NANCY SWEENEY
CLERK DISTRICT COURT

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**MONTANA FIRST JUDICIAL DISTRICT COURT**
**LEWIS AND CLARK COUNTY**

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| ASSOCIATION OF MONTANA RETIRED PUBLIC EMPLOYEES, RUSSELL WRIGG, MARLYS HURLBERT, CAROLE CAREY, I. EDWARD SONDENO,<br><br>Plaintiffs,<br><br>v.<br><br>STATE OF MONTANA, MONTANA PUBLIC EMPLOYEE RETIREMENT ADMINISTRATION, PUBLIC EMPLOYEE RETIREMENT BOARD, GOVERNOR STEVE BULLOCK, in his official capacity,<br><br>Defendants. | Cause No.: DDV-2013-788<br><br>**ORDER ON MOTION FOR SUMMARY JUDGMENT** |

Plaintiffs Association of Montana Retired Public Employees and certain individual members thereof (collectively AMRPE) seek a declaratory judgment that section 5 of House Bill 454[1], which reduces the guaranteed annual benefit adjustment (GABA) for all members of the Public Employee Retirement

[1] 2013 Mont. Laws Ch 390.

System (PERS) defined benefit plan[2], is unconstitutional. AMRPE also seeks a permanent injunction barring Defendants State of Montana, Montana Public Employee Retirement Administration (MPERA), Public Employee Retirement Board (PERB), and Governor Steve Bullock (collectively State) from implementing section 5 of HB 454. Leo Barry, Chad Adams, and Jessie L. Luther represent AMRPE. Stuart Segrest represents the State.[3]

Before the Court are cross-motions for summary judgment. AMRPE filed its motion on September 5, 2014. The State filed its motion on October 21, 2014. The parties have fully briefed both motions; the Court heard oral argument on January 13, 2015. For the following reasons, the Court concludes that AMRPE's motion should be granted, the State's motion should be denied, and a permanent injunction should issue.

## FACTUAL AND PROCEDURAL BACKGROUND

AMRPE consists of retired Montana public employees. Plaintiff Russell Wrigg is the president of AMRPE. Plaintiffs Carole Carey, Marlys Hurlbert, and I. Edward Sondeno are retired public employees who receive state retirement benefits, including the GABA.

The Montana Legislature created the PERS in 1945. The system is governed by Chapters 2 and 3 of Title 19 of the Montana Code Annotated. MPERA and PERB administer PERS. With each paycheck, public employees pay a percentage of their salaries into a trust fund and public employers contribute an equivalent percentage of each employee's pay. When an employee retires, she is

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[2] In this order, PERS refers to the PERS defined benefit plan only, unless otherwise specified.

[3] Michael Black initially represented the State as co-counsel. On February 17, 2015, the State filed a notice of withdrawal indicating that Black was no longer affiliated with the Office of the Attorney General and is no longer representing the State in the matter.

entitled to receive monthly benefit payments calculated by a formula contained in statute. Until the late 1990s, the monthly retirement benefit paid to any particular retiree remained the same for the retiree's life, regardless of external economic changes.

In 1997, recognizing that a flat retirement benefit necessarily loses value over time, the Montana Legislature enacted the GABA through HB 170. 1997 Mont. Laws, Ch. 287 at 1337; § 19-3-1605, MCA. Initially, the GABA was a 1.5 percent increase in benefit, compounded annually. This meant that each January, the amount received by an individual retiree the preceding January was increased by 1.5 percent and that increased amount became the monthly benefit payable for the rest of the year. The following January, the benefit would increase another 1.5 percent. The GABA is not, strictly speaking, a cost-of-living adjustment (COLA) because it is not dependent on the actual cost of living at the time. Rather, the GABA is applied regardless of whether it is higher or lower than the change in the cost of living.

In 2001, the Montana Legislature increased the GABA to three percent. In 2007, the legislature changed the GABA to 1.5 percent for all new employees who began work after July 1, 2007, but left it at three percent for existing employees and retirees.

Leading up to the 2013 legislative session, the funding ratio of the PERS was 67 percent, meaning the fund was only able to meet 67 percent of its current liabilities. Facing no prospect of achieving actuarial soundness in the fund without legislative action, the 2013 Montana Legislature passed HB 454 which comprises a variety of reforms to the PERS. The bill allocates funds from the Coal Severance Tax account to the PERS trust fund and increases the employee and

employer contributions to the fund. These increased contribution rates will decrease once the amortization period for PERS falls below 25 years.

Section 5 of HB 454, the section to which AMRPE objects, decreases the GABA to 1.5 percent for all PERS members, whether currently working or already retired. Unlike the 2007 amendment, which applied only to new hires, HB 454 decreases the GABA for everyone, including retired public employees who had previously enjoyed a three percent GABA. Section 5 provides for further GABA decreases if the unfunded liability of PERS falls below 90 percent.

Upon application of AMRPE, the Court issued a preliminary injunction on December 20, 2013, enjoining the State from enforcing section 5 that amended § 19-3-1605, MCA, and reduced the GABA. Because HB 454 was to take effect on January 1, 2014, no decrease in the GABA has occurred.

## STANDARD OF REVIEW

"Summary judgment is appropriate if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." *Lewis & Clark County v. Hampton*, 2014 MT 207, ¶ 22, 376 Mont. 137, 333 P.3d 205 (citing M. R. Civ. P. 56(c)(3)).

The parties agree that the material facts are not in dispute and the issues may be resolved as a matter of law.

## ANALYSIS

AMRPE claims that HB 454 violates the contract clause of both the Montana and United States Constitutions because retired public employees have a contractual right to the GABA and, by unilaterally reducing the GABA, the legislature has impaired that right. Article II, section 31 of the Montana

Constitution provides, in part, "No . . . law impairing the obligation of contracts . . . shall be passed by the legislature." Article 1, section 10 of the United States Constitutions provides, in part, "No State shall . . . pass any . . . Law impairing the Obligation of Contracts."

**1. Level of Scrutiny**

The parties appear to dispute the level of scrutiny the Court must apply to claims of contract clause violations. AMRPE argues that the Court must apply strict scrutiny because the contract clause is found in article II of the Montana Constitution and the Montana Supreme Court has "repeatedly held that the rights enumerated in the Declaration of Rights (Article II) of Montana's Constitution are fundamental constitutional rights . . . that deserve the highest level of court scrutiny and protection." *Kortum-Managhan v. Herbergers NBGL*, 2009 MT 79, ¶ 25, 349 Mont. 475, 204 P.3d 693.

Without conceding the appropriateness of strict scrutiny, AMRPE argues in the alternative that, if not strict scrutiny, the Court should apply the three-part test for contract clause claims in *City of Billings v. County Water Dist. of Billings Heights*, 281 Mont. 219, 935 P.2d 246 (1997). In that case, the Montana Supreme Court held that the contract clauses of the Montana and United States Constitutions are "interchangeable guarantees against legislation impairing the obligation of contract," and articulated a test for claims of contract clause violations borrowed from the United States Supreme Court. *City of Billings*, 281 Mont. at 227, 935 P.2d at 251 (quoting *Carmichael v. Workers' Compens. Ct.*, 234 Mont. 410, 414, 763 P.2d 1122, 1125 (1988)).

The State notes that *Kortum-Managhan* dealt with the right to a jury trial, not a contract clause issue, and thus does not support the application of strict

scrutiny in this case. Instead, the State argues, the Court should apply the three-part contract clause test found in *Seven-Up Pete Venture v. State*, 2005 MT 146, 327 Mont. 306, 114 P.3d 1009. The test as articulated in *Seven-Up Pete* is identical to the *City of Billings* test. See *Seven-Up Pete*, ¶ 41.

Both *City of Billings* and *Seven-Up Pete* trace the roots of the test used to the Montana Supreme Court's decision in *Carmichael*. See *City of Billings*, 281 Mont. at 227, 935 P.2d at 251; *Seven-Up Pete*, ¶ 41. *Carmichael*, in turn, notes that the Montana Supreme Court regularly applies the three-tiered test used by the United States Supreme Court in *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, 459 U.S. 400 (1983), which applied the test announced in *U.S. Trust Co. of New York v. New Jersey*, 431 U.S. 1 (1977).

Without necessarily agreeing with the State that the general rule that all rights contained in Article II of the Montana Constitution are to be analyzed under strict scrutiny must give way to a more specific test applied to contract clause matters in both Montana and federal law, as discussed above, the Court will apply the three-part test used in *City of Billings* and *Seven-Up Pete* to determine whether HB 454 violates the contract clause of the Montana and United States Constitutions. *City of Billings*, *Seven-Up Pete*, *Carmichael*, *Energy Reserves Group*, and *U.S. Trust Co.* all use the same test. AMRPE's alternative argument for application of the test in *City of Billings* is not at odds with the State's position that the Court should apply the *Seven-Up Pete* test, because both cases apply the same test under Montana law.

The three-part test used in *City of Billings* and *Seven-Up Pete* to analyze the contract clause of the Montana and United States Constitutions requires the Court to consider: (1) Whether the state law is a substantial

impairment to the contractual relationship; (2) Whether the State has a significant and legitimate purpose for the law; and (3) Whether the law imposes reasonable conditions that are reasonably related to achieving the legitimate and public purpose. *City of Billings*, 281 Mont. at 228, 935 P.2d at 251; *Seven-Up Pete*, ¶ 41.

**2. Scope of the Contract**

Before applying the test, a court must identify the contractual right claimed to be impaired. *U.S. Trust Co.*, 431 U.S. at 17. Here, the Court must determine whether public employees have a contractual right to the GABA.

It is presumed that statutes do not create contractual obligations. *Wage Appeal of Mont. St. Hwy. Patrol Officers v. Bd. of Personnel Appeals*, 208 Mont. 33, 41, 676 P.2d 194, 199 (1984). "If contractual rights are to be created by statute, the language of the statute and the circumstances must manifest a legislative intent to create private rights of a contractual nature enforceable against the state." *Wage Appeal*, 208 Mont. at 41, 676 P.2d at 199. Durational or contractual words are suggestive of such legislative intent. *Justus v. State*, 336 P.3d 202, ¶ 29 (Colo. 2014).

The parties agree that at least some benefits are protected by a contract; the dispute is over the scope of that protection. Section 19-2-502(2), MCA, provides:

> Benefits and refunds to eligible recipients are payable pursuant to a contract as contained in statute. The contract is entered into on the first day of a member's covered employment and may be enhanced by the legislature. Unless specifically provided for by statute, the contract does not contain revisions to statutes after the time of retirement or termination of membership.

AMRPE argues that the contract comprises Chapters 2 and 3 of Title 19 of Montana Code Annotated, including § 19-3-1605, the GABA statute.

AMRPE urges application of the California rule as articulated by the California Supreme Court in *Betts v. Bd. of Admin. of the Pub. Employees' Ret. Sys.*, 582 P.2d 614 (Cal. 1978). "An employee's contractual pension expectations are measured by benefits which are in effect not only when employment commences, but which are thereafter conferred during the employee's subsequent tenure." *Betts*, 582 P.2d at 619. AMRPE asserts the GABA, therefore, is included as part of the pension benefits guaranteed to retired public employees by their contracts with the State.

The State argues for a significantly narrower construction. Section 19-2-502(2), MCA, provides that "*benefits and refunds* are payable pursuant to a contract" (emphasis added). There is no mention of the GABA. Section 19-2-303(10)(a), MCA, defines "benefit" as "the service retirement benefit, early retirement benefit, or disability retirement or survivorship benefit payment provided by a defined benefit retirement plan." The GABA is not mentioned in that definition. The service retirement benefit is calculated by a formula in § 19-3-904, MCA, that likewise does not refer to the GABA. Similarly, the formula for the early retirement, disability, and survivorship benefits do not refer to the GABA. See §§ 19-3-906, 19-3-1008, 19-3-1205, MCA. The contract contemplated by § 19-2-502(2), therefore, contains only the benefits defined as service retirement, early retirement, or disability or survivorship, not the GABA.

The Montana Supreme Court has not addressed the scope of a public employee's pension contract in regards to the GABA. Lacking direct precedent, the State directs the Court to *Wage Appeal*, in which the Montana Supreme Court held that highway patrol officers did not have a contractual right to a one percent yearly salary increase. In that case, the 1975 Montana Legislature supplanted a statewide pay plan that provided for one percent annual salary increases with a new

plan that provided for longevity increases of $10 per month for each five years of service. *Wage Appeal*, 208 Mont. at 35-36, 676 P.2d at 196. A group of highway patrol officers sued, claiming the new legislation impaired their contractual right to a one percent annual increase. The Montana Supreme Court rejected their argument, citing "the general rule that an employee's right to compensation vests or accrues only after he or she has performed the required services for that pay period." *Wage Appeal*, 208 Mont. at 42, 676 P.2d at 199. Because the officers had not yet worked and earned their salaries for future years, they were not contractually entitled to future salary increases. *Wage Appeal*, 208 Mont. at 43, 676 P.2d at 199.

The State argues that *Wage Appeal* supports the position that retired public employees have no contractual right to the GABA. But the GABA is different from a salary increase. Retired public employees have already worked their entire careers, unlike the officers in *Wage Appeal*. They have already performed the services that make up their half of the contract and are thus entitled to whatever compensation was promised by the State. Whether the GABA is part of that promised compensation must still be determined.

Other states' courts have considered whether members of a state's public pension system have contractual rights to various components of their benefits. The California Supreme Court held in 1978 that a pension is an element of compensation which vests upon acceptance of employment. *Betts*, 582 P.2d at 617. An employee does not have a right to fixed or specific benefits, but rather to a "reasonable pension." *Betts*, 582 P.2d at 617. The legislature may modify the benefits prior to retirement to maintain the integrity of the pension system as a whole, but if such modifications are to be reasonable, any resulting disadvantages

to employees must be offset by corresponding advantages. *Betts*, 582 P.2d at 617.

Betts was a retired state treasurer. He left office in 1967, and at that time California law calculated his pension by multiplying his years of service by the salary of the current treasurer.[4] In 1974, after Betts had left office but before he retired, the California Legislature changed the law so that his pension was calculated by multiplying his years of service by the highest salary *he* earned while in office. *Betts*, 582 P.2d at 615. The effect of this change was to substitute a fixed benefit for a fluctuating benefit; under the prior system, pensions would slowly increase as the salary of the current treasurer increased, while under the new system pensions would always remain the same.

Switching to a fixed benefit pension is a disadvantage to employees because it freezes the amount of their pensions. Because no corresponding advantages were granted by the change in the pension scheme, the California Supreme Court deemed the change unconstitutional as applied to Betts "because the amendment withdraws benefits to which he earned a vested contractual right while employed." *Betts*, 582 P.2d at 619. Betts' contractual right to pension benefits vested the day he began employment and included those benefits in effect at that time, as well as any beneficial modifications.

Nebraska has adopted the California rule. See *Calabro v. City of Omaha*, 531 N.W.2d 541, 551 (Neb. 1995) ("We now adopt the California rule in

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[4] Cal. Gov. Code § 9359.1(b) (1967) "The retirement allowance . . . is an annual amount equal to five percent (5%) of the compensation payable at the time payments of the allowance fall due, to the officer holding the office which the retired member last held prior to his retirement, or five percent (5%) of the highest compensation fixed for such office during the member's last term or any subsequent term prior to his retirement, whichever is greater, multiplied by [years of service credit]."

Nebraska and hold that a public employee's constitutionally protected right in his or her pension vests upon the acceptance and commencement of employment, subject to reasonable or equitable unilateral changes by the Legislature.").

The Arizona Supreme Court follows a similar rule that an employee is "entitled to have his retirement benefits calculated based upon the formula existing when he began employment, rather than a less-favorable formula subsequently adopted during his employment." *Fields v. Elected Officials' Ret. Plan*, 320 P.3d 1160, ¶ 27 (Ariz. 2014) (citing *Yeazell v. Copins*, 402 P.2d 541, 545 (Ariz. 1965)). Beneficial amendments automatically become part of an employee's contract because acceptance of the modification is presumed, but acceptance cannot be presumed when a modification is detrimental to the employee. *Thurston v. Judges' Ret. Plan*, 876 P.2d 545, 547-548 (Ariz. 1994).

A key difference between Arizona and Montana, however, is that as of 1998 Arizona's Constitution provides that "[m]embership in a public retirement system is a contractual relationship . . . and public retirement benefits shall not be diminished or impaired." Ariz. Const. art. 29, § 1. Montana's Constitution has no such provision that directly addresses the contractual nature of public retirement benefits.[5]

Other courts have determined that employees do not have contractual rights to post-retirement benefit adjustments. The United States District Court for the District of Maine held that "it is not clear and unmistakable that a 'cost-of-living adjustment' falls under the umbrella of [retirement benefits due]." *Me.*

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[5] Montana's constitutional provision on public employee retirement systems requires the systems be actuarially sound and directs the governing board of the PERS to administer the system as fiduciaries of system participants and their beneficiaries. Mont. Const. Art. VIII, § 15.

*Ass'n. of Retirees v. Bd. of Trustees. of the Me. Pub. Employees Ret. Sys.*, 954 F.Supp.2d 38, 53 (D. Me. 2013). The reason was that the relevant statute listed certain provisions of the Maine Retirement System as "solemn contractual commitments." The COLA provision was not included in that list and, therefore, the Court concluded that the legislature did not intend for COLAs to be part of the employment contracts. *Me. Ass'n. of Retirees*, 954 F.Supp.2d at 53.

Additionally, the COLA was based on the Consumer Price Index (CPI) and thus could fluctuate, leaving the possibility of a zero percent COLA. "Given the potential for variations in the payment to be made, the Court cannot conclude that Former Section 17801 included not-yet-determined COLAs under the umbrella of 'benefits' that could not be reduced." *Me. Ass'n. of Retirees*, 954 F.Supp.2d at 53.

Similarly, the Washington Supreme Court held that public employees did not have a contract right to an unalterable COLA because the statute authorizing the payment of COLAs explicitly reserved the legislature's right to modify or repeal it and specified that the statute did not create contractual rights.[6] *Wash. Educ. Ass'n v. Dept. of Ret. Sys.*, 332 P.3d 439, ¶ 6 (Wash. 2014). The New Mexico Supreme Court also found that COLAs were not contractually protected retirement benefits. COLAs were defined separately from the statute that defined the employee's retirement benefits, the legislature had amended the COLA statute numerous times in the past and, because the COLA was tied to the CPI and could be zero percent, the COLA was "antithetical to a vested . . . right." *Bartlett v. Cameron*, 316 P.3d 889, ¶ 22 (N.M. 2014).

[6] "The legislature reserves the right to amend or repeal this section in the future and no member or beneficiary has a contractual right to receive this postretirement adjustment not granted prior to that time." RCW 41.32.489(6) (1995).

The Colorado Supreme Court found that public employees were not contractually entitled to a COLA because there was "no contractual or durational language stating or suggesting a clear legislative intent to bind itself, in perpetuity, to paying [Public Employees' Retirement Association] members a specific COLA formula." *Justus*, ¶ 29. The Court compared the COLA statute to other laws it had previously determined created contractual rights, using words such as "entitled," "future," and "payable for the life of the retiree," and noted that the COLA statute did not contain any such language. *Justus*, ¶ 32. Moreover, the Court noted that "[b]y its very nature a statutory cost of living adjustment is a periodic exercise of legislative discretion that takes account of changing economic conditions in the state and/or nation." *Justus*, ¶ 24. The COLA statute had been amended numerous times over the years, switching at times between a fixed-percentage adjustment and an adjustment tied to the CPI. *Justus*, ¶¶ 8-11.

While these cases from other states are helpful to the Court's analysis, none address an identical situation to that in the present case. The GABA is not a COLA that is tied to economic factors outside the control of the legislature. It is a fixed percentage that compounds annually, regardless of market performance. In that sense, the GABA is unlike the COLAs in New Mexico, Maine, or Colorado which were not contractually protected because, in part, they were subject to the whims of the economy. See *Bartlett*, ¶ 22; *Me. Ass'n. of Retirees*, 954 F.Supp.2d at 53; *Justus*, ¶¶ 8-11.

The State contends that *Wage Appeal* is instructive here, and shows that there is no contract right to the GABA. But as noted above, *Wage Appeal* is factually distinguishable. Moreover, *Wage Appeal* does not describe a meaningful framework to analyze the language of a statute to determine whether it "manifest[s]

a legislative intent to create private [contract] rights." *Wage Appeal*, 208 Mont. at 41, 676 P.2d at 199. The Montana Supreme Court simply declares the "[n]either the circumstances nor the language of the statute suggest that a contractual obligation was intended to be created." *Wage Appeal* 208 Mont. at 41-42, 676 P.2d at 199. The Colorado Supreme Court in *Justus* suggested words such as "entitled," "future," and "payable for the life of the retiree," evince intent to create contractual rights. *Justus*, ¶ 32.

The Court concludes that the GABA statute uses language suggesting legislative intent to bind itself contractually. The statute provides that "the *permanent* monthly benefit . . . *must* be increased." Section 19-3-1605, MCA (emphasis added). See also § 19-3-1605(3), MCA (eligible retirees "*must receive* the minimum annual benefit adjustment . . ."). Notably, this language referring to "permanent benefits" that must be increased was present in the original version of the GABA statute as well as all later, amended versions. See 1997 Mt. HB 170, § 19-3-1605, MCA (2011), § 19-3-1605, MCA (2014). Even the title of the adjustment, the guaranteed annual benefit adjustment, suggests that the legislature intended to bind itself contractually.

Section 19-2-502, MCA, which specifies that PERS members have a contract right to benefits entered into on the first day of a member's covered employment, notes that the contract may be enhanced by the legislature. Unlike the Washington statutes at issue in *Wash. Educ. Ass'n.*, which explicitly permitted the Washington Legislature to modify or repeal them, the Montana statute limits the ability of future legislatures to alter benefits by use of the word "enhance," which means "to increase or improve." http://www.merriamwebster.com/ dictionary/enhance. This is different than reserving authority to modify or repeal

statutory elements of the contract and is in line with the California rule and Arizona cases holding that beneficial changes to an employment contract are presumed to be accepted by the employee. Here, the Montana Legislature enhanced the benefits payable to retirees under their employment contracts by instituting the GABA. Once that enhancement was made, it became part of the contract.

The Montana Legislature has, in other contexts, explicitly reserved the right to modify retirement benefits. Section 19-3-2106, MCA, provides that the provisions governing the defined contribution plan and university system retirement programs are subject to amendment by the legislature. "Employees choosing the defined contribution plan or university system retirement program . . . do not have a contract right to the specific terms and conditions specified in statute on the date the employee's choice becomes effective." *See also* section 19-3-1607, MCA, expressly providing that GABA does not apply to defined contribution retirees. "Unless otherwise explicitly provided in this part, none of the provisions of this part [GABA] apply under the defined contribution plan." In contrast, neither section 19-2-502 nor section 19-3-1605, the GABA statute, has such language.

The statement of intent accompanying HB 170, which established the GABA, bolsters this interpretation that the legislature intended to bind itself contractually to the GABA. "It is the intent of the legislature to guarantee a minimum level of annual benefit increases for retired members and their contingent annuitants or survivors under each of the statewide public employee retirement systems." 1997 Mont. Session Laws, Ch. No. 287 at 1338. The legislature could have described its intent in other ways that would suggest a

current policy choice, such as "give" a benefit increase, or "reward" retirees for their work. That the legislature chose the word "guarantee" indicates a promise to ensure that something will happen. Here, that something is the annual benefit increase called the GABA.

Publications produced by MPERA and distributed or made available to PERS members further support the interpretation that the GABA is part of the members' contract. A January 2007 newsletter states on the first page, "Your retirement benefits are a protected contract right. Proposed benefits changes will be for new members only." A PowerPoint presentation from an employee workshop put on by MPERA contains a slide titled Defined Benefit Retirement Plan Guarantees and lists two things: Guaranteed lifetime retirement income and the GABA. The 2001 PERS member handbook states that the "Guaranteed Annual Benefit Adjustment (GABA) will increase your retirement benefit every year." Other MPERA workbooks contain statements such as "The GABA ensures a 3% increase in your benefit from the previous year." Letters sent to employees upon retirement indicate that the retired employee "will receive [their] gross monthly retirement benefit for [their] lifetime. This benefit will increase by 3% each January . . . in accordance with the Guaranteed Annual Benefit Adjustment (GABA)."

These publications show that public employees were told before and after they retired that they could count on the GABA. Some of the publications specifically describe the GABA as a contract right. They discuss benefits and benefit increases in the same sentence, suggesting that the State's interpretation that "benefit" does not include the GABA is incorrect.

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By focusing on the definitions in § 19-2-303, MCA, the State engages in a myopic analysis that misses the point of the retirement system: to provide for people who have dedicated their careers to the State. It is true that § 19-2-303, MCA, does not mention GABA by name, but the GABA statute is part and parcel of the same title of the Montana Code Annotated. Section 19-2-502(b), MCA, provides that the benefits are "payable pursuant to a contract as contained in statute" without any further specification. The statutes do not limit the contract to the definitions in § 19-2-303, MCA.

The Court cannot conclude that "contained in statute" refers to only the definitions section or the section describing part of the formulae for calculating benefits. When the legislature created the GABA, it enhanced the retirement benefits for all PERS-eligible employees, working or retired, as § 19-2-502, MCA, contemplates may happen from time to time. The legislature did not reserve the right to reduce that enhancement in the future, nor did it declare that the GABA was not part of the contract. The legislature knew that public employees had a contractual right to retirement benefits and chose to guarantee an additional benefit beyond those in existence at the time. Given the structure and language of the relevant statutes, and the promises made to public employees, the Court concludes that the GABA is part of the contract between public employees and the state.

**3. Contract Clause Analysis**

Having determined that retired public employees have a contractual right to the GABA, the Court now proceeds to apply the three-part test for contract clause claims.

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### A. Substantial Impairment

The first part of the test is to determine whether HB 454 is a substantial impairment of that contractual right. "Total destruction of contractual expectations is not necessary, and a law which restricts a party to gains reasonably expected from a contract is not a substantial impairment. Further, the extent that the particular industry has been regulated in the past will modify the amount of impairment, if any." *Neel v. First Fed. Savings & Loan Ass'n. of Great Falls*, 207 Mont. 376, 392, 675 P.2d 96, 105 (1984) (citing *Energy Reserves Group*, 459 U.S. at 411).

AMRPE offers examples of things that other state and federal courts have found to be substantial impairments. The Ninth Circuit Court of Appeals held that a one- to three-day delay in the issuing of paychecks was a substantial impairment of public employees' collective bargaining agreement with the state.[7] *Univ. of Hawaii Prof'l Assembly v. Cayetano*, 183 F.3d 1096 (9th Cir. 1999). The West Virginia Supreme Court of Appeals found that a reduction in the COLA—part of West Virginia's public employee retirement benefits—was a substantial impairment to the contracts of current public employees who had spent sufficient time in the system to have relied, to their detriment, on the expectation of the higher COLA. *Booth v. Sims*, 456 S.E.2d 167 (W. Va. 1995). The Oregon

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[7] The State notes, correctly, that a collective bargaining agreement is not at issue in the present case. But the Ninth Circuit's analysis did not rest on the fact that the contract was a collective bargaining agreement. Rather, the Ninth Circuit focused on the "financial embarrassment and displacement" that could result from the employees' delayed receipt of their paychecks. *Univ. of Hawaii*, 183 F.3d at 1106.

Supreme Court found that modification of the assumed earning rate adjustment[8] on public pensions, which resulted in 12 to 20 percent decrease in monthly benefits, was a substantial impairment. *Strunk v. Pub. Employees Ret. Bd.*, 456 P.3d 1058, 1094 (Or. 2005).

The State focuses on the "extent of past regulation" aspect of *Neel*, arguing that retirement benefits are heavily regulated and the GABA statute has been amended several times since its inception. The State also argues that the constitutional requirement that PERS be funded on an actuarially sound basis means that AMRPE should have reasonably expected the GABA to change over time.

The Court is persuaded that, by reducing in the GABA from three percent to 1 percent, HB 454 constitutes a substantial impairment of retired public employees' contract rights. From a strictly financial point of view, the reduction in the GABA would have a substantial effect on the total value of payments a retiree could receive over his or her retirement—thousands of dollars in some cases. (See Pl.'s State. Undisputed Facts, Ex. 2, Aff. Mike O'Connor (Oct. 20, 2014).) This reduction in lifetime value of benefits payments is substantially greater than the lost value caused by a short delay in payment that was found to be a substantial impairment in *University of Hawaii*. There, the plaintiffs had only to wait a few

[8] Public employees who joined Oregon's Public Employee Retirement System before 1996 were entitled to a guaranteed minimum rate of return, called the assumed earnings rate, on their "regular" account, an individual account consisting of the employee's contributions and earnings from the Public Employee Retirement fund. Amounts calculated by the assumed earnings rate were credited to employee accounts each year. A 2003 change prohibited the crediting of employee according to the assumed earnings rate if doing so would cause a deficit in the fund. The Oregon Supreme Court found this change to be a substantial impairment of the employees' contracts. *Strunk*, 456 P.3d at 1072.

days to receive their pay, while here, if the GABA reduction is allowed to stand, retired public employees will never receive the money.

Moreover, reducing the GABA frustrates retired public employees' legitimate expectations. As described above, PERB distributed literature and held seminars and workshops that repeatedly assured employees that the GABA was guaranteed, not subject to the whims of the market, and something on which they could rely. Indeed, the named plaintiffs in this case relied on the three percent GABA when deciding when to retire or whether to purchase service credits. (See Pl.'s State. Undisputed Facts (Oct. 20, 2014): Ex. 18, Aff. Carole Carey; Ex. 20, Aff. Marlys Hurlbert; Ex. 22, Aff. I. Edward Sondeno.) This reliance was reasonable, given the reassurances they received from PERB.

Retired public employees reasonably expected that the GABA would not decrease, despite the fact that the GABA statute had been amended in the past, because the GABA had never been reduced, except for new hires. Section 19-2-502(2), MCA, provides that the contract may be *enhanced* by the legislature. An increase in the GABA percentage is exactly that—an enhancement. The past modifications, then, could not give employees notice that the GABA might be reduced in the future because all past modifications did only what the statute permitted: enhanced their contracts.

In 2007, the Montana Legislature reduced the GABA to 1.5 percent for employees hired after January 1, 2007. This further strengthens AMRPE's reasonable expectation that the GABA, as applied to them, would not decrease. The Montana Legislature decreased the GABA for new hires to help maintain constitutionally-mandated actuarial soundness in PERS, but it did so without modifying the GABA as applied to existing employees and retirees. This action

is in line with the understanding that an employee's contract entered into on the first day of employment includes the GABA. Public employees have a legitimate expectation that the GABA is part of their contracts with the State, and a reduction in GABA substantially frustrates that expectation.

Because the reduction of the GABA has the effect of significantly decreasing the amounts retired public employees reasonably expected to receive as pension payments under their employment contracts, the Court concludes that HB 454 operates as a substantial impairment to their contractual rights.

**B. Significant and Legitimate Purpose**

Part two of the test is a determination of whether there is a significant and legitimate purpose for the law, and here the parties agree that HB 454 has a significant and legitimate purpose. Article VIII, section 15 of the Montana Constitution requires that public retirement systems be funded on an actuarially sound basis, and the preamble to HB 454 states that it is an attempt to fulfill that constitutional duty. Plaintiffs "do not dispute the State's obligation to ensure PERS is actuarially sound is a compelling governmental interest." (Pl.'s Br. Supp. Mot. S.J. at 15 (Sept. 5, 2014).)

**C. Reasonably Related to Achieving that Legitimate Purpose**

The third part of the test is whether "the law impose[s] reasonable conditions which are reasonably related to achieving the legitimate and public purpose." *City of Billings*, 281 Mont. at 227, 935 P.2d at 251; *Seven-Up Pete*, ¶ 41. The Montana Supreme Court, the Ninth Circuit, and the United States Supreme Court have all included a "necessity" component in the analysis of the third prong. See *City of Billings*, 281 Mont. at 229, 935 P.2d at 252 ("an impairment may be constitutional if it is reasonable and necessary to serve an

important public purposes."); *Seven-Up Pete*, ¶ 40 (citing *City of Billings*); *Univ. of Hawaii*, 183 F.3d at 1106 ("We must next determine whether . . . the impairment was both reasonable and necessary to fulfill an important public purpose."); *U.S. Trust Co.*, 431 U.S. at 29 ("We can only sustain the repeal . . . if that impairment was both reasonable and necessary to serve the admittedly important purposes claimed by the State."). The burden is on the State to prove that the impairment was reasonable and necessary. *Univ. of Hawaii*, 183 F.3d at 1106.

The State argues that is does not need to prove necessity and refers to, without citing, *Seven-Up Pete*. *Seven-Up Pete*, however, quotes *City of Billings*, stating that "an impairment may be constitutional if it is reasonable *and necessary* to serve and important public purpose." *Seven-Up Pete,* ¶ 40 (quoting *City of Billings*, 281 Mont. at 229, 935 P.2d at 252) (emphasis added). The language in *City of Billings* in turn is a quote from *Buckman v. Montana Deaconess Hosp.*, 224 Mont. 318, 327, 730 P.2d 380, 385, which in turn quotes *U.S. Trust Co.*, 431 U.S. at 25. The element of necessity has always been a part of modern contract clause jurisprudence, and the State therefore must prove its action was necessary.

Though courts generally defer to the legislature's judgment, in this case "complete deference to a legislative assessment of reasonableness is not appropriate because the State's self-interest is at stake. . . . 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 Clause would provide no protection at all." *U.S. Trust Co.*, 431 U.S. at 26. See also *City of Billings*, 281 Mont. at 229, 935 P.2d at 252 ("[A] heightened level of scrutiny applies when a governmental entity is party to the contract."); *Seven-Up Pete*, ¶ 47 ("[W]e will not give complete deference to a legislative assessment and will apply a heightened

level of scrutiny when the State is a party to the contract or if its self interest is at stake.")

The State argues that heightened scrutiny is not applicable here and the Court should defer to the legislature's judgment because the State is not acting in its own self interest and HB 454 actually increases the State's obligations. Section 1 of HB 454 directs up to $21 million from the Coal Tax Severance fund to the PERS trust fund. Section 4 of HB 454 creates an additional employer contribution to PERS. Initially set at 1.27 percent of the employee's pay, the additional amount will increase by 0.1 percent each year. The additional payments, however, will terminate when the amortization period of unfunded liabilities in PERS is 25 years or less. As in *Seven-Up Pete*, where the challenged law prohibiting cyanide leaching in mining operations forced the State to forego millions in royalties from mines, the State argues here that because HB 454 increases funding obligations to PERS it cannot be in the State's self-interest.

Nevertheless, the cases both parties cite make clear the when the State is a party to the contract that is substantially impaired, complete deference to the legislature is inappropriate. And the State is clearly a party to the employment contracts of public employees. The Court, therefore, will not grant complete deference to the legislature and will instead apply a heightened level of scrutiny.

AMRPE argues that the reduction in the GABA was not reasonable because it "placed the entire burden of any unfunded liability [in PERS] primarily on the backs of the Retirees." (Pl.'s Br. Supp. Mot. S.J. at 15 (Sept. 5, 2014).) "[The] State is not completely free to consider impairing the obligations of its own contracts on a par with other policy alternatives. Similarly, a State is not free to impose a drastic impairment when an evident and more moderate course would

serve its purposes equally well." *U.S. Trust Co.*, 431 U.S. at 30-31.

Reducing the GABA is not reasonable, AMRPE argues, because there are numerous alternatives the legislature could have adopted to address the actuarial soundness of PERS, including:

1) Extending the amortization period beyond 30 years;

2) Adopt HB 454 as initially proposed, without GABA reductions;

3) Increase employer contributions;

4) Make a one-time payment to PERS from the General Fund reserves;

5) Divert money from other trust accounts, such as the Coal Severance Tax trust fund, the Montana Tobacco Settlement trust fund, or the Big Sky Economic Development trust fund, into PERS;

6) Increase revenue through taxes.

Even if alternatives might be "politically more difficult," the State is limited in its ability "to abridge its contractual obligations without first pursuing other alternatives." *Univ. of Hawaii*, 183 F.3d at 1107. The State offers no evidence or argument that it considered alternatives, but rather simply declares that "the rights and responsibilities of the parties were adjusted to ensure current employees and retirees continue to receive retirement benefits," and such action was "of a character appropriate to the public purpose." (Def.'s Comb. Resp. Pl.'s Mot. S.J. & Br. in Supp. Mot. S.J. at 18 (citing *Energy Reserves Group*, 459 U.S. at 412)).

There is no dispute that reducing the GABA helps make PERS actuarially sound. If the GABA were decreased, PERS has to pay out less money in benefits (nearly $700 million less, in this case). In that sense, reducing the

GABA bears a reasonable relationship to the admittedly important purpose of keeping PERS actuarially sound.

The test however requires "reasonable conditions" that are reasonably related to the public purpose. By reducing the GABA, the State has significantly decreased the benefit payments that retired public employees receive. Decreasing benefits for those who have already given their entire working life to the State, benefits to which they are contractually entitled, is not reasonable or necessary, when other broader remedies were available.

The Court thus concludes that reducing the GABA was not reasonable and necessary to achieve the legitimate purpose of maintaining actuarial soundness in PERS. The substantial impairment of contract rights caused by Section 5 of HB 454, therefore, is in violation of the contract clause of both the Montana and United States Constitutions. AMRPE is entitled to summary judgment and a permanent injunction.

Because the Court concludes that AMRPE is entitled to summary judgment on its contract clause claim, the Court declines to address AMRPE's takings claim.

**4. Attorney Fees**

AMRPE argues that it should be awarded attorney fees. The State did not address fees in its briefs or at oral argument.

"Montana follows the general American Rule that a party in a civil action is not entitled to attorney fees." *Trustees of Ind. Univ. v. Buxbaum*, 2003 MT 97, ¶ 19, 315 Mont. 210, 69 P.3d 663. However, in certain circumstances, a court may award attorney fees to the prevailing party. A "district court may award attorney fees in a declaratory relief action under § 27-8-313, MCA, only if

equitable considerations support that award." *Horace Mann Ins. Co. v. Hanke*, 2013 MT 320, ¶ 34, 372 Mont. 350, 312 P.3d 429. "While § 27-8-313, MCA[,] gives district courts the discretion to award 'further relief' in the form of attorney fees if a court determines such an award is 'necessary and proper,' implicit in that determination is a threshold question of whether the equities support a grant of attorney fees." *United Nat'l Ins. Co. v. St. Paul Fire & Marine Ins. Co.*, 2009 MT 269, ¶ 38, 352 Mont. 105, 214 P.3d 1260.

Here, AMRPE does not provide an argument as to how the equities support a grant of attorney fees. Only once has the Montana Supreme Court upheld an award of attorney fees under § 27-8-313, MCA, since it first interpreted the statute in *Trustees of Ind. Univ. v. Buxbaum*. In *Renville v. Farmers Ins. Exch.*, 2004 MT 366, 324 Mont. 509, 105 P.3d 280, the Montana Supreme Court upheld an award of attorney fees because the plaintiff, who prevailed in the case, would have been worse off than before she initiated the suit if the court had not awarded her fees. Here, the Court issued a preliminary injunction and the reduced GABA never took effect. All retired public employees have continued to receive the three percent GABA, and thus they would not be worse off than before filing suit but for an award of attorney fees.

The Court concludes that the equities do not support departure from the general rule that each party is responsible for its costs and declines to award attorney fees to AMRPE.

**IT IS ORDERED** that:

1. AMRPE's motion for summary judgment is GRANTED.
2. The State's motion for summary judgment is DENIED.

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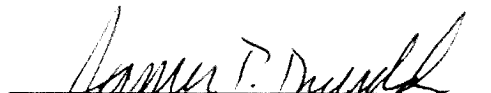
3. The State is permanently enjoined from enforcing the amendments to § 19-3-1605, MCA, contained in section 5 of HB 454, reducing the GABA for retired public employees.

4. AMPRE's request for the award of attorney fees is DENIED. Each party shall pay its own attorney fees.

***Let Judgment Be Entered Accordingly.***

DATED this 4 day of March 2015.



JAMES P. REYNOLDS
District Court Judge

c: Leo Berry/Chad Adams/Jessie L. Luther
Stuart Segrest

JPR/d