



**ARIZONA SUPREME COURT
ORAL ARGUMENT CASE SUMMARY**



**HON. KENNETH FIELDS (ret.) et al. v. THE ELECTED OFFICIALS'
RETIREMENT PLAN et al.**
CV-13-0005-T/AP

PARTIES:

Appellants: Elected Officials' Retirement Plan, Members of the Board of Trustees of the Public Safety Personnel Retirement System (together, "EORP"), and the State of Arizona

Appellees: Kenneth Fields and Jefferson Lankford, retired Arizona judges, on behalf of themselves and others similarly situated

Amici Curiae: Senate President Andrew Biggs and Speaker of the House Andrew M. Tobin and the Arizona League of Cities and Towns

FACTS:

Employers under EORP, Arizona's elected officials' retirement plan, include the State, the counties, and some municipal governments. Funds for EORP come from a combination of employer contributions, employee contributions, judicial fees, and investment proceeds. Each year EORP's actuary sets employer contributions, calculating the amount needed to fund fully EORP's obligations based upon actuarial projections of payouts to beneficiaries and estimated income from market returns. When EORP is less than completely funded, the employer contribution is raised to cover unfunded liabilities.

This case concerns the constitutionality of amendments the legislature made in 2011 to address structural actuarial flaws in the EORP Plan that caused a steep fall in its funding level. The amendments change how annual increases in EORP base benefits are funded and determined; they generally having the effect of lessening or eliminating increases in the benefits retirees covered under the Plan will receive in the years to come.

Before 2011, the Plan operated on a 1998 formula under which benefit increases varied based on the Plan's investment earnings. If investments yielded a return greater than 9%, half of the return above that 9% "hurdle rate" would be used to fund benefit increases, up to a 4% annual maximum increase. Once the maximum increase was funded, any remainder would be rolled over into a future benefit increases reserve instead of returning to EORP's main Plan.

The 2008–2009 financial collapse significantly affected all the retirement plans' finances. EORP's funding ratio fell more than half from 2001 to 2011. Under the 1998 formula, even when the Plan lost money retirees received 4% annual increases. The rate of return fell, diminished by the 1998 formula's requirement that in years with returns above 9%, half of the amount above the 9%

hurdle rate would be diverted into reserves to pay future benefit increases. But in bad financial years, no funds were taken out of the benefit increase reserve to replenish the plans, leaving public employers to make up the shortfall. The employer contribution rate rose from 8.94% in 2001 to 29.79% in 2011 and 32.99% in 2012.

In 2011 Senate Bill (SB) 1069 changed the benefit increase structure. First, benefit reserves could be used to pay for benefits until they were used up, but greater earnings not used for benefit increases in the current year would return to the main plan to restore its funding ratio. Second, the bill increased the earnings rate hurdle from 9% to 10.5%; this would require higher earnings before the earnings would become available for use to pay benefit increases. Third, the legislation tied the maximum benefit increase to the plan's funding ratio. If the funding ratio was 60% or lower, benefits would not increase. If the ratio reached 60-65%, retirees would be eligible for a 2% increase. For each 5% increase in the ratio above 65%, the maximum would increase 0.5%, and the 4% maximum would be available if the ratio was at least 80%. (Employee contribution rates increased for active members of all plans, but plaintiffs did not raise that issue in this case.)

The retired judges sued in superior court, seeking declaratory judgment saying the amendments to the benefit increase formula were unconstitutional. The trial court agreed with the retired judges, declaring the application of SB 1609 as it pertains to the calculation of increased benefits under A.R.S. § 38-818 (entitled "Benefit Increases") violates the Arizona Constitution, article 29, section 1(C), and issued an injunction stopping SB 1609 from being applied. The trial court stayed the injunction until this appeal is resolved. Appellants EORP appealed and petitioned successfully for transfer of the appeal from the Court of Appeals to this Court.

ISSUES:

Appellants EORP:

Do the provisions of Senate Bill 1609 violate Article XXIX, section 1(C) of the Arizona Constitution as to members of the Elected Officials' Retirement Plan who were retired as of the legislation's effectiveness date, by amending the provisions for contingent future annual increases in base benefits?

Appellant State of Arizona:

1) Did the superior court err in holding that retirees had a vested interest in a prior statutory mechanism for calculating future-benefit increases under the Elected Officials Retirement Plan such that the Legislature's prospective amendment of the statutory mechanism in SB 1609 violates the Arizona Constitution?

2) Did the superior court err in holding that the prior statutory mechanism for calculating future-benefit increases under the Elected Officials Retirement Plan is itself a "benefit" that is constitutionally protected?

3) Did the superior court err in choosing to enforce one part of Article 29 of the Constitution, the portion that forbids impairment or diminution of benefits, while ignoring Article 29's other requirements that the Plan be funded using actuarial

methods and assumptions that are consistent with generally accepted actuarial standards and that the Plan members' contractual relationship be interpreted in accordance with the Constitution's Contract Clause, art. 2, § 25?

DEFINITIONS:

Arizona Constitution, article 29, section 1(C) provides: "Membership in a public retirement system is a contractual relationship that is subject to article II, section 25, and public retirement system benefits shall not be diminished or impaired." Article 2, section 25 says, "No . . . law impairing the obligation of a contract, shall ever be enacted."

Actuary: A business professional who weighs the financial impact of risk and uncertainty, using mathematics to evaluate the probability of events and to quantify the contingent outcomes to minimize financial loss. The adjective describing an actuary's work is "actuarial."

Funding ratio: The ratio of a pension plan's assets to its liabilities. A ratio of less than 100 percent means that the liabilities, including benefit payments to retirees, cannot be covered by its assets and must be supplemented by additional contributions or returns on investment.

Return on investment: A measure of what an investment yields in profit to the investor (here, EORP or the Plan).

This Summary was prepared by the Arizona Supreme Court Staff Attorneys' Office solely for educational purposes. It should not be considered official commentary by the Court or any member thereof or part of any brief, memorandum, or other pleading filed in this case.