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IN THE SUPREME COURT OF ARIZONA

THE HONORABLE KENNETH FIELDS (ret.), a retired state court judge; and THE HONORABLE JEFFERSON LANKFORD (ret.), a retired state court judge, on behalf of themselves and others similarly situated,

Plaintiffs/Appellees,

v.

THE ELECTED OFFICIALS' RETIREMENT PLAN; BRIAN TOBIN; RICHARD PETRENKA; GREGORY FERGUSON; LAUREN KINGRY; JEFF MCHENRY; and RANDIE STEIN, are all named in their official capacities as Members of the Board of Trustees of the Elected Official Retirement Plan of the State of Arizona; and THE STATE OF ARIZONA,

Defendants/Appellants.

Arizona Supreme Court No. CV-13-0005-T/AP

Court of Appeals
Division One
No. 1 CA-CV 12-0748

MARICOPA County
Superior Court
No. CV2011-017443

ANSWERING BRIEF OF PLAINTIFFS AND THE CLASS

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INTRODUCTION*

In 1998, voters amended the Arizona Constitution to add Article XXIX, which prohibits the State from diminishing or impairing public retirement system benefits under any circumstances: "Membership in a public retirement system is a contractual relationship that is subject to article II, section 25, *and public retirement benefits shall not be diminished or impaired*." Ariz. Const. art. XXIX, § 1(C) (emphasis added). Although no Arizona appellate court has interpreted this provision, the Attorney General has emphasized that while the first clause confirms that pensions are contracts protected under Arizona's Contract Impairment Clause, Article II, Section 25, the second clause "provides additional, substantive protection in the form of a prohibition against reduction of benefit payments." Opinion of Attorney General, No. I09-009 at 8, APP249. States with similar provisions have reached the same conclusion. *See* Argument § I(C).

Notwithstanding the protection provided by Article XXIX, § 1(C), in 2011 the State enacted Senate Bill 1609 which, among other things, drastically impaired the statutory formula for providing permanent base benefit increases to retired beneficiaries under the Elected Officials' Retirement Plan ("**EORP**" or "**the Plan**"). *See* 2011 Ariz. Sess. Laws, Ch. 357 (1st Reg. Sess.) (hereinafter

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* For the Court's convenience, the page numbering in this brief matches the electronic PDF page numbers. Case citations also include hyperlinks to Westlaw.

Most record items cites are included in Plaintiffs/Appellees' Separate Appendix to Answering Brief, which is cited by the page number (e.g., APP001).

"**SB1609**"). SB1609 retroactively removed monies set aside for permanent base benefit increases, reduced the likelihood of monies being made available to fund future increases, and reduced the amounts of future increases. Critically, it had a real and immediate impact on Plan beneficiaries—instead of receiving 4% permanent base benefit increases in fiscal year ("**FY**") 2012 and FY 2013, they received a mere 2.47% increase in FY 2012, and no increase in FY 2013.[1] And the benefit SB1609 took away was promised by statute, earned by years of public service, vested by law, and constitutionally protected. The superior court thus correctly held that SB1609 badly ran afoul of Article XXIX, § 1(C).

Defendants' arguments to the contrary implicitly rest on asking the Court to write new language into Article XXIX, § 1(C) and ignore the plain language that does exist. But this request, to in effect amend Article XXIX, § 1(C), is not something the Court may do. Because the State chose not to amend this constitutional provision, it must accordingly live with the language as written—language SB1609 clearly violates. Lastly, and contrary to Defendants' contention, SB1609 also constitutes a classic example of a substantial impairment precluded by the State and Federal Contract Impairment Clauses. The Court should, therefore, affirm.

[1] *See* APP045-APP046 (responses to interrogatories 5-6); *see also* APP136 (141:2-16).

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STATEMENT OF THE CASE

In 2011, Plaintiffs sued on behalf of themselves and a class of almost 1000 similarly situated beneficiaries against EORP and its board members. The class includes Plaintiffs, retirees who provided years of public service in consideration for the pension benefits promised, as well as their surviving spouses and children.[2] The class sought a declaratory judgment that SB1609 violated Article XXIX, § 1(C), of the Arizona Constitution and/or the Contract Impairment Clauses of the United States and Arizona constitutions; it also sought mandamus and injunctive relief to prohibit the State from enforcing SB1609.[3] The State of Arizona intervened to defend SB1609.[4]

On November 22, 2011, Plaintiffs moved to preliminarily enjoin implementation of SB1609.[5] The superior court consolidated the preliminary injunction hearing with a trial on the merits.[6]

After an evidentiary hearing, Judge Buttrick ruled that SB1609 violated Article XXIX, § 1(C) of the Arizona Constitution; therefore, he declined to address whether it also violated the State or Federal Contract Impairment Clauses.[7] Judge

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[2] *See* APP028-APP029.

[3] *See* APP006, APP011-APP017.

[4] *See* Clerk's Record ("**CR**") 28; CR31.

[5] *See* CR16.

[6] *See* CR23.

[7] *See* APP031-APP036.

Buttrick later entered a judgment for declaratory, mandamus, and injunctive relief.[8] After reassignment of the case to the Honorable Robert Oberbillig,[9] the superior court entered a Rule 54(b) judgment, and the parties agreed to a stay pending this appeal.[10]

STATEMENT OF FACTS

I. Benefits and Funding of the Elected Officials' Retirement Plan

The Elected Officials' Retirement Plan was established in 1985 as a defined benefit pension fund serving various elected officials, judges and plan administrators (and certain survivors) upon the Plan member's completion of a set number of years of service.[11] Pensioners, upon retirement, are eligible to receive yearly payments totaling up to 80% of their pre-retirement salaries. *See* A.R.S. § 38-808(B)(1). They are also entitled to additional financial benefits including medical subsidies, *see id.* § 38-817, a spousal survivor benefit, *see id.* § 38-806, and permanent base benefit increases, *see id.* § 38-818. Of Arizona's public retirement systems, the Plan is the smallest.[12]

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[8] *See* CR85.

[9] *See* CR89.

[10] *See* APP038-APP040 (Rule 54(b) Judgment); CR117 (staying judgment).

[11] *See* APP165-APP166 (226:22-227:4); APP042 (list of officials covered by EORP).

[12] *See* APP115 (79:18-24).

A combination of employer and employee contributions, judicial fees, and investment proceeds fund the Plan.[13] Employer contribution rates are calculated based upon actuarial projections of projected payouts to beneficiaries and estimated income from market returns, and are designed to fully fund the Plan's obligations over a thirty-year period.[14] The Plan also uses a seven-year averaging process known as actuarial "smoothing" to determine its fiscal-year-end actuarial value of assets.[15] So, for example, if the Plan has a loss, that loss is averaged out and applied over a seven-year period.

When the Plan is less than 100% funded, employer contribution rates are adjusted to cover unfunded liabilities, with that calculation taking into account other funding sources.[16] For example, a statutorily specified share of judicial fees subsidizes the employer contribution rate for State and county employers (but not municipal employers). *See* A.R.S. § 38-810(C) (monies deposited into the court-fee EORP fund "shall be used to reduce the contributions required of state and county employers only."); *see also id.* §§ 12-119.01(B)(2) (supreme court fees), 12-120.31(D)(2) (court of appeals fees), 12-284.03(A)(6) (superior court fees), 22-

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[13] *See* APP075.

[14] *See* APP147 (162:2-8); *see also* A.R.S. § 38-810(C) ("[E]ach employer shall make level per cent compensation contributions *sufficient under the actuarial valuation to meet both the normal cost plus the actuarially determined amount required to amortize the unfunded accrued liability . . . .*" (emphasis added)).

[15] *See* APP072.

[16] *See* APP147 (162:9-21).

281 (C)(3) (justice of the peace fees), 41-178(6) (notary oaths, bonds, and certificates). These fees provide "a significant source of funding" for EORP.[17]

In fact, in the late 1990s and early 2000s, the amount of court fees paid to fund the Plan eliminated the need for ***any*** employer contributions.[18] But those happy days ended with the "dot-com" bubble in the early 2000s and the recession in 2008. As of April 2012, however, court fees still accounted for 40% of the total employer contribution rate.[19]

In recent years, employer contribution rates have increased to assure the Plan's actuarial soundness. All employers have always made their required contributions,[20] and there is no evidence to suggest this will stop. Additionally, although SB1609 reduces the benefits promised to Plan members in the name of reducing employer contributions, those reductions are comparatively small: the Plan estimates that without SB1609, the rates will be approximately 45-50% of employee salaries in 2025, but with SB1609 they will be approximately 40-45%.[21]

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[17] *See* APP116 (87:4-11).

[18] *See* APP120-APP124 (95:6-99:20 (State and counties made no monetary contributions from FY 1998 to FY 2001 due to court fees)).

[19] APP116-APP117 (87:15-88:6); *see also* APP161-APP162 (196:25-197:11 (FY 2012 unsubsidized rate was 32.99%, but because of judicial fees the State and counties only had to pay 17.96%)).

[20] *See* APP117-APP119 (88:10-90:4).

[21] *See* APP068-APP069 (comparing the two scenarios); *see also* APP151-APP152 (166:24-167:10).

Moreover, these figures were calculated ***before*** accounting for the subsidies from other funding sources.[22]

II. The Plan's Permanent Base Benefit Increase Provisions

From 1985 to 1990, the Plan lacked a statutory mechanism for awarding permanent base benefit increases, and instead the Legislature increased benefit payments ad hoc each year. *See* A.R.S. § 38, Ch. 5, Art. 3, Elected Officials' Retirement Plan (Historical and Statutory Notes). In 1990, however, the State enacted A.R.S. § 38-818 (1990), Arizona's first statutory mechanism for permanent increases (such mechanisms were common in other states). That provision sunsetted in 1994, but was revived with substantial changes in 1996—this time without a sunset clause. *See* 1996 Sess. Laws, Ch. 198 (2d Reg. Sess.).

After this experimentation, the Legislature reverted back to a system similar to the 1990 statute by amending A.R.S. § 38-818 in 1998 ("**the 1998 Formula**"). *See* 1998 Ariz. Sess. Laws, Ch. 264, § 1 (2d Reg. Session). Under the 1998 Formula, in any year in which the Plan earned a return in excess of 9% (referred to as the "hurdle rate"), one-half of the excess return was set aside in a reserve fund. A.R.S. § 38-818(C), (E). The reserve fund was then used to fund up to a 4% permanent base benefit increase depending upon the monies available at the end of each plan year. *Id.* § 38-818(F). This dedicated reserve fund paid for a benefit

[22] *See* APP163-APP164 (202:15-203:14 (confirming that estimated future employer contributions rates are unsubsidized)).

increase based upon the total actuarial cost of the permanent increase over the life of the Plan beneficiary. *Id.* § 38-818(B). Thus, if a beneficiary was to receive an increase of $1,000 per year, the Plan would determine how much that increase would cost over the remainder of the beneficiary's actuarial life, and would then transfer that amount from the reserve fund back into the Plan's main fund. In other words, ***each benefit increase was fully paid for when granted***.

If reserve fund assets were not used up in a given year, they rolled over to the next year; that is, ***they remained in the dedicated reserve fund*** to fund future benefit increases, including for years in which the Plan did not earn more than a 9% return. *Id.* § 38-818(E). A good year of returns could pay for several years of future benefit increases. In fact, this statutory mechanism was so successful that the fund provided a 4% increase every year between 1998 and 2010.[23]

A.R.S. § 38-818(A) made explicit that the promised benefit increases were an entitlement upon which plan beneficiaries could rely, stating that a retired Plan member (or survivor) is "***entitled***" to 1998-Formula benefits so long as he or she satisfies one of two conditions: (1) the member must have been receiving benefits on or before July 31 of the two previous years; or (2) the member must be 55 years of age or older on July 1 of the current year and was receiving benefits on or before July 31 of the previous year.

[23] *See* APP046-APP047 (response to interrogatory 7); APP079 (showing increases in years where there were no excess earnings).

III. The Constitutional Amendment to Protect Public Pension Rights

In 1998, after implementation of the 1998 Formula, Arizona voters amended the Constitution to add certain protections for public pension beneficiaries: "Membership in a public retirement system is a contractual relationship that is subject to article II, § 25, *and* public retirement system benefits shall not be diminished or impaired." Ariz. Const. art. XXIX, § 1(C) (emphasis added). Article XXIX § 1(C) thus includes two independent clauses. The first clause clarifies that pensions are not gifts, but contractual in nature. The second clause, the "Pension Impairment Clause," "provides additional, substantive protection in the form of a prohibition against reduction of benefit payments." Opinion of Attorney General, No. I09-009 at 8, APP249.

In addition, voters sought to protect pension beneficiaries by requiring that public retirement systems be funded "using actuarial methods and assumptions," Ariz. Const. art. XXIX, § 1 (A), and that their assets be administered and distributed "solely in the interests of the members and beneficiaries," *id.* at § 1 (B).

IV. The Plan's Mismanagement Before SB1609

In the late 1990s the Plan's portfolio suffered particularly significant losses because it "lacked the kind of diversification that it should have had."[24] This mismanagement continued in the 2000s when the Plan concentrated its assets in

[24] *See* APP125-APP126 (106:17-107:6), APP129 (110:10-20).

Arizona real estate.[25] Unsurprisingly, the Plan again suffered losses in 2008 from mismanagement and volatile markets.[26] Consequently, employers, who contributed little or nothing to the Plan for years, began making meaningful contributions. Judicial filing fees continued, however, to heavily subsidize employer contributions.[27]

V. The State's Enactment of SB1609 in an Effort to Reduce Its Contribution Rates, Notwithstanding the Harm to Class Members and EORP's Counsel's Legal Opinion That the Legislation Violated the Constitution

In early 2010, as the employer contribution rate increased, the State and EORP began exploring methods to lower employer contribution rates. EORP asked its attorneys for an opinion on various options, including whether the Legislature could legally deprive retirees of promised, earned and vested benefit increases under the 1998 Formula.[28]

EORP's attorneys opined that the State could deprive new hires of benefits, but that the benefits due retired Plan members under the 1998 Formula "probably cannot be legislatively modified" without violating the Pension Impairment

[25] APP134-APP135 (135:16-136:1).

[26] *See id.*

[27] *See* APP161-APP162 (196:25-197:11 (showing actual employer contribution rate in 2012 of 17.96% of payroll)).

[28] *See* APP132 (132:1-22).

Clause.[29] EORP distributed the legal opinion to third parties, including the Arizona Legislature.[30]

Undeterred by the legal opinion and Constitution, the State enacted SB1609 in 2011 to diminish and impair the benefits to which Plaintiffs and the class (collectively, "**Pensioners**") were entitled, including the 1998 Formula.[31] SB1609 devastated the existing 1998 Formula in two key ways. First, it retroactively eliminated funding that was set aside for permanent increases. Although SB1609 became effective on July 20, 2011, it applied ***retroactively*** to May 31, 2011 to eliminate the transfer of excess earnings above the 9% hurdle rate to the dedicated reserve fund. *See* SB1609 at § 62, APP236-APP237.[32] Thus, although $31 million—an amount sufficient to allow for 4% permanent increases for both FY 2012 and FY 2013—had been transferred to the reserve fund on July 1, 2011, SB1609 poached that money.[33]

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[29] APP064.

[30] *See* APP133 (133:2-15).

[31] SB1609 also changed employee contribution rates for active EORP members, *see* SB1609 at § 19, APP224-APP226, which is not at issue in this case.

[32] Although SB1609 sweeps the reserve fund only into the main EORP corpus, assets that the State otherwise would have been required to contribute to the Plan were subsidized by the reserve fund, and thus became available to the State for other purposes.

[33] *See* APP046 (response to interrogatory 6); *see* APP136 (141:2-16).

This retroactive removal significantly impacted Pensioners. Rather than receive 4% increases, they only received a 2.47% increase in FY 2012,[34] and no increase in FY 2013.[35] Consequently, Judge Fields will receive $155.86 less per month from July 1, 2011 until his death, and $432.42 per month less from July 1, 2012 until his death.[36] Similarly, Judge Lankford will receive $144.88 less per month from July 1, 2011 until his death, and $399.02 per month from July 1, 2012 until his death.[37] ***Significantly, Defendants do not even attempt to defend this retroactive aspect of SB1609.***

Second, and in addition to SB1609's retroactive poaching, the legislation devastated the 1998 Formula by creating a new formula, effective July 1, 2013, that reduces the promised, but unpaid, future benefits in three ways. *See* A.R.S. § 38-818.01(A). First, the new formula makes it much less likely that investment returns will be available to fund new increases by increasing the hurdle rate from

[34] *See* APP045 (response to interrogatory 5).

[35] *See* APP136 (141:2-16), APP137 (142:16-18).

[36] *See* APP081 (Judge Fields's monthly benefit before July 1, 2011, was $10,187.07. A 4% increase effective July 1, 2011 would have totaled $407.48 per month, but the 2.47% increase he actually began receiving was $251.62, a difference of $155.86. Moreover, if he had received a 4% increase on July 1, 2011 and another 4% increase on July 1, 2012, he would have started receiving an additional $423.42 per month, but instead received no increase.).

[37] *See* APP082 (Judge Lankford's monthly benefit before July 1, 2011, was $9,600.51. A 4% increase effective July 1, 2011 would have totaled $384.02 per month, but the 2.47% increase he actually began receiving was $237.14, a difference of $146.88. Moreover, if he had received a 4% increase on July 1, 2011 and another 4% increase on July 1, 2012, he would have started receiving an additional $399.02 per month, but instead received no increase.).

9% to 10.5%. *Id.* § 38-818.01(C). Second, the formula depletes any unspent excess funds, which were previously saved for the next year. *See id.* § 38-818.01(E). Third, the new formula makes the amount of the benefit conditional on the Plan's overall funding ratio. If the funding ratio is 60% or less, no benefit whatsoever will be paid. If the ratio is between 60% and 65%, a reduced benefit of only 2% will be paid. For each additional 5% increase in the funding ratio, an additional .5% increase will be paid, but no more than 4%. *Id.* § 38-818.01 (A), (C). In short, by replacing the 1998 Formula with the new formula, SB1609 ensures that future permanent increases will be (1) much less frequent and (2) much smaller when granted.[38]

In passing SB1609, the Legislature disregarded other available revenue sources to make up for the shortfall caused by EORP's mistakes. But many options were available, including increasing judicial fees,[39] having municipalities impose fees,[40] or using excess health insurance premiums.[41] It also did not consider whether the fact that employers paid little or nothing into the Plan for years now warranted higher employer contributions rates.[42] It also chose not to

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[38] *See* APP139-APP140 (152:15–153:9).

[39] *See* APP177-APP181 (76:14-80:7); *see also* APP150-APP151 (165:24-166:19).

[40] *See* APP156 (171:5-8).

[41] *See* APP130-131 (119:7-120:14).

[42] *See* APP120-APP124 (95:6-99:20), APP143-APP147 (158:5-162:1).

amend the Arizona Constitution. Instead, it simply proceeded to reduce the benefits retirees had already earned through their years of service.

VI. The Superior Court's Ruling That SB1609 Violates Article XXIX, § 1(C) of the Arizona Constitution

In 2011, after an evidentiary hearing, the superior court determined that SB1609 violated the Pension Impairment Clause. The court concluded that permanent benefit increases, including the 1998 Formula, were a "benefit" under that clause, and that "[t]he ***purpose and effect*** of SB1609 is to impair and diminish the permanent benefit increases provided by A.R.S. § 38-818 to Plaintiffs."[43] It found that "[t]he ***obvious purpose*** of SB1609 is to slow down benefit increases, make them less frequent, and make them less than 4%."[44] And, contrary to EORP's assertion (at 3, 25), the superior court interpreted the Pension Impairment Clause by applying its plain language.[45]

ISSUES PRESENTED

1. The Arizona Constitution, Article XXIX, § 1(C), states in relevant part that "public retirement system benefits shall not be diminished or impaired." SB1609 altered the statutory scheme under which pensioners receive permanent base benefit increases, which (1) caused a reduction in benefits for FY 2012 and FY 2013, and (2) ensured that promised, earned and vested future increases will be

[43] APP035 (emphasis added).

[44] *Id.* (emphasis added).

[45] *See* APP035-APP036.

smaller and less frequent. Did the superior court correctly determine that SB1609 "diminished or impaired" a "public retirement system benefit[]," and thus violated the Arizona Constitution?

2. Does the Pension Impairment Clause merely duplicate the Contract Impairment Clause, and implicitly incorporate the three-part test used in cases involving the Federal and Arizona Contract Impairment Clauses (U.S. Const. art. I, § 10 and Ariz. Const. art. II, § 25) notwithstanding the lack of any mention of that in the Constitution?

3. If the impairment or diminishment of public retirement benefits should be determined by the three-part Contract Impairment Clause test,

a. should this Court affirm because the record confirms the judgment may be sustained on the basis that SB1609 violates the Federal and/or Arizona Contract Impairment Clauses?

b. Alternatively, and because the superior court expressly declined to consider the Contract Impairment Clause issue, should the Court remand so the superior court may consider the factors relevant to the Contract Impairment Clause analysis in the first instance?

STANDARD OF REVIEW

This Court reviews de novo the interpretation of a constitutional provision such as Article XXIX. *Coleman v. City of Mesa*, 230 Ariz. 352, 356 ¶ 8, 284 P.3d 863, 867 (2012). The superior court's factual findings are reviewed for clear error.

See In re Non-Member State Bar of Ariz., Van Dox, 214 Ariz. 300, 304 ¶ 15 n.3, 152 P.3d 1183, 1187 n.3 (2007). Pensioners bear the burden of showing that the statute violates the Arizona Constitution, *New Times, Inc. v. Ariz. Bd. of Regents*, 110 Ariz. 367, 370, 519 P.2d 169, 172 (1974), but to the extent the Court determines that the State substantially impaired its own contract, the State "has the burden of establishing that [SB1609] is both reasonable and necessary to an important public purpose." *S. Cal. Gas Co. v. City of Santa Ana*, 336 F.3d 885, 894 (9th Cir. 2003).

ARGUMENT

The superior court correctly construed Arizona's Pension Impairment Clause by applying the plain language of that provision to conclude that the 1998 Formula is a "public retirement system benefit[]" and that SB1609 "diminished or impaired" the 1998 Formula. Ordinary usage, law from jurisdictions with provisions similar to the Pension Impairment Clause, and cases considering pension rights in other contexts all confirm that a statutory formula to increase payments over time is a "benefit," and that a change to such a formula diminishes or impairs it.

The superior court also correctly declined to adopt a Contract Impairment Clause analysis because grafting such an analysis onto the Pension Impairment Clause would render that clause meaningless and superfluous. But even if the Court determines that a Contract Impairment Clause analysis applies, it should

either affirm because the existing record confirms that SB1609 violates that standard, or remand for the superior court to conduct that analysis in the first instance.

I. The Superior Court Correctly Held That SB1609 Violates Arizona's Pension Impairment Clause

The plain language of both Article XXIX, § 1(C) and A.R.S. § 38-818 confirm that the superior court correctly held that SB1609 violates the Pension Impairment Clause.

A. The Superior Court Correctly Construed the Term "Benefit"

Contrary to EORP's contention, the superior court correctly construed the term "benefit" as it is used in the Pension Impairment Clause.

1. The Plain Language of the Pension Impairment Clause and A.R.S. § 38-818 Show That the Promise to Make Pension Payments in Accordance with the 1998 Formula Is a "Benefit"

When interpreting a constitutional provision, Arizona courts "first examine the plain language of the provision" and "do not depart from the language unless the framers' intent is unclear." *Cain v. Horne*, 220 Ariz. 77, 80 ¶ 10, 202 P.3d 1178, 1181 (2009) (internal quotation marks and citation omitted); *see also Rumery v. Baier*, 231 Ariz. 275, 278 ¶ 15, 294 P.3d 113, 116 (2013) (courts must give words in constitutional provisions "their natural, obvious and ordinary meaning" (internal quotation marks and citation omitted)). Similarly, when interpreting statutes, courts apply "the rule that the best and most reliable index of

a statute's meaning is its language and, when the language is clear and unequivocal, it is determinative of the statute's construction." *Deer Valley Unified Sch. Dist. No. 97 v. Houser*, 214 Ariz. 293, 296 ¶ 8, 152 P.3d 490, 493 (2007) (internal quotation marks and citation omitted).

As used in Article XXIX, § 1(C), "benefit" means a "financial benefit"—a fact conceded by the Arizona Attorney General. *See* Opinion of the Attorney General, No. I09-009 at 7, APP248 (citing *The American Heritage Dictionary* 171 (2d Coll. ed. 1976) (defining benefit as "[s]omething that promotes or enhances well-being; advantage" and "[p]ayments made or ***entitlements***" (emphasis added))). Under any normal use of language, an annuity that includes a promise to annually increase annuity payments pursuant to a specified formula is a financial benefit. And, such a promise is a benefit even if the formula makes the increases contingent.

For example, consider an annuity that promises to increase future payments by 4% if and only if the Dow gains at least 9% during the prior year. Although the formula for calculating future benefits depends on a contingency—the Dow gaining at least 9%—the promise to make payments in accordance with this formula is a financial benefit. Consequently, under any ordinary use of language the 1998 Formula qualifies as a financial benefit—and a substantial one at that.

Moreover, as the superior court emphasized, A.R.S. § 38-818(A) states unequivocally that Plan beneficiaries are "***entitled*** to receive a permanent increase

in the base benefit" as calculated by the 1998 Formula.[46] Black's Law Dictionary defines "entitlement" as "[a]n absolute right to a . . . ***benefit*** . . . upon meeting a legal requirement." Black's Law Dictionary 573 (8th ed. 2004) (emphasis added); *see also* Merriam-Webster Online Dictionary, http://www.merriam-webster.com/dictionary/entitlement (last visited May 1, 2013) ("entitlement" means "a government program providing ***benefits*** to members of a specified group" or "funds supporting or distributed by such a program" (emphasis added)).

Accordingly, as the superior court found, A.R.S. § 38-818 confers the right to receive payments calculated by the 1998 Formula, and that right is "a 'benefit' as that term is used in the [Pension] Impairment Clause." *See Police Pension & Relief Bd. of City & Cnty. of Denver v. McPhail*, 338 P.2d 694, 696 (Colo. 1959) (finding that pensioners had a "benefit" under a statute that stated they were "***entitled*** to an increase in the amount of their pension equal to one-half of the raise in pay granted in the rank said member held at the time he was retired") (emphasis added); *Strunk v. Pub. Emps. Ret. Bd.*, 108 P.3d 1058, 1103 (Or. 2005) (holding that a cost of living increase ("**COLA**") is a vested benefit—even when it is only payable when the Consumer Price Index is above a certain threshold—because the underlying statute confirms that pensioners are "***entitled*** to receive" it (emphasis added)). Any other construction would ignore the plain language of both A.R.S. § 38-818 and the Pension Impairment Clause, as well as other basic principles of

[46] APP035 (emphasis added by superior court).

statutory construction. *See* A.R.S. § 1-211(B) (1995) ("Statutes shall be liberally construed to effect their objects and to promote justice.").

2. The State and EORP's Definition of "Benefit" Ignores Common Sense and Common Usage, and Is Unsupported by Any Authority

Ignoring that common sense teaches that a promise to make payments pursuant to an agreed-upon formula is a benefit, the State contends (at 4-5) that "only an immediate right to a liquidated sum of money under a pension plan" qualifies as a benefit. "Benefit," the State argues, means "the payment of a sum of money," and thus because "the statutory mechanism for future benefit increases . . . is not the payment of a sum of money," it is not a benefit. (State's Br. at 5.) But the retirement "benefit" owed to a pensioner necessarily includes the method by which ***the amount*** of the payment is determined. In other words, the term "benefit" cannot mean simply the act of paying ***any*** sum of money, but rather means paying the amount promised (i.e., the amount required by the formula that was promised to be used in calculating the payments). For the same reason, "benefit" cannot mean merely the "immediate right" to a liquidated sum; otherwise, the State could cut off all future pension benefits because they are contingent upon the retiree remaining alive.

Attempting to salvage the State's flawed argument, EORP argues (at 30) that there is a significant difference between "changing the contingency of a future increase in benefits" and "cutting benefits." According to EORP (at 29-30),

SB1609 merely affected "benefit *increases*," but did not affect any "present entitlements to payments," and therefore did not affect a "benefit," i.e., "a payment" under an annuity or pension plan. But EORP does not and cannot explain why the formula used to increase benefit payments is not itself a benefit, even if the formula depends on some contingencies. That is because the promise to use a specific formula is itself a "present entitlement" to have benefits paid pursuant to the formula. In fact, it is fundamental to American law that a promise to pay in the future is as much a "benefit" as an actual payment. *See, e.g., U.S. Fid. & Guar. Corp. v. Advance Roofing & Supply Co.*, 163 Ariz. 476, 478-79, 788 P.2d 1227, 1229-30 (App. 1989) (affirming damages for a defendant's breach of its "promise to pay").

Moreover, the Attorney General agrees with Pensioners. He concluded that the Pension Impairment Clause "prohibits ASRS from ***reducing the actual benefit payments*** to System members," which encompasses the 1998 Formula. Opinion of Attorney General, No. I09-009 at 8, APP249 (emphasis added). Pensioners' benefit payments included the 4% increases that were paid every year from 1998 to 2010; the increase from one year to the next was unquestionably part of the "actual benefit payments to System members."

EORP further ignores that whether benefits have been "cut" depends on the basis of comparison. When a pension or annuity fails to make payments in accordance with the formula it promised would be used to calculate increases, it

cuts benefits as compared to the amount it promised to pay. Thus, and directly contrary to EORP's suggestion, precisely because SB1609 has and will cut the payments to which Plan beneficiaries were entitled, it will cut their "actual payments"—something EORP concedes (at 29) violates the Pension Impairment Clause.

Smith v. City of Phoenix, 175 Ariz. 509, 514, 858 P.2d 654, 659 (App. 1992), which EORP cites (at 30-31), actually undercuts its position. *Smith* found that a municipal judge lacked any vested interest in a statute *that never went into effect*. *Id.* (allowing modification of formula setting judges' salaries because it was modified "before the effective date of the state legislation that would have triggered its operation."). Here, of course, the 1998 Formula went into effect, and the Plan beneficiaries performed their service before or while it was in effect. Precisely for that reason, the Pension Impairment Clause bars the Legislature from tinkering with that promised, earned, and vested benefit.

EORP's reliance (at 31-32) on *United States v. Will*, 449 U.S. 200 (1980), which involved the Judicial Compensation Clause, is likewise misplaced. There is no reasoned basis to interpret the word "Compensation" in the Federal Compensation Clause, U.S. Const. art. III, § 1, to mean the same thing as the word "benefit" in Arizona's Pension Impairment Clause; as set forth above, "retirement benefits" may include much more than just a "base salary."

Moreover, and contrary to EORP's assertion, SB1609 would run afoul of the Compensation Clause. *Will* involved a salary increase mechanism that was "neither definite nor precise," and instead "depended on the discretionary decisions of the President's agent and the Advisory Committee on Federal Pay," *Beer v. United States*, 696 F.3d 1174, 1181 (Fed. Cir. 2012) (en banc) (internal quotation marks and citation omitted), *cert. denied*, ___ U.S. ___, 2013 WL 55994 (Apr. 22, 2013). In contrast, when salary increases are provided "according to a mechanical, automatic process" that is "dependable"—like the 1998 Formula—employees ***do*** have "'an employment expectation' at a certain salary level." *Id.* at 1182-83.

In sum, it would be incoherent for a company that had sold an annuity to say to its customer, "by the way, we are modifying the formula we agreed to use to calculate your future payments so that they will likely be less than you expected, but do not worry because this will not affect your benefit." Yet that is, at its core, Defendants' position.

B. The Superior Court Correctly Construed the Phrase "Diminished or Impaired"

Contrary to Defendants' contention, the Superior Court also correctly concluded that "[t]he purpose and effect of SB1609 is to impair and diminish the permanent benefit increases provided by A.R.S. § 38-818 to Plaintiffs."[47]

[47] APP035.

1. SB1609 Diminished or Impaired Pensioners' Right to Permanent Base Benefit Increases Under A.R.S. § 38-818

EORP acknowledges (at 37) that the word "diminish" generally means "to make less or cause to appear less." (quoting *Merriam-Webster's Collegiate Dictionary* at 326). Similarly, "impair" means "[t]o diminish in strength, value, quantity, or quality." *The American Heritage Dictionary* 644 (2d Coll. Ed. 1976). Yet these definitions show that SB1609 diminished and impaired Pensioners' right to permanent increases. Indeed, the reason the State enacted it was to ensure that this benefit would be less than promised, i.e., the purpose was to diminish and impair benefits.[48]

Decisively, SB1609 has already accomplished much of what it set out to do. It reduced the amount promised in FY 2012, and withheld an increase altogether in FY 2013. Because SB1609 raided the dedicated reserve fund of $31 million, Pensioners received a smaller, 2.47% permanent increase in FY 2012 and no increase in FY 2013, rather than 4% increases both years.[49] Defendants do not and cannot defend this aspect of SB1609.

But SB1609's diminishing effect goes well beyond this poaching of funds dedicated to this benefit by reducing Pensioners' promised increases for the rest of

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[48] *See* APP139-APP140 (152:15-153:9); *see also* APP076 (SB1609 replaced 1998 Formula with a new formula "that will provide adjustments only periodically, not annually").

[49] *See* APP045-APP046 (responses to interrogatories 5-6); APP136 (141:2-16).

their lives, and the lives of their eligible surviving spouses. A.R.S. § 38-818.01 takes effect on July 1, 2013, and replaces the 1998 Formula to which Pensioners are entitled. Without the rollover of leftover reserves from year to year, and with an increased hurdle rate of 10.5%, *see* A.R.S. § 38-818.01(C), (E), SB1609 will eliminate increases to which Pensioners were entitled under the 1998 Formula.[50]

Furthermore, by tying future increases to the funding ratio of the plan, any future increases (if there are excess reserves for the year) will be small—much smaller than the historic 4% increases that EORP members received under the 1998 Formula. *See* A.R.S. § 38-818.01 (C). Over time, SB1609 significantly diminishes and impairs the promised, earned, and vested benefits.

2. Defendants' Interpretation of Diminished or Impaired Violates the Rule That Constitutional Provisions Must Be Interpreted in Accordance with Their Plain Meaning

In attempt to evade the plain meaning of the words "diminished" or "impaired" (and the conclusion that necessarily follows), EORP suggests (at 37) that the Pension Impairment Clause merely means "that the state cannot reduce benefits being received," and thus it may "chang[e] the likelihood of a contingent future increase . . . ."

This interpretation deviates significantly from the plain constitutional language, which protects benefits from being "diminished or impaired," and therefore must be rejected. *E.g.*, *Cain*, 220 Ariz. at 80 ¶ 10, 202 P.3d at 1181

[50] *See* APP138 (150:2-6).

(courts "first examine the plain language of [a constitutional] provision" and "do not depart from the language unless the framers' intent is unclear" (internal quotation marks and citations omitted)). Indeed, EORP never explains how the benefit was not impaired, and instead argues that it was not "substantially" impaired—a modifier nowhere found in the Pension Impairment Clause. By further emphasizing that benefits may not be "diminished," the Pension Impairment Clause leaves no room to argue that even a modest decrease in benefits is permissible. *Cf.* Opinion of Attorney General, No. I09-009 at 8, APP249 (Pension Impairment Clause "provides additional, substantive protection in the form of a prohibition against reduction of benefit payments.").

Moreover, EORP's suggestion (at 37) that "a failure to increase" benefits does not "diminish[]" them again ignores the relevant basis of comparison. If a pension refused to pay the increase in benefits required by an agreed-upon formula, anyone who speaks English would understand that the benefits have been diminished below (i.e., made "less" than) what was promised.

EORP's reliance on a statement by Legislative Council in the Proposition 100 pamphlet is misplaced for two reasons. First, the Legislative Council made clear that Article XXIX § 1(C) was adding two ***separate*** "rules to the Arizona Constitution" (in addition to the rules added by the other sections of Article XXIX):

* * * *

4. Membership in a public retirement system is a contractual relationship that shall not be hurt by law.

5. Public retirement system benefits shall not be decreased or impaired.[51]

Thus, while the Legislative Council's assertion that Proposition 100 was "consistent with current law and practices" is at best cryptic, its explanation that "[p]ublic retirement system benefits shall not be decreased or impaired" is clear.[52]

Second, EORP's argument (at 38) that Article XXIX's only purpose was to prevent the Legislature from impairing benefits by "sweep[ing] away pension funds to pay for other projects," ignores the full language of Article XXIX. Section1(B)—which states that the assets of the Plan "shall be invested, administered and distributed as determined by law solely in the interests of the members and beneficiaries of the public retirement systems"—addressed the concerns identified by EORP. EORP's interpretation would therefore inappropriately render Section 1(C) superfluous to Section 1(B). *See Cronin v. Sheldon*, 195 Ariz. 531, 540 ¶ 44, 991 P.2d 231, 240 (1999) (declining to interpret separate provisions of the Arizona Constitution the same because doing so would render one provision "superfluous or redundant, something [the Court has] consistently declined to do").

[51] APP090.

[52] *Id.*

Moreover, SB1609 represents precisely the type of "legislative raiding" that even Defendants acknowledge is impermissible. The original plan for SB1609 was to transfer all of the assets of the dedicated reserve fund into the State's general fund—a clear violation of Article XXIX, § 1(B).[53] Instead, the Legislature transferred the money earmarked for permanent base benefit increases and used it for purposes "unrelated to . . . payment of benefits."[54] Because the dedicated reserve fund was swept into the EORP main fund before the employers' contribution rates had been actuarially calculated, that poaching meant employers necessarily paid less into the fund. SB1609 therefore impairs Pensioners' benefits because it "allows employers to deplete moneys in the existing pension fund by reducing the amount of employer contributions." *McDermott v. Regan*, 624 N.E.2d 985, 989-90 (N.Y. 1993) (holding that excess investment income kept in a reserve fund is a "benefit" of a public pension program that may not be impaired).

In other words, the State and other employers' contributions have been subsidized by funds earmarked for benefit increases, leaving the State and other employers free to use funds that would have gone into the plan for purposes

[53] *See* APP064 ("[W]e understand the Arizona Legislature is considering amendments to the Plans' enabling legislation to *divert* the assets in the Reserves to the State's general fund for uses *unrelated to* the payment of COLAs *or the payment of benefits to the Plans' members or retirees*." (emphasis added)).

[54] *Id.*

"unrelated to . . . payment of benefits."[55] The purpose and consequence of SB1609, therefore, was very much to "sweep away pension funds to pay for other projects," which EORP acknowledges (at 38) would be improper. Thus, under even EORP's cramped reading of Article XXIX, § 1(C), SB1609 "diminished or impaired" Pensioners' promised, earned, and vested benefits.

C. Decisions from Other Jurisdictions Applying Constitutional Provisions Similar to Article XXIX, § 1(C) Confirm That SB1609 Is Unconstitutional

Significantly, and although courts across the country have been considering challenges to changes made in public benefits, EORP cites no authority that would support its novel interpretation of the Pension Impairment Clause. Indeed, because the great weight of authority is against it, EORP (at 28 n.79) discourages the Court from looking at other states' authority. The Court, however, may find such authority helpful. *See, e.g.*, *Schultz v. City of Phoenix*, 18 Ariz. 35, 42, 156 P. 75, 77 (1916) (decisions from other states with similar constitutional provisions are "very persuasive").

Article XXIX, § 1(C) is nearly identical to the pension impairment provisions in New York and Illinois, which commentators agree are, like Arizona, among the most favorable towards the rights of public sector retirees of any such provisions in the country. *See* Kenneth T. Cuccinelli, II et. al., *Judicial Compulsion and the Public Fisc - A Historical Overview*, 35 Harv. J.L. & Pub.

[55] *Id.*

Pol'y 525, 535 (2012) (identifying Arizona, New York, and Illinois as three of only six states that "have a constitutional provision that, in general, explicitly provides that membership in, or accrued benefits from, a state's retirement system creates a contract between the state and its employees that cannot be impaired").[56]

Moreover, Arizona's Pension Impairment Clause is similar to provisions in other states. Cases from these other jurisdictions confirm that SB1609 runs afoul of the Pension Impairment Clause. To conclude otherwise would make Arizona an extreme outlier.

1. New York and Illinois Cases Confirm That a Formula Providing Permanent Increases Is a Benefit That May Not Be Diminished or Impaired

Like Arizona's Constitution, the New York Constitution provides that "membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which ***shall not be diminished or impaired***." N.Y. Const. art. V, § 7 (emphasis added). Similarly, Illinois's Constitution provides that "[m]embership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which ***shall not be diminished or impaired***." Ill. Const. art. XIII, § 5

[56] Indeed, in another case currently pending in the Court of Appeals, *Cross v. Elected Officials Retirement Plan*, 1-CA-CV 12-0884, EORP actually *emphasized* that "New York has a constitutional provision that is almost identical" to Article XXIX, § 1(C). *See* APP254-APP256 (EORP's Opening Brief in *Cross v. EORP*).

(emphasis added). Courts in both states have held that promised future payments and statutory formulas for calculating payments—like the 1998 Formula— are "benefits."

In *Kleinfeldt v. New York City Employee Retirement System*, for example, the New York Court of Appeals invalidated a "statutory limitation on the amount of ***increased*** compensation" used to determine a payment because it was designed to "circumvent the constitutional protections by devices designed to limit ***future*** retirement benefits." 324 N.E.2d 865, 868 (N.Y. 1975) (emphasis added). Using new mortality tables to compute the annuities of existing members is also an impairment of their benefits. *Ayman v. Teachers' Ret. Bd. of City of N.Y.*, 172 N.E.2d 571 (N.Y. 1961). So is changing an actuarial table if the new table would pay lower benefits. *Pub. Emps. Fed'n, AFL-CIO v. Cuomo*, 467 N.E.2d 236, 239 (N.Y. 1984) (discussing *Birnbaum v. N.Y. State Teachers Ret. Sys.*, 152 N.E.2d 241 (N.Y. 1958)); *see also Kranker v. Levitt*, 281 N.E.2d 840 (N.Y. 1972) (vacation accrual scheme in formula for calculating pension benefits is a pension benefit that may not be "impaired."); *McDermott*, 624 N.E.2d at 989-90 (excess investment income kept in reserve fund is a "benefit" of a public pension program); *Poggi v. City of New York*, 491 N.Y.S.2d 331, 341 (N.Y. App. Div. 1985) ("a pension benefit based upon an altered method of calculation is invalid ***even if the benefit level after the change is not less than the level was before the change***." (emphasis added)), *aff'd*, 492 N.E.2d 397 (1986).

Similarly, the Appellate Court of Illinois has held that the City of Chicago unconstitutionally impaired the benefits of retired police officers by passing a law in which "the 3% automatic annual statutory increases previously calculated from age 63 should be recalculated from the actual retirement date." *Miller v. Ret. Bd. of Policemen's Annuity*, 771 N.E.2d 431, 435 (Ill. App. Ct. 2001). The Court found that ***modifying the payment formula*** diminished benefits even for officers "who suffered no reduction in benefits" from one year to the next because it would have caused them "to lose ***the increased benefits they have been granted***." *Id.* at 444 (emphasis added).

2. Other States Agree That a Pension Payment Increase Mechanism Is a Benefit

Courts in several other states have also held that a statutory promise to increase benefit payments over time is a "benefit" entitled to protection. For example, the Rhode Island Supreme Court recently found that "a COLA is a ***vested pension benefit*** when a jurisdiction has adopted a mixed contract/deferred compensation theory of pension benefits." *Arena v. City of Providence*, 919 A.2d 379, 394 (R.I. 2007) (emphasis added). The Colorado Court of Appeals also affirmed that a statutory COLA increase is a pension benefit subject to protection. *Justus v. State*, ___ P.3d ___, 2012 WL 4829545, ¶ 45 (Colo. App. Oct. 11, 2012) (remanding for analysis under Contract Impairment Clause).

Similarly, the West Virginia Supreme Court found unconstitutional a statute that reduced a cost-of-living increase, explaining that "employees who contribute to a state pension fund and who rely substantially to their detriment on a specific contribution ***and benefits schedule*** have immediate legitimate expectations that rise to the level of constitutionally protected contract property rights." *Booth v. Sims*, 456 S.E.2d 167, 185 (W. Va. 1995) (emphasis added).

Alaska's Supreme Court, interpreting a constitutional provision nearly identical to Arizona's, likewise found that a pensioner's benefit is diminished or impaired when a statutory scheme provides that the pensioner receives less money than he otherwise would have. *Sheffield v. Alaska Pub. Emps. Ass'n, Inc.*, 732 P.2d 1083, 1087, 1089 (Alaska 1987). This is so even if the new formula provides the "average employee with the present value equivalent to benefits calculated under the [earlier] factors." *Id.* at 1087.

A number of courts have also found that statutory increases to pension payments are included in the rights that a pensioner receives upon retirement, i.e., a "benefit." *See Hayden v. Hayden*, 665 A.2d 772, 774-75 (N.J. Super. Ct. App. Div. 1995) ("[P]ost-retirement [COLA] increases are as much a part of the pension as the amounts initially established by the pension system on retirement."); *Baker v. Okla. Firefighters Pension & Ret. Sys.*, 718 P.2d 348, 353 (Okla. 1986) (holding that pensioners have a right in a "pension adjustment provision" that provided them with future increases); *Cnty. of Orange v. Ass'n of Orange Cnty.*

Deputy Sheriffs, 121 Cal. Rptr. 3d 151, 168 (Cal. Ct. App. 2011) (noting that a statutory increase in a base pension payment is itself a benefit).

In short, as these decisions demonstrate, the promise made in A.R.S. § 38-818 to increase pension payments under the 1998 Formula is a benefit that may not be diminished or impaired.

II. Defendants' Contention That Pensioners' Rights in the 1998 Formula Did Not Vest Is Contrary to Settled Law, and Indeed Reveals a Fatal Flaw Underlying Their Arguments

Notwithstanding that the retired EORP members earned their promised retirement benefits after years of service, the State claims (at 2-4) that they have no vested right to these benefits. According to the State, "[u]ntil each annual adjustment was calculated, it was subject to a contingency that might never occur," and thus the retired EORP members had no vested rights in the 1998 Formula. This argument—which mirrors EORP's arguments (at 38-32 and 43-46)—collapses the distinction between (1) what events must occur to entitle one to the benefit, and (2) the method used to calculate the benefit to which one is entitled.

In the public benefits context, this Court has held that benefits are "contingent" if they "come into existence on an event or condition which may not happen or be performed until such other event may prevent their vesting." *Thurston v. Judge's Ret. Plan*, 179 Ariz. 49, 50, 876 P.2d 545, 548 (1994) (citation omitted). In accordance with this principle, a widow's right to survivor benefits does not vest until her husband's death; the wife may die before her husband, or

the husband may remarry. *Id.* at 50-51, 876 P.2d at 547-548. Similarly, a right to disability only becomes vested "at the instant the employee is injured in the course of his employment." *Fund Manager, Pub. Safety Pers. Ret. Sys. v. City of Phoenix*, 151 Ariz. 487, 489, 728 P.2d 1237, 1239 (App. 1986). Like a spousal death benefit, a disability benefit is contingent because it "***only come[s] into existence*** on an event or condition which may not happen"—the employee becoming disabled. *Thurston*, 179 Ariz. at 50, 876 P.2d at 546 (emphasis added) (citation omitted).

Retirement benefits for the particular retiree are, however, different. By statute, "[a]n eligible claimant's right to benefits [under a pension plan] vests on the date of the member's application for those benefits or the member's last day of employment under the plan, whichever occurs first." A.R.S. § 38-810.02(B); *cf. Fund Manager*, 151 Ariz. at 489, 728 P.2d at 1239 (explaining "that a public employee's interest in a retirement benefit or pension is so significant that it should become a right or entitlement at the outset of employment."). Moreover, as a constitutional matter, a judge's pension rights vest when the judge "fulfill[s] every condition precedent to having his contributions returned." *Id.* at 490, 728 P.2d at 1240 (quoting *Krucker v. Goddard*, 99 Ariz. 227, 230, 408 P.2d 20, 22 (1965)).

In this case, where the entire Plaintiff class is retired, there can be no question that Pensioners' rights to their retirement benefits have vested. They have earned their pensions by completing their service to the State, have retired, and

there is no event "which may not happen" that may prevent them from being entitled to their benefits. *Thurston*, 179 Ariz. at 50, 876 P.2d at 546.

Those benefits necessarily include the 1998 Formula. Indeed, it has been settled for nearly half a century that a pensioner has a right to rely on the terms of pension legislation "as it existed at the time he entered the service." *Yeazell v. Copins*, 98 Ariz. 109, 117, 402 P.2d 541, 546 (1965). Additionally, A.R.S. § 38-810.02(A) makes plain that "the legislature intends that the plan as enacted at a particular time be construed and applied as a coherent whole ***and without reference to any other provision of the plan in effect at a different time***." (Emphasis added.)

When Pensioners retired, the statutes codified their benefits, including the right to have pension payments made in accordance with the 1998 Formula. A.R.S. § 38-810.02 (B). As *Yeazell* recognizes, that promise of future payments pursuant to that formula was "a valuable part of the consideration for the entrance into and continuation in public employment," *Yeazell*, 98 Ariz. at 115, 402 P.2d at 545, and thus has already vested. And those Pensioners who retired before enactment of the 1998 Formula became vested in the Formula because "it automatically [became] part of the contract by reason of the presumption of acceptance." *Thurston*, 179 Ariz. at 51, 876 P.2d at 547.

Bennett ex rel. Arizona State Personnel Commission v. Beard, 27 Ariz. App. 534, 556 P.2d 1137 (1976), which the State cites (at 3-4), does not suggest

otherwise. It involved a challenge to the method by which annual leave would accrue on a going forward basis ***for future service***. *Id.* at 535-36, 556 P.2d at 1138-1139. In distinguishing *Yeazell*, *Bennett* carefully noted that, unlike here, "in this case, we are not dealing with the retroactive impairment of vested rights, we are concerned with the power to make contracts ***for future employment***." *Id.* at 536, 556 P.2d at 1139 (emphasis added). *Bennett* even "emphasize[d] that appellee makes no contention that the new personnel rules affect any leave benefits he has accrued ***by reason of his prior service***." *Id.* at 537, 556 P.2d at 1140 (emphasis added). To top it off, there was no "statute giving" the employee the right asserted. *Id.* *Bennett* thus confirms that Plaintiffs' rights have vested.

In sum, although the amount of a future payment may depend on future events set forth in a formula, the right to have the payment calculated pursuant to ***that formula*** does not depend on any future contingency. Put another way, even if an annuity promised to increase future payments by 4% if and only if the Dow gains at least 9%, the right to have future payments made pursuant to that formula would be a vested right in the annuitant.

III. The Superior Court Correctly Concluded That the Second Clause in Article XXIX, § 1(C) Resolves This Case

Notwithstanding Arizona's constitutional mandate that "public retirement system benefits shall not be diminished or impaired," EORP argues (at 40) that the Pension Impairment Clause simply clarified that "public pension systems are a

contractual relationship," and that the Pension Impairment Clause provides only "conditional" protection. Contrary to EORP's contentions, however, the superior court correctly concluded that the Pension Impairment Clause resolves this case.

A. Contrary to Defendants' Contention, the Pension Impairment Clause Protects Any Impairment or Diminishment of Vested Retirement Benefits

Article XXIX, § 1(C) first states that "[m]embership in a public retirement system is a contractual relationship that is subject to article II, § 25 . . . ." Ariz. Const. art. XXIX, § 1(C). Article II, Section 25 provides in pertinent part that no "law impairing the obligation of a contract, shall ever be enacted." In light of that, if the Pension Impairment Clause was merely intended to make public retirement benefits subject to article II, Section 25, it would have stopped there. But, Section 1(C) continues: "***and*** public retirement benefits shall not be diminished or impaired." (Emphasis added.) Consequently, to construe the second clause in Article XXIX, § 1(C) as merely repeating the first clause runs contrary to its plain language, and would render the second clause completely "superfluous" and "redundant." *Cronin*, 195 Ariz. at 540 ¶ 44, 991 P.2d at 240; *see also Pinal Vista Props., LLC v. Turnbull*, 208 Ariz. 188, 190 ¶ 10, 91 P.3d 1031, 1033 (App. 2004) (courts should give effect "to each word or phrase . . . so that no part is rendered void, superfluous, contradictory, or insignificant.").

Moreover, Defendants ignore that the two parts of Article XXIX, § 1(C) serve different purposes. The first part establishes that public pensions are

contractual in nature, rather than a "gratuity" or improper gift. Indeed, before *Yeazell*, pension benefits were often described "as mere 'gratuities,' granted at the benevolent will of the sovereign." *See Proksa v. Ariz. State Sch. for the Deaf & the Blind*, 205 Ariz. 627, 631 ¶ 18, 74 P.3d 939, 943 (2003) (citation omitted). The second part, the Pension Impairment Clause, protects pension benefits by imposing an absolute prohibition against diminishing or impairing them.

Additionally, and contrary to EORP's contention (at 41) and the State's contention (at 7), interpreting Section 1(C) as absolutely prohibiting the diminishment or impairment of benefits does not conflict with Section 1(A) of Article XXIX. Section 1(A) requires that the Plan be "funded with contributions and investment earnings using actuarial methods and assumptions that are consistent with generally accepted actuarial standards." Ariz. Const. art. XXIX, § 1(A). The Plan's actuaries calculate employer contributions according to those standards, and will continue to do so once SB1609 is invalidated. The requirements for funding the Plan (the money flowing into the plan) are distinct from the absolute prohibition against cutting benefits (the money paid by the plan).

B. Construing the Pension Impairment Clause to Provide Less Protection Than Its Plain Language Affords Would Needlessly Entangle the Judiciary with Legislative Changes to Benefits

In addition to running contrary to basic principles of statutory construction, Defendants' construction would make applying the Pension Impairment Clause more difficult, and thus make future litigation more likely. Using the highly fact-

specific test developed for the Contract Impairment Clause context, as Defendants suggest, would require judges to evaluate the wisdom of fiscal rationales for legislative decisions, thereby becoming needlessly entangled with legislative judgments. Given the Pension Impairment Clause's plain language, there is no reason to force the judiciary to become entangled in these issues.

In contrast, construing the Pension Impairment Clause to mean what it says—that "retirement benefits shall not be diminished or impaired"—avoids such issues and makes future application of the Clause predictable. Indeed, by construing this language in accordance with its plain meaning, EORP's attorneys correctly opined that the benefits given retired Plan members "probably cannot be legislatively modified" without violating the Pension Impairment Clause.[57] Having clarity in this constitutional provision makes good sense.

C. Defendants' Contention That the Court Should Write "Flexibility" into the Pension Impairment Clause Ignores That the Law Already Provides a Method for Change if Necessary to Avoid Catastrophe

Defendants' case for "flexibility" also ignores the purpose of a constitutional right. The entire point of a constitutional right is to give it greater protection than that otherwise afforded by statute. *Cf. Kilpatrick v. Super. Ct.*, 105 Ariz. 413, 419, 466 P.2d 18, 24 (1970) ("The Constitution is, of course, the supreme law of the State circumscribing the otherwise plenary power of the Legislature.").

[57] APP064.

Defendants' position also overlooks that the appropriate amount of "flexibility"—that needed to avoid financial catastrophe or other significant harm—already exists. Like a statute, a constitutional provision may be modified (or eliminated). *See* Ariz. Const. art. XXI (setting forth methods for amending constitution). Precisely to ensure that such modifications will only occur if truly necessary, constitutional changes are by design more difficult. Consequently, although the record does not support Defendants' claims that SB1609 was necessary to avoid a financial catastrophe, if such a catastrophe were imminent, the Pension Impairment Clause could be modified or eliminated.

Indeed, the Arizona House of Representatives proposed an amendment to Article XXIX specific to EORP that provided "this section does not prohibit increases in member contributions or reductions in cost of living adjustments consistent with generally accepted actuarial standards and in the interests of the stability of the plan." H.C.R. 2060, 2d Reg. Sess. (2012). Ultimately this legislation was never referred to the voters. *See* H.C.R. 2060 Bill Status Overview, *available at* http://www.azleg.gov//FormatDocument.asp?inDoc=/legtext/50leg/2r/bills/hcr2060o.asp&Session_ID=107 (last visited April 24, 2013). Consequently, the State is bound by the existing language of the Pension Impairment Clause.

IV. The Court Need Not Consider Defendants' Contract Impairment Clause Analysis, but if It Does It Should Affirm Because SB1609 Violates the State and Federal Contract Impairment Clauses

A. If the Court Concludes That the Pension Impairment Clause Does Not Resolve This Case, It Should Affirm or Remand for the Superior Court to Rule on the Issue and Make the Appropriate Findings

As Defendants acknowledge, the superior court did "not reach the issue whether SB1609 violates the State or Federal Contract Impairment Clauses."[58] In light of that, there is no ruling on this issue for the Court to review on appeal. Moreover, although this Court "will consider any legal theory within the issues and supported by the evidence which tends to support and sustain the judgment," *Cross v. Cross*, 94 Ariz. 28, 31, 381 P.2d 573, 575 (1963), it generally will not reverse on the basis of an issue not ruled upon by the lower court, particularly if it is not a purely legal one. *See, e.g., Ariz. Water Co. v. Ariz. Dep't of Water Res.*, 208 Ariz. 147, 158 ¶ 47, 91 P.3d 990, 1001 (2004) ("Given that the courts below did not address" the argument made on appeal to reverse, "we decline in the first instance to address that fact-intensive issue, but instead remand this case").

In this case, as Defendants' briefing makes clear, the three-part Contract Impairment Clause analysis involves a fact-intensive inquiry:

1. Has the state law operated as a substantial impairment of a contractual relationship?

2. If so, is there a significant and legitimate public purpose behind the legislation?

[58] APP036 n.3.

3. If a legitimate public purpose has been identified, is the adjustment of the rights and responsibilities of the contracting parties based upon reasonable conditions and of a character appropriate to the public purpose justifying the adoption of the legislation?

Fund Manager, 151 Ariz. at 491, 728 P.2d at 1241 (citing *Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 411-12 (1983)). Moreover, had the superior court made findings pertinent to these issues, they would be reviewed for clear error. *See, e.g.*, *Queiroz v. Harvey*, 220 Ariz. 273, 274 n.1, 205 P.3d 1120, 1121 n.1 (2009) ("[W]e defer to the superior court's findings of fact unless clearly erroneous.").

To top it off, the facts relevant to this issue, including the strength of the State's justification for impairing benefits, may change. In particular, the Arizona House of Representatives recently passed House Bill 2608, which would close EORP to ***new*** employees, and replace it with a defined contribution plan. *See* HB 2608, 1st Reg. Sess. (2013). The bill is currently pending in the Senate. If the Plan is closed to new employees, benefit payments and employer contributions will decline as existing Plan members pass away. Honoring the promise made to retired Plan members will thus become much easier for the State and EORP. Indeed, proponents have stated that closing the EORP plan to new members will save the state over $350 million. *Hearing on HB 2608 Before Senate Finance Committee*, 51st Leg., 1st Reg. Sess. (2013) (statements by Rep. Phil Lovas, sponsor of HB 2608) available at http://azleg.granicus.com/MediaPlayer.php?

view_id=21&clip_id=12239 at 10:25. Consequently, the State's entire justification for impairing Plan beneficiaries' promised, earned, and vested contract rights may soon melt away.

Therefore, although the Court may affirm because the record shows that SB1609 violates the State and Federal Contract Impairment Clauses, it should not reverse based on any contract impairment analysis without first remanding for the superior court to make findings relevant to the issue.

B. SB1609 Substantially Impaired a Contractual Relationship

Although this Court has never addressed the appropriate contract impairment test in the public retirement benefit context, the Court of Appeals adopted the above three-part Contract Impairment Clause analysis (the same test used by federal courts). *Fund Manager*, 151 Ariz. at 491, 728 P.2d at 1241. Under the first prong, the "substantial impairment" inquiry asks "whether there is a contractual relationship, whether a change in law impairs that contractual relationship, and whether the impairment is substantial." *Gen. Motors Corp. v. Romein*, 503 U.S. 181, 186 (1991).

1. The 1998 Formula Is a Contractual Benefit

Arizona courts have held since *Yeazell* that pension rights become vested when an employee begins work, and Pensioners are also vested under A.R.S. § 38-810.02(B) because they are all retired. *See* Argument § II. Moreover, "[w]e presume that the legislature, when it passes a statute, knows the existing laws."

Daou v. Harris, 139 Ariz. 353, 357, 678 P.2d 934, 938 (1984). Consequently, when the Legislature enacted A.R.S. § 38-818 and made "a permanent increase in the base benefit" as calculated by the 1998 Formula an "entitle[ment]," A.R.S. § 38-818(A), it presumptively knew it was creating rights in the formula. Additionally, voters then clarified that those rights were subject to the Contract Impairment Clause by adopting Article XXIX, § 1(C). As demonstrated above, this constitutional and statutory scheme necessarily gave rights to Plan beneficiaries to have their pension benefits calculated in the manner promised.

In other words, against the backdrop of Arizona precedent and constitutional law, passing A.R.S. § 38-818 created a "contractual agreement regarding the specific . . . terms allegedly at issue." *RUI One Corp. v. City of Berkeley*, 371 F.3d 1137, 1147 (9th Cir. 2004) (quoting *Gen. Motors*, 503 U.S. at 187). Thus, contrary to EORP's contention, there is an abundance of "unmistakable" evidence that the State intended to give employees the pension rights promised to them in the 1998 Formula.

Defendants' reliance on various sunset provisions misses the point. Precisely because an earlier version of A.R.S. § 38-818 included a sunset provision and the 1998 Formula did ***not***, Plan members could reasonably expect the rights granted under the 1998 Formula to be certain and continue. *See* 1996 Ariz. Sess. Laws, Ch. 198, (2d Reg. Sess.) (reinstituting permanent base benefit increases); 1998 Ariz. Sess. Laws, Ch. 264, § 1 (2d Reg. Sess.) (creating 1998 Formula, but

not adopting any sunset clause). Additionally, the fact that ***the entire Plan*** includes a sunset provision, as the State emphasizes at (10-11), is irrelevant to whether those with vested benefits have a contractual right to those benefits. In other words, the State may choose to eliminate the entire Plan, but that does not alter its contractual promise to pay statutorily defined benefits.[59] Were the law otherwise, the State could simply wipe out all of the benefits promised to an employee with 19 years of service by eliminating the Plan—a result the State concedes is impermissible. *Cf. Pub. Emps. Fed'n, AFL-CIO*, 467 N.E.2d at 240 ("[A] limitation on the duration of a statute which confers a benefit does not render the benefit a temporary one.").

2. SB1609 Impairs Contractual Rights—Specifically, Pensioners' Rights to Permanent Increases Under the 1998 Formula

The trial court ruled that "[t]he *purpose and effect* of SB1609 is to impair and diminish the permanent benefit increases provided by A.R.S. § 38-818 to Plaintiffs."[60] As explained above (in Argument § I(B)(1)), SB1609 swept away $31 million in dedicated funds and withdrew promised benefits worth thousands of dollars in FY 2012 and FY 2013. This significantly impaired Pensioners' rights.

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[59] *See* APP099 (2005 Legislative Sunset Review explaining that "the retirement, survivor and disability benefit entitlements of the . . . EORP participants could not be changed, since these participants have a constitutionally protected property interest in these benefits. Therefore, even if the system were terminated, the state would still need an administrative mechanism to distribute benefits . . . .").

[60] APP035 (emphasis added).

Perhaps aware that it cannot contest that SB1609 impaired Pensioners' contract with the State, EORP invokes (at 46–47) "traditional defenses that would excuse breach of any contract at common law." But EORP has cited no authority for the proposition that common-law contract defenses are relevant to the substantial impairment analysis.

Moreover, Defendants' arguments regarding mutual mistake, impracticability, and lack of consideration are misplaced. Had Defendants wished to assert them, they had ample opportunity to timely raise those affirmative defenses. *See* Ariz. R. Civ. P. 8(c) (identifying affirmative defenses); 26.1(a)-(b) (requiring disclosure of factual and legal basis for defense). They failed to do so, and therefore waived these defenses. *See, e.g., City of Phoenix v. Fields*, 219 Ariz. 568, 574 ¶ 27, 201 P.3d 529, 535 (2009) (failure to set forth affirmative defense in answer or Rule 12 motion waives defense); Ariz. R. Civ. P. 37(c)(1) ("A party who fails to timely disclose information required by Rule 26.1 shall not, unless such failure is harmless, be permitted to use as evidence at trial" information not disclosed).[61]

Moreover, EORP has cited no authority suggesting that the proper remedy for a contract subject to such a defense is unilateral modification. Ordinarily, as the cases cited by EORP confirm, a common-law contractual defense results in discharge, rescission, or judicial reformation. *See Renner v. Kehl*, 150 Ariz. 94,

[61] *See* APP019-APP026.

96, 722 P.2d 262, 264 (1986) (rescission); *Nelson v. Rice*, 198 Ariz. 563, 566, 12 P.3d 238, 241 (App. 2000) (reformation or rescission); *7200 Scottsdale Road Gen. Partners v. Kuhn Farm Mach., Inc.*, 184 Ariz. 341, 345, 909 P.2d 408, 412 (App. 1995) (discharge).

Here, EORP is not seeking rescission of the entire pension contract, or to have the contract discharged. They have not sought judicial reformation. They have cited no cases approving unilateral modification (otherwise known as breach of contract) as a proper remedy when an affirmative common-law contract defense is available. In *Yeazell*, the Court forbade that: "Tucson now attempts to apply the changes retroactively to vary the terms of its contract with appellant. We hold the changes, if applied to appellant without his assent, would constitute an alteration, a modification of his contract. This Tucson may not do." 98 Ariz. at 116, 402 P.2d at 546.

Likewise, impracticability is unavailable here because there are no "certain events occurring after a contract is made [that] constitute an impediment to performance by either party." *7200 Scottsdale Rd.*, 184 Ariz. at 345, 909 P.2d at 412. Impracticability has traditionally been applied "to three categories of supervening events: death or incapacity of a person necessary for performance, destruction of a specific thing necessary for performance, and prohibition or prevention by law." *Id.* It is wholly inapplicable when the alleged impracticability is merely greater difficulty in contract performance than the party anticipated.

And Defendants have not proven that it is impracticable for employers to make contributions to the Plan. *See Yeazell*, 98 Ariz. at 116, 402 P.2d at 546 ("It is not appellant's burden to show the lack of grounds for a rescission or a modification of the contract. The party who asserts a fact has the burden to establish the fact."). Rather, they have only established that employers prefer not to make contributions. But "[t]he obligation to keep the Fund sound is not that of the [pensioners], it is the obligation of the [State]." *City of Phoenix v. Boerger*, 5 Ariz. App. 445, 454, 427 P.2d 937, 946 (1967).

EORP also contends that those class members who retired before 1998 provided no consideration for their increased benefits. But it has long been the law that "when the amendment is beneficial to the employee or survivors, it automatically becomes part of the contract by reason of the presumption of acceptance." *Thurston*, 179 Ariz. at 51, 876 P.2d at 547. Moreover, Defendants accepted any modification that benefited the class members by performing on the contract for over a decade. *See Rubenstein v. Sela*, 137 Ariz. 563, 564, 672 P.2d 492, 494 (App. 1983) ("If one makes an executory contract which lacks a consideration" and "chooses to execute the contract by performance, . . . he cannot turn around and seek to undo his voluntary act." (internal quotation marks and citation omitted)).

The cases cited by EORP (at 45 n.83) also do not support its assertion that Pensioners have no vested contract right to the 1998 Formula. As set forth above

in Argument § I(a)(2), *Will* is inapplicable because it addresses the Compensation Clause, and in any event *Beer* establishes that the 1998 Formula would be a vested contract right under that Clause. *See Beer*, 696 F.3d 1174. Likewise, *Grant v. Nellius* concerned salaries, not pensions. Unlike the 1998 Formula, the salary increase provision at issue was not designed "to compensate State employees for past services rendered, or to induce individuals to enter and remain in public service." 377 A.2d 354, 357-58 (Del. 1977) (internal quotation marks and citation omitted). Finally, *Zucker v. United States*, 758 F.2d 637 (Fed. Cir. 1985), addresses the Takings Clause—not the Contract Impairment Clause—and thus is not useful for determining whether the 1998 Formula is a vested contract right, especially in light of Article XXIX, § 1(C).

3. The Impairment Is Substantial

To determine whether impairment of a contract is substantial, a court may consider whether the impairment undermined "the reasonable expectations of the complaining party." *Matter of Estate of Dobert*, 192 Ariz. 248, 253 ¶ 21, 963 P.2d 327, 332 (App. 1998) (citing *Energy Reserves*, 459 U.S. at 416). In addition, "[a]n impairment of a public contract is substantial if it deprives a private party of an important right, thwarts performance of an essential term, defeats the expectations of the parties, or ***alters a financial term***." *S. Cal. Gas Co.*, 336 F.3d at 890 (emphasis added) (citations omitted). A modification also substantially impairs a contract with a public employee if it "jeopardize[s] the rights of vested

beneficiaries." *McClead v. Pima Cnty*, 174 Ariz. 348, 359, 849 P.2d 1378, 1389 (App. 1992).

In this case, SB1609 "substantially impairs" the retired Plan members' benefits in all three senses. First, it impaired Pensioners' reasonable expectations in their pension benefits. The evidence at trial showed that both Ms. Betty O'Melia (Judge Michael O'Melia's surviving spouse) and Judge Fields had reasonable and actual expectations that they would be paid what the State had promised them. Ms. O'Melia testified that she was aware of the survivor's benefit and benefit increases, and that she and Judge O'Melia relied on these benefits in planning their future—the benefits of the Plan "was what was going to take care of" them.[62] Judge Fields "considered all the benefits before [he] made the decision to buy into or buy . . . additional years," and among "the benefits [he] definitely considered was the excess earning provision, COLA, whatever you want to call it."[63] Given that they were told the 1998 Formula was an entitlement they could count on in retirement, those expectations were reasonable.

Second, by providing pensioners with lower payments than they would have otherwise received, SB1609 "alters a financial term" of A.R.S. § 38-818. *S. Cal. Gas Co.*, 336 F.3d at 890. As detailed above, Judges Fields and Lankford, along

[62] APP108-APP111 (53:11-56:9).

[63] APP112-APP113 (64:23-65:4).

with the other 1000 or so class members, have each been paid less as a result of SB1609. *See* Argument § 1(B)(1).

Lastly, SB1609 "jeopardize[d] the rights of vested beneficiaries." *McClead*, 174 Ariz. at 359, 849 P.2d at 1389. Retired Plan members not only received less than what they were promised in fiscal years 2012 and 2013, SB1609 more than "jeopardize[d]" their rights to have future payments made in accordance with the method they were promised; it destroyed that right. *See* Argument § 1(B)(1).

Defendants offer no cogent explanation as to how the impairment was not substantial. Moreover, they ignore that this Court has already recognized that public retirement benefits are "a valuable part of the consideration for the entrance into and continuation in public employment," *Yeazell*, 98 Ariz. at 115, 402 P.2d at 545, and thus have already vested.

C. No Significant and Legitimate Public Purpose Justified SB1609's Impairment of Pensioners' Contractual Right to Permanent Increases Under the 1998 Formula

If a court finds that a state law substantially impairs a contractual relationship, then if either (1) there is either no significant and legitimate public purpose behind the law, or (2) the law is not a reasonable means of addressing the purpose behind it, the law violates the Contract Impairment Clause. *Gen. Motors*, 503 U.S. at 186. With respect to the first issue, Defendants contend that the State's interests in the fiscal health and actuarial integrity of the Plan warranted the impairment. This argument, however, ignores that the Plan is actuarially sound as

a matter of law. Article XXIX, § 1(A) requires the Plan to be funded "with contributions and investment earnings using actuarial methods and assumptions that are consistent with generally accepted actuarial standard." The Plan, therefore, ***must*** be funded to ensure its health. Indeed, the current statutory funding mechanism for the EORP will always, by design, provide sufficient funding of the EORP because the employer contribution rate is adjusted to make up for any shortfall over the long run. *See* A.R.S. § 38-810(C) (employers must make contributions "sufficient under the actuarial valuation to meet both the normal cost plus the actuarially determined amount required to amortize the unfunded accrued liability").

Thus far, employers always satisfy their obligation.[64] Moreover, there is simply no evidence that the employers cannot fund contributions to ensure the health of the Plan. Although EORP highlights the Plan's funding ratio, its actuary acknowledges that "with regard to funding ratios, the most important thing is the direction and not the absolute level."[65] Because the actuaries evaluate the plan and recommend contribution rates based upon the Plan's performance, "[b]y the end of the amortization period, the funded ratio has to be 100 percent."[66] Regardless of the Plan's current amortization rate, actuaries will "refigure the contribution rate

[64] *See* APP117-APP119 (88:7-90:4 (employers have always paid contributions)).

[65] APP169-APP170 (36:10-37:13).

[66] APP171 (46:6-21).

each year based upon all of the experience known up until that time so that you at the end of the amortization period reach your 100 percent funding target."[67]

At the very most, EORP can show only that with SB1609 in place, the rate of total employer contributions—***before they are subsidized*** by judicial filing fees—will rise to "something in the area of 40 percent" before declining, instead of cresting at "just over 50 percent" of payroll.[68] In short, the employers need only marginally increase their unsubsidized contribution rate to fund increases under the 1998 Formula (and otherwise comply with pre-SB1609 benefits). EORP has put forward no evidence whatsoever to suggest that without SB1609, the counties or municipalities will fail to pay their obligations, or that future pensioners will not be paid if the State honors its contract with pensioners.

EORP's actuary even declined to describe the Plan as troubled, noting that "I questioned whether we use the terms such as sustainable or unsustainable."[69] In fact, the actuary consistently reiterated that he had only calculated "the cost of the COLA program," and not evaluated the Plan's soundness.[70] He confirmed that if the contribution rates were paid, the plan would not fail.[71] There is, therefore, no actual evidence that the Plan is actuarially unsound which leaves EORP only able

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[67] APP171-APP172 (46:24-47:15).

[68] APP151-APP152 (166:24-167:10).

[69] APP174 (69:1-2).

[70] APP175 (74:1-12).

[71] *See* APP180 (79:9-11).

to invoke the self-serving floor statements by those who passed the bill. This falls far short of demonstrating that "there is a significant and legitimate public purpose served by the amendment," which "an unconstitutional impairment exists." *Fund Manager*, 151 Ariz. at 491, 728 P.2d at 1241; *cf. S. Cal. Gas Co.*, 336 F.3d at 894 (state bears burden of proof when it substantially impairs its own contract).

The case upon which EORP relies (at 49-50), *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942), confirms this. That case involved a bankruptcy filing by the City of Asbury Park in the depth of the Great Depression; as the Supreme Court described it, the policy was enacted to counter "**the *public emergency*** arising from a ***default*** in the payment of municipal obligations, and the resulting ***impairment of public credit***." *Id.* at 504 (emphasis added) (internal quotation marks and citation omitted). Here, EORP has failed to establish any emergency, default, or threat to public credit.

D. SB1609 Was Not a Reasonable and Necessary Means of Addressing Any Perceived Funding Issues with the Plan

SB1609 also violates the Contract Impairment Clauses because it was not a "reasonable means" of addressing the purported purpose behind it. *Fund Manager*, 151 Ariz. at 491, 728 P.2d at 1241. In analyzing this issue, "complete deference to a legislative assessment of reasonableness and necessity is not appropriate." *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 25-26 (1977) ("If a State could reduce its financial obligations whenever it wanted to spend the money for what it

regarded as an important public purpose, the Contract Impairment Clause would provide no protection at all.").

1. The Legislature's Failure to Consider Alternatives Establishes That Its Enactment of SB1609 Was Unreasonable

The record here shows that at least two policy alternatives—in addition to simply allowing employer contribution rates to increase—were ignored. Instead of impairing Pensioners' contractual rights, any shortcoming in the Plan's finances could have been met by (1) increasing judicial fees, and/or (2) closing the Plan to new employees. In fact, after the trial court ruled that SB1609 was unconstitutional, both policies have been considered or adopted.

When designing actuarial projections for the Plan, the administrator never considered a model that included "increasing judicial filing fees to give [the Plan] more revenue."[72] Nonetheless, after enacting SB1609, civil filing fees were increased by 5% on March 18, 2013,[73] further subsidizing employer contributions to the Plan. This development not only demonstrates that the Plan erred in failing to consider whether increased filing fees could improve the financial stability of the Plan, it also renders the Plan's relied-upon actuarial projections inaccurate.

Additionally, on February 27, the Arizona House of Representatives passed HB 2608, which, if it becomes law, will close the Plan to new employees and

[72] APP151 (166:10-14).

[73] *See* News Release, Arizona Supreme Court – Administrative Office of the Courts, *Civil Filing Fee Increase to Take Effect March 18, 2013*, APP258.

replace it with a deferred contribution plan. *See* HB 2608, 1st Reg. Sess. (2013). As EORP itself demonstrates, its concerns about future payments to EORP members presuppose that a large number of "future actives"—people who have not yet even entered service—will collect pension benefits on retirement.[74] Closing the Plan to new hires will, at a minimum, greatly reduce any concerns about the amount of employer contributions necessary to fund the Plan.

In fact, EORP's administrator created an internal document detailing the various alternatives to cutting Pensioners' benefits which was presented only to the EORP Board, but not the Legislature.[75] In it, the administrator noted that issuing bonds, raising judicial filing fees, taxing pension benefits, or creating a new plan for new hires would all have improved the Plan's financial health.[76] Notwithstanding having researched other potential policy solutions, EORP recommended to the Legislature only that it impair its contractual agreement with Pensioners, even after receiving legal advice that such a course of action was unconstitutional.[77]

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[74] APP087.

[75] *See* APP052-APP058 (discussing alternatives); APP156-APP160 (171:23-175:14).

[76] *See* APP052-APP058.

[77] *See* APP132 (132:18–22).

2. Passing SB1609 Was Unreasonable in Light of the Circumstances

"[A] State cannot refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote the public good, rather than the private welfare of its creditors." *U.S. Trust*, 431 U.S. at 29. But this is exactly what the State did by enacting SB1609.

The record shows that far from acting to save the Plan itself, EORP has always worked principally to minimize employer contributions, regardless of the health of the Plan. In 2006, for example, when the actuarial funding ratio for the Plan was declining, the EORP Board changed the Plan's actuarial methodology, which "had the effect in the short term of reducing the employer contributions."[78] As has been previously noted, when it first sought legal advice, the Plan's proposed course of action was to "divert the assets in the Reserves to the State's general fund for uses ***unrelated to*** the payment of COLAs ***or the payment of benefits to the Plans' members or retirees***."[79]

In light of all of this—the fact that other sources of funding were available for the Plan, the fact that the Legislature was on notice that its new law was unconstitutional, and the fact that the Plan's health is guaranteed by statute—it was unreasonable for the Legislature to impair Pensioners' benefits through the passage of SB1609.

[78] APP146-APP147 (161:4-162:1).

[79] APP064 (emphasis added).

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REQUEST FOR ATTORNEYS' FEES

The Court should award Pensioners their reasonable attorneys' fees and costs incurred in connection with this appeal pursuant to A.R.S. § 12-2030 and under the common fund doctrine, *see, e.g.*, *Kerr v. Killian*, 197 Ariz. 213, 217-18 ¶ 19, 3 P.3d 1133, 1137-38 (App. 2000).

As of the date of this brief, the superior court has not yet ruled on Pensioners' Application for Attorneys' Fees.

CONCLUSION

For more than a decade, Pensioners planned their financial futures relying on the State's promise to pay benefits under a fixed formula. Because the people of Arizona had amended their Constitution to include some of the most stringent protections for public retirement systems in the nation, Pensioners' reliance was entirely reasonable. Before it chose to pass SB1609, the State received a legal opinion from EORP's attorneys concluding that EORP's proposed course of action violated the Constitution. It nevertheless proceeded to deprive Pensioners of their promised, earned, and vested benefits. Now defending that action, Defendants claim that a promise to provide permanent increases pursuant to a statutory formula is not a "benefit," and that changing that formula does not "diminish or impair" it. The superior court applied well-settled principles of statutory and constitutional construction in concluding that SB1609 violates Article XXIX, § 1(C).

Moreover, SB1609 impermissibly impairs Pensioners' contractual right to permanent increases under the 1998 Formula. There was no justification for that impairment given that the Plan is actuarially sound as a matter of law and reasonable alternatives were available to the State (some of which it has now taken advantage). Finally, EORP's common-law contractual defenses are waived and are meritless. The Court should affirm.

Respectfully submitted this 1st day of May, 2013.

OSBORN MALEDON, P.A.

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