be construed as clearly established contract rights with respect to pension benefits. This is in keeping with the U.S. Trust case and the AG Memoranda which set forth the first step in the analysis as identifying if a contract has arisen.

a. In this regard, we believe that in VSRS the legislature has identified an individual with 5 years of creditable service as being "vested." Such a member may allow employee contributions to remain in VSRS and "receive a deferred vested retirement allowance," based on their compensation and service at termination. (Title 3, Chapter 16, § 465)

b. With regard to VSTRS, we believe this same status is established under Title 16, Chapter 55, § 1940(a).

c. With regard to benefit payment, we also believe that the Vermont statutes establish entitlements at certain combinations of age and service. See for example Title 16, Chapter 55, § 1937(a) for VSTRS and Title 3, Chapter 16, § 455(13) for VSRS.

d. In addition, both VSTRS and VSRS are established as qualified governmental pension plans under Internal Revenue Code Sections 401(a) and 414(d). Under these Sections, benefits must be vested upon attainment of normal retirement age

and upon plan termination, to the extent funded. (***Note*:** Both VSTRS and VSRS were submitted for IRS approval and those applications are still pending.)

Based upon the foregoing and applying the general principles of the state law cases and the Jacobs rationale, we believe the contractually protected members would be:

a. VSRS and VSTRS members who have reached normal retirement age are vested in their benefits because the legislature has clearly said that VSRS and VSTRS are qualified, governmental pension plans.

b. VSRS and VSTRS members who have reached eligibility for normal or early retirement benefits have a contract right in those benefits because the legislature has said that they are entitled to these benefits.

c. VSRS and VSTRS members who have at least five years of service are vested in their accrued benefit and thus have a contract right with respect to that benefit (leaving open the question of what is a member's "accrued benefit" at any point in time, and whether the protection extends to benefits not yet earned or accrued).

d. VSRS and VSTRS members who do not have five years of service are not vested in a benefit and thus have no contract right.

We realize that this analysis leaves a "middle group" (those who are vested but have not reached eligibility for a benefit) where the Commission must analyze whether a contract right exists with respect to a particular benefit feature. In this regard, we recommend that the Commission do additional fact finding with respect to any specific changes it is interested in. This would include identifying if there has been any modification to the plan with respect to that benefit feature at any time or times during the career of the middle group. This will be helpful to measure the length of time that the benefit feature has been applicable. The Commission may also wish to consider any other relevant facts concerning any new tiers or coverage changes affecting the middle group.

Under the U.S. Trust case and the state law principles, including cases cited in the Burlington case, these contractually protected benefits could be modified ("impaired") in the following situations:

a. Where a disadvantage is offset by an advantage.

b. Where the stability or the integrity of the pension system requires the change and the change is reasonable.

c. Where a compelling situation requires unilateral change.

B. Retiree Health Benefits

With regard to retiree health benefits, Title 3, Chapter 21, Section 631 provides that

"the secretary of administration may contract on behalf of the state with any insurance company … to secure the benefits of franchise or group insurances. Beginning July 1, 1978, the terms of coverage under the policy shall be determined under section 904 of this title [collective bargaining], but may include … hospital, surgical, and medical benefits for any class or classes of state employees or for those employees and any class or classes of their dependents. *** For purposes of group hospital-surgical-medical expense insurance, the term "employees' shall include … former employees … who are retired and receiving a retirement allowance from the Vermont state retirement system or the state teachers' retirement system of Vermont.

As stated in the Asay Memoranda, it is not clear from the above whether the extension of medical coverage to retirees is intended to be a contractual right by the legislature. If the a court were to find that a contract exists, it appears that the contract would only be for access to coverage, not for a particular level of benefits or for a particular level of premiums.

V. VERMONT QUESTIONS

A number of questions have been identified as being helpful to understanding how to apply the legal framework described above.

A. Pension

1. Summary of Pension Groups

a. There are four defined benefit groups under VSRS for state employees. Each group must considered separately for certain purposes:

(i) Group F for state employees

(ii) Group D for judges

(iii) Group C for state law enforcement officers

(iv) Group A original retirement plan which some members elected to remain in, and predecessor to plan F.

b. For VSTRS, there are basically two groups remaining:

(i) Group C for public school teachers employed within the State of Vermont on or after to July 1, 1990. Group B members as of on July 1, 1990, are now in Group C.

(ii) Group A for public school teachers employed within the State of Vermont prior to July 1, 1981 and elected to remain in Group A.

2. Raising Retirement Age

Questions: Can the legislature raise normal retirement and/or early retirement age for all current state employees and teachers? Certain current state employees and teachers? Non-vested state employees and teachers? Could ages be changed to reflect the Social Security structure?

Analysis: Based upon Jacobs and Burlington and the general state law principles, it appears that a court could find that the Vermont statutes are intended to create certain contractual rights in a pension benefit.

a. Assuming that a court would find that contractual rights apply, raising normal and/or early retirement ages for any member who had already reached eligibility for a retirement benefit would not be permissible without an offsetting advantage or unless reasonable and necessary to preserve the pension system.

b. It is not clear whether the court would find that a vested member who had not reached retirement age would receive the same degree of protection, or only be protected in the amount of benefit earned to the point of the change. If the court found either, the court would then likely need to decide if the change in retirement age was an impairment. If yes, then the court would likely analyze whether the impairment was reasonable and necessary to protect the financial integrity or flexibility of the pension system.

c. Because the legislation has not expressed any intent to create a contract for a non-vested member, under general state law principles, a court could uphold a change in normal and/or early retirement age for a non-vested member.

3. Revise Early Retirement Criteria

Questions: Can the following elements be modified with respect to early retirement:

- Age eligibility restriction?
- Application of penalty based on actuarial cost?

Analysis:

a. We believe changing the early retirement age would follow the analysis outlined in 1 above.

b. As to changes in the actuarial reduction factors, a good argument can be made that this either is not a contractually protected provision, or even if it is a protected provisions, reasonable modifications should be considered as a reasonable and necessary actions to retain the integrity of the plan. Actuarial factors, such as life expectancy, change over time. Boards typically retain the ability to review their plan's actuarial experience and modify assumptions and factors based on the actuary's recommendations. We see this as presenting different arguments than changing the age. As to the first

question, whether it is a contractually protected benefit, we note Title 3, Chapter 16, § 459(d) provides early retirement reduction factors as follows:

(i) Group A (except DOC facility employees) – early retirement is "actuarial equivalent of normal retirement allowance." "Actuarial Equivalent" is defined in § 455(a)(2) as "a benefit of equal value under the actuarial assumptions last adopted by the retirement board under subsection 472(a)(h)." That subsection gives the board the express right to modify the assumption by resolution.

(ii) Group F (except for certain exceptions) – early retirement is reduced by .5%/month under age 62; although if a group member first participated on or after July 1, 2008 the reduction varied by years of service but was measured from 65.

(iii) Group D – early retirement reduced by .25%/month under age 62.

Therefore, it seems clear the legislature reserved the right to change the assumptions for Group A. Groups D and F are less clear as to whether there is a contract right in the early reduction factor. If the court found there was, it would then likely analyze whether the impairment was reasonable and necessary to protect the financial integrity or flexibility of the plan. One question to consider is whether the reductions for Groups F and D represent actuarial reductions as of the time that they were implemented (o/a 1990)

c. Group C is entitled to retire at age 50 with 20 years of service without penalty for early retirement. Without a showing of necessity, we do not believe that these eligibility conditions could be changed for a member who has reached either the normal retirement of 55 or the early retirement of 50 and 20.

If the Commission wishes to consider changes in this category, it may wish to identify all the requirements for each group and plan for early retirement and normal retirement and create a protected category in each group and plan of all members who meet those requirements. We also think the Commission would want to review what changes (if any) had been made in the different factors over time. Lastly, the Commission will want to have an actuary consider whether the factors would be different today if they were to be "actuarial equivalents" of the unreduced benefit.

4. <u>Increase Employee Contribution Rates For All Groups and Consider Appropriate Contribution Rates for Different Groups or Plans</u>

<u>Questions</u>: Would it be possible to raise contribution rates for <u>all current</u> state employees and teachers, in order to provide long-term sustainability for the current plan and benefit levels? <u>Certain current</u> state employees and teachers? <u>Non-vested</u> state employees and teachers? Would it be possible to tie employee contributions to salary or age?

Analysis:

a. Title 3, Chapter 16, § 473(b) establishes employee contribution rates as follows:

> (i) Group A: The amounts so allocated as regular contributions shall be determined as if the rate of contribution of four percent has been continuously in effect in the predecessor system from which such amounts were transferred and the balance of any amount so transferred on account of any group A member shall be deemed additional contributions. In the case of group C members who were members as of the date of establishment and D members all contributions transferred from predecessor systems shall be deemed regular contributions. Those members who, prior to the date of establishment of this system, had been contributing at a rate less than four percent shall have any benefit otherwise payable on their behalf actuarially reduced to reflect such prior contribution rate of less than four percent.
>
> (ii) Groups C and F: Contributions shall be made on and after the date of establishment at the rate of five percent of compensation except at a rate of 6.18 percent of compensation for each group C member unless the member was a group C member on June 30, 1998 in which case contributions shall be at the rate of six percent of compensation for each group C member who has elected not to have his or her compensation from the state be subject to Social Security withholding or at the rate of five percent of compensation if the member elected to have compensation from the state subject to Social Security withholding and at the rate of five percent of compensation of each group F member and, commencing July 1, 2019, at the rate of 4.75 percent of compensation for each group F member.

Consequently, it appears as though the legislature has already changed the employee contribution rates in the past, sometimes with some "grandfathering." We are unaware that there has been any contract impairment found. This would suggest that there was not a reasonable expectation of a contract right to a particular rate for the entire career. The Commission would likely want to have a complete history of the different contribution rates and the previous changes, as well as an actuarial study giving the effect on the rates.

b. As provided in state cases, if there is a contract right in a particular rate, any increase in contribution rates can be deemed appropriate if offset by benefit improvements. Additionally, if increased contributions were reasonable and necessary to maintain the retirement system, state cases would support the proposition that contributions could be increased without a benefit improvement. The U.S. Trust case would support the proposition that a change in a contract (if it existed) could be modified if reasonable and necessary.

c. We would have to research decisions and guidance under the Age Discrimination and Employment Act if the Commission wishes to consider age based contributions. There has been litigation on that issue.

5. Revise Multiplier Used to Calculate Benefits for All Groups and Plans

Questions: Can the legislature change the multiplier going forward for all current state employees and teachers? Certain current state employees and teachers? Non-vested state employees and teachers? ***Note:*** Assume that for the time already earned, the current multiplier would be used, but going forward a lower multiplier would be used.

Analysis:

> The general state law principles and the Vermont cases do not provide any guidance on whether there is a contract right that prevents prospective changes in the multiplier. In certain states that follow a strict contract law approach, a prospective change in a multiplier would be considered a contract impairment. If we looked to federal law, this approach would be permitted since only the benefit accrued (or earned) to the date of the change would be preserved.

We think there would likely be no contract right for the non-vested employees and teachers. We also believe that based upon the AG Memoranda and the state case law principles it would be defensible to take the position that prospective multiplier changes are permissible

6. Revise Vesting Period

Questions: Can the legislature change things like vesting period (5 to 10 years) for all current state employees and teachers? Certain current state employees and teachers? Non-vested state employees and teachers?

> Analysis: "Vesting" is established by Title 3, Chapter 16, § 465(a), as five years for a deferred vested retirement allowance. Under the general state law principles, we believe that a court would hold that increasing the number of years would not be permissible for a member who already had five years unless there was an offsetting advantage or unless the change was reasonable and necessary to preserve the pension system. For non-vested members, we believe the change would likely be permitted.

7. Define Types of Income Eligible for Calculation of Average Final Compensation (AFC)

Question: Can the elements of AFC be modified? Based upon our conversations with retirement system staff, we understand the definition of AFC to be described as follows:

a. VSRS Group A is a closed group with just a few members. AFC for this group is similar to Group C, that is, the highest 3 consecutive fiscal years, or the last 36 months including unused annual leave pay off.

b. VSRS Group B is a closed non-contributory group with just a few active members.

c. VSRS Group C (Public Safety): AFC is the average of gross pay for the last 24 months of employment or any 2 consecutive fiscal years. AFC consists of gross pay, but does not include the payment of unused sick leave, except that ½ of the time period of sick leave at the final annual salary can be substituted for the period of lowest pay. Contributions are not made on this amount. With regard to State Troopers, there is a cap on the amount of overtime that can be counted.

d. VSRS Group D (Judges): AFC consists of the statutory pay for the year in which the judge retires. For example, if the legislature sets the annual salary rate at $125,000 for FYE June 2010, then the AFC for a judge who retires in that Fiscal Year is $125,000 regardless of whether the judge has received $125,000 by the time he/she retires.

e. VSRS Group E is a closed plan.

f. VSRS Group F (most State employees): AFC is the average of gross pay for 3 consecutive fiscal year or the last 36 months of employment. AFC excludes unused annual leave pay off. AFC includes compensatory time and personal time. Contributions are also made on these amounts.

g. VSTRS Group A (Only 25 left): AFC is the highest 3 consecutive years, including unused annual leave, such leave, and bonus/incentives.

h. VSTRS Group C: AFC is the 3 consecutive year average. AFC is based upon what they earn as teacher plus compensation for extracurricular activities. This is the same base for benefits and contributions. AFC cannot include any retirement incentives. The Board has to approve any increase that exceeds 10% year to year.

i. VSTRS Group B is closed.

Analysis: The pension contract (to the extent it exists) likely includes the definition of AFC. "Average final compensation" is defined in Title 3, Chapter 16, § 455(a)(4). In every case except judges, the term refers to "average annual earnable compensation." Title 3, Chapter 16, § 455(a)(8) defines that as the full rate of compensation that would be payable to an employee if the employee worked the full normal working time for the employee's position. Therefore, in general, the definition of AFC would be considered part of the benefit that is vested and/or protected for employees – so that protected categories would include vested members and members eligible for a benefit. However, it may be that a change for a member of a protected group would be permissible if the change was needed for integrity of the retirement system – for example, to prevent benefit spiking. In addition, the Commission may want to review when any prior changes to the definition occurred in VSRS Groups C and F and VSTRS Group C.

8. Review Impact of Going From a Three Year to Five Year Salary Calculation for AFC

Question: Can the calculation of AFC be expanded to include 5 years instead of 3?

Analysis: As to the first point of whether there is a constitutionally protected benefit, the normal retirement benefit for groups in VSRS is based on "average final compensation"(except for judges, which is based on their salary). Title 3, Chapter 16, § 459. "Average final compensation" is defined in Title 3, Chapter 16, § 455(a)(4) as the "average annual earnable compensation" in the three (for Group A and F: two for Group C) consecutive fiscal years or last three (two) employment years. Therefore, as noted above, the definition of AFC would be considered part of the benefit that is vested and/or protected for employees – so that protected categories would include vested members and members eligible for a benefit.

If the Commission is interested in further considering this, the Commission may also want to consider whether a special protected group of those within 3 or 5 years of retirement eligibility should be created, so that any change here would allow some additional security for that population.

9. Revise COLA Changes and Revise Definition of CPI

Questions: Can COLAs be changed, including a revision to the definition of CPI?

Analysis: Title 3, Chapter 16, § 470 establishes the COLA provisions. Every group has a COLA based on CPI. For some group it is either a full or half-COLA. Group A, C and D's COLA is as follows:

> as of June 30 in each year, commencing June 30, 1972, a determination shall be made of the increase or decrease, to the nearest one-tenth of a percent, in the ratio of the average of the Consumer Price Index for the month ending on that date to the average of said index for the month ending on June 30, 1971 or the month ending on June 30 of the most recent year subsequent thereto as of which an increase or decrease in retirement allowance was made. If the increase or decrease, so determined, equals or exceeds one percent, the retirement allowance of each beneficiary in receipt of an allowance for at least one year on the next following December 31st shall be increase or decreased, as the case may be, by an equal percentage. Such increased or decrease shall commence on the January 1st immediately following such December 31st. Such percentage increase or decrease shall also be made in the retirement allowance payable to the beneficiary in receipt of an allowance under an optional election, provided the member on whose account the allowance is payable and such other person shall have received a total of at least 12 monthly payments

> by such December 31st. The maximum adjustment of any retirement allowance resulting from any such determination shall be five percent and the minimum shall be one percent, and no retirement allowance shall be reduced below the amount payable to the beneficiary without regard to the provisions of this section.

Group F members' COLA is as follows:

> as of June 30 in each year, commencing January 1, 1991, a determination shall be made of the increase and decrease, to the nearest one-tenth of a percent of the Consumer Price Index for the preceding fiscal year. The retirement allowance of each beneficiary is receipt of an allowance for at least one year on the next following December 31st shall be increased or decreased, as the case may be, by an amount equal to one-half of the percentage increase or decrease. Commencing January 1, 2014, the retirement allowance of each beneficiary who was an active contributing member of the group F plan as of June 30, 2008 and who retires on or after July 1, 2008 shall be increased or decreased, as the case may be, by an equal percentage of the Consumer Price Index for the preceding year. The increase or decrease shall commence on the January 1st immediately following such December 31st. The adjustment shall apply to group F members receiving an early retirement allowance only in the year following attainment of age 62, provided the member has received benefits for at least 12 months as of December 31 of the year preceding any January adjustment. The maximum adjustment of any retirement allowance resulting from any such determination shall be five percent and the minimum shall be one percent, and no retirement allowance shall be reduced below the amount payable to the beneficiary without regard to the provisions of this section.

The language of the statute provides that benefits "shall be increased or decreased" indicating that in specified circumstances the benefits shall be adjusted up or down as a result of CPI. This would seem to mean that a decrease resulting from CPI would be part of the contract and/or there has been a reservation of rights to amend the contract.

10. Review Potential of Limiting Allowable Earnings After Retirement

a. VSTRS: Teachers may "retire" and receive a pension so long as they occupy a non-qualified position – that is, a position that is not covered by VSTRS. If a retired teacher returns to a position covered by VSTRS, then the retiree is not allowed to earn more than 60% of a teacher's salary.

b. VSRS: A retired state employee may not return to active permanent employment. However, a retired state employee may return to a temporary or contractual position.

Analysis: As noted in Section VI, state law changes with regard to the reemployment of retirees have been made in other states. This is an area where, if a contractual right is found, changes may be made to preserve a pension system's integrity.

11. Member Options

Questions: Could the legislation offer an option to all current state employees and teachers for an increase in the employee contribution rate to retain existing benefit levels versus retaining the existing contribution rate but with reductions in some of the benefit levels and/or plan provisions? Certain current state employees and teachers? Non-vested state employees and teachers?

Analysis: There is no clear guidance on this point under the Vermont cases, but we believe the analysis would be similar to that above.

However, an additional concern would be that the Internal Revenue Service is very restrictive on elections with respect to employee levels of contributions if those contributions are pre-tax. Thus, additional tax analysis would be needed if the Commission is interested in pursuing any solutions involving member options.

B. Retiree Health Care

The Treasurer's Office has advised us that a couple of years ago, Vermont instituted, in legislation, a new tiered retiree health coverage plan for new state employees. Instead of being able to get 80% coverage retiring after 5 years of service and age 55, new state employees must work 10 years to get 40% coverage, 15 years for 60% coverage, and 20 years for 80%. Could the legislation apply that system to all current employees? Certain current employees? Same question for teachers.

Analysis: Based upon the Jacobs analysis, it is not clear that any contract has been established with respect to any term of retiree health coverage for retirees. Therefore, it may be permissible to make any of these changes.

- Could the legislature provide no retiree health benefits for new state employees and/or teachers?

Analysis: We believe the answer is yes.

- Can the legislature change retiree health coverage for already retired state employees and/or teachers?

Analysis: We do not believe that the legislature has established any right to health insurance other than coverage under the program. It appears that the terms of that coverage can be modified.

VI. RECENT STATE ACTIVITY

A. Pensions

Many other states are considering a range of pension and/or retiree medical changes, and in some cases have actually passed legislation containing changes. We thought the Commission would want to be aware of this activity. For this discussion we relied heavily on a National Council of State Legislatures ("NCSL") report ("State Revisions and Retirement Legislation 2009"), dated August 17, 2009, as well as information from the National Association of State Retirement Administrators ("NASRA"). See also "Trends in Public Sector Retirement Systems" presented in Commission's August 20, 2009 meeting.

The changes may be briefly summarized as follows.

a. **Changes for New Hires**. Six states created new benefit structures for new hires. In two of those states (Georgia and Louisiana) the primary effect was an elimination (Georgia) or limitation (Louisiana) on post-retirement benefit increases. In the other four (Nevada, New Mexico, Rhode Island and Texas), the changes were more extensive – affecting retirement ages, service requirements, the amount of the benefit or COLA, and/or the amount of the reduction for any early retirement. The other type of change for new hires was to change employee contribution. For example, New Hampshire increased the employee contribution from 5% to 7% for new members (effective July 1, 2009).

b. **Employee Contribution Changes for Existing Employees**. Nebraska and New Mexico and Texas increased employee contributions for existing employees (1% increase in Nebraska for school employees for five years, 2% increase for state patrol and a 1.5% increase in New Mexico for two years, and a .45% increase for Texas ERS members). Employee unions in New Mexico have brought action to overturn these changes as unconstitutional. Texas also added an employee contribution (.5%) in a previously non-contributing plan (law enforcement and custodial members).

c. **Benefit Changes for Current Employees**. Bills were passed in a few states that impacted current members. Those changes tended to be very targeted at particular features. Notable examples include the following:

- eliminated of ability of elected officials to be credited with a full year's credit for as little as one day of service and/or receive a "termination allowance" (Massachusetts),
- eliminated "out-of-grade" accidental disability pensions (Massachusetts),
- revised the compensation definition for benefit calculations (Massachusetts),

- imposed a period of separation before retiree could be retired
  - 90 days (Texas ERS)
  - 180 days (Arkansas)
  - 60 days (Kansas) (Note: Kansas also imposed special payments for employees and employers for rehired retirees),
- imposed restrictions on working in retirement for certain elected officials (West Virginia),
- imposed suspension of retirement benefit for rehired retiree less than NRA (Georgia),
- suspension of benefits in certain reemployment situations (Indiana).

d. **Benefit Reductions for Current Retirees**. None, except a few COLA changes.

B. Health

The accounting changes imposed by the Government Accounting Standards Board have caused many states to review their benefits and their funding for retiree health care. See "Trends in Public Sector Post Retirement Health Care Benefits" in Commission's August 20, 2009 materials for general summary.

There were changes to retiree health programs in the 2009 sessions. Examples include the following:

a. New Hampshire (added withholding to help fund retiree health coverage).

b. New Mexico (increased employer and employee contributions to fund).

c. Creation of new funding vehicles for retiree medical (Georgia, Delaware, Alaska).

d. Kentucky (established employer rate schedule for retiree medical).