

IN THE SUPREME COURT OF THE STATE OF MONTANA
Supreme Court Cause No. DA 15-0554

EDWARD D. WRZESIEN and
LACEY VAN GRINSVEN, individually
and on behalf of all similarly situated persons,
and MEGAN ASHTON, individually,

Appellants

v.

STATE OF MONTANA and MONTANA
PUBLIC EMPLOYEE RETIREMENT
ADMINISTRATION,

Appellees.

**On appeal from the Montana First Judicial District Court
Cause No. DDV 2012-931
The Honorable James P. Reynolds, District Court Judge**

APPELLANT'S OPENING BRIEF

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I. STATEMENT OF ISSUES

- A. Did the district court correctly conclude that DB Plan participants and DC Plan participants are not members of similarly situated classes?
- B. Did the district court correctly conclude that state action is lacking?
- C. If addressed by the Court did, the district court err when it concluded that the Plan Choice Rate and the additional 1% employer contribution do not violate equal protection?
- D. Did the district court err when it concluded that the Plan Choice Rate and the additional 1% employer contribution do not violate substantive due process?

II. STATEMENT OF THE CASE

In 1999, the Montana Legislature decided to change the Montana Public Employees Retirement System (“PERS”) to add a defined contribution plan, which functions like what is commonly referred to as a 401(k).¹ PERS had historically offered only a defined benefit plan, more commonly referred to as a pension. Beginning July 1, 2002, PERS members could elect to participate in the Defined Benefit Plan (“DB Plan”) or the Defined Contribution Plan (“DC Plan”). Currently, each PERS member contributes 7.9% of pay to his or her respective plan. In addition to the employee contribution, all PERS members receive an employer contribution of 8.17%.

¹ PERS-eligible classified employees of the Montana University System were also given the option of participating in the Montana University Systems’ Optional Retirement Program, which had previously been available only to “academic and professional administrative personnel with individual contracts under the authority of the Board of Regents.” Mont. Code Ann. §19-21-201; Mont. Code Ann. §19-21-213.

While the DB Plan and the DC Plan are intended to be entirely separate, DC Plan participants, through a mechanism known as the Plan Choice Rate, see 2.37% of their employer contribution allocated to the DB Plan. In 2013, the Legislature directed all PERS employers to pay an additional 1.0% employer contribution, which was also allocated to the DB Plan for all PERS members. DC Plan participants, however, are prohibited from receiving benefits from the DB Plan.

On October 25, 2012, Edward Wrzesien and Megan Ashton filed suit challenging the Plan Choice Rate on equal protection and due process grounds. On October 4, 2013, an amended complaint was filed which added Lacey Van Grinsven² as a plaintiff and challenged the additional 1.0% employer contribution to the extent it was allocated to the DB Plan rather than to DC Plan participants' accounts. While brought as a class action, the parties and the district court agreed it would be most efficient to address the substantive issues before considering class certification. As such, the State filed a motion for summary judgment on March 28, 2014. Participants responded and filed a cross-motion on May 23, 2014. The district court held a hearing on the motions on October 7, 2014.

The district court entered an order granting the State's motion and denying Participants' cross-motion on November 13, 2014. For unknown and unexplained

² Unless context requires otherwise, Mr. Wrzesien, Ms. Ashton, and Ms. Van Grinsven will be referred to collectively as "Participants," while the State of Montana and Montana Public Employee Retirement Administration will be referred to collectively as "the State."

reasons, the order was not provided to the parties until August 2015, nearly nine months later. Final judgment was entered on August 6, 2015. The State served a notice of entry of judgment on August 11, 2015. On September 10, 2015, Participants filed a timely notice of appeal.

III. STATEMENT OF FACTS

A. PERS and the Plan Choice Rate.

PERS is established and governed by statute and covers the vast majority of state employees, employees of political subdivisions, and employees of other governmental entities. For most employees of participating employers, participation in PERS is mandatory. (District Court Docket Entry No. 21, ¶8) (hereinafter “(Dkt. No. __”)”); (Dkt. No. 25, ¶4). PERS is a single retirement system that includes two retirement plans, the DB Plan and the DC Plan. Mont. Code Ann. §19-3-103. Newly hired employees have one year to decide whether to participate in the DB Plan or the DC Plan, a decision that is irrevocable once made. Mont. Code Ann. §19-3-2111.

PERS members must contribute a statutorily-set amount toward their own retirement. Currently, the contribution rate for all members is 7.9%.³ Mont. Code

³ Before July 1, 2013, the employee contribution rate for PERS members was 6.9% for those hired before July 1, 2011, and 7.9% for those hired on or after July 1, 2011. The 2013 Legislature changed the employee contribution rate to 7.9% for all PERS members. Mont. Code Ann. §19-3-315(1)(a)(i)-(ii) (2011); Mont. Code Ann. §19-3-315(1) (2013).

Ann. §19-3-315(1)(a). In addition to the employee contribution, PERS employers must contribute a statutorily-set amount toward each employee's retirement. When the parties filed their motions, the "base" contribution was 6.9% of compensation. Mont. Code Ann. § 19-3-316(1). PERS employers also paid an additional contribution of 1.27%. Mont. Code Ann. § 19-3-316(3). For DB Plan participants, the entire employer contribution is paid into the DB Plan. Mont. Code Ann. §19-3-316. Once eligible, DB Plan participants receive a statutorily-established retirement benefit. Mont. Code Ann. §19-3-901 *et seq.* The retirement benefit is subject to annual increase and is paid for life – and potentially for the life of a beneficiary – regardless of the performance of investments in the DB Plan. Mont. Code Ann. §19-3-1201 *et seq.*; Mont. Code Ann. §19-3-1601 *et seq.*

Unlike DB Plan participants, who see their entire employer contribution used to fund the plan in which they participate, DC Plan participants see only 4.19% of the 6.9% "base" employer contribution paid into their respective retirement accounts. Of the base contribution, 2.37% is paid to the DB Plan through the Plan Choice Rate. Mont. Code Ann. §19-3-2117(2)(a).⁴ Yet DC Plan

⁴ For all PERS members, 0.30% of the employer contribution is allocated to a long-term disability plan trust fund and 0.04% is allocated to an education fund. Mont. Code Ann. §19-3-2117(2)(a). All PERS members are eligible to benefit from the disability plan and the education fund. Mont. Code Ann. §19-3-112; Mont. Code Ann. §19-3-2141.

participants are precluded from receiving benefits from the DB Plan. (Dkt. No. 21, ¶14); (Dkt. No. 25, ¶10).

Of the 1.27% “additional” employer contribution, 1% was previously allocated to the DB Plan, while the remaining 0.27% was allocated to the DB Plan until certain actuarial triggers were met, at which time the 0.27% would be allocated to the disability plan trust fund.⁵ Mont. Code Ann. § 19-3-2117(2)(b)-(c) (2013). Due to changes enacted by the 2015 Legislature, the entire 1.27% is now part of the Plan Choice Rate. Mont. Code Ann. §19-3-2117(2)(b)-(d), (3).⁶

B. The Montana University System’s Optional Retirement Program.

Classified employees of the Montana University System (“MUS”) are eligible to participate in PERS or MUS’s Optional Retirement Program (“ORP”).⁷ See Mont. Code Ann. §19-21-214. Classified employees who participate in PERS can choose the DB Plan or the DC Plan. Employee and employer contribution rates

⁵ For ease of reference, the additional 1% contribution and the Plan Choice Rate will be referred to collectively as “the Plan Choice Rate.” When context requires separate references, the additional 1% employer contribution will be referred to as “the 1% contribution.”

⁶ Participants did not challenge the allocation of the 0.27% employer contribution because, while it was paid to the DB Plan, it was scheduled to revert to the disability plan trust once certain triggers were met and DC Plan participants are eligible to receive benefits from the disability plan.

⁷ ORP was renamed the Montana University System Retirement Program in 2013. Because the parties and the district court referred to the program as ORP throughout the proceedings below, Participants will continue to use ORP. Unless context requires otherwise, the DC Plan and the ORP will be referred to collectively as “the DC Plan.”

for classified employees are the same as those for other public employees. Mont. Code Ann. §19-21-214. Classified employees who participate in ORP are subject to the Plan Choice Rate and the 1% contribution that applies to DC Plan participants.⁸ *Id.* Like the DC Plan, money obtained from the Plan Choice Rate and the 1% contribution obtained from classified employees participating in ORP is allocated to the DB Plan. *Id.* Classified employees who participate in ORP do not and cannot receive benefits from the DB Plan. (Dkt. No. 21, ¶20); (Dkt. No. 25, ¶15).

C. Participants and the Effect of the Plan Choice Rate.

As of December 31, 2012, there were 2,281 active participants in the DC Plan and 335 active participants in ORP. (Dkt. No. 43, Ex. 4, *Interrog. Nos. 1 & 2*).⁹ This is a fraction of the 28,401 active members of the DB Plan. (Dkt. No. 43, Ex. 5 at 60). In any given year since the DC Plan's inception, no more than 11% of PERS-eligible employees elected to participate in the DC Plan. (Dkt. No. 43, Ex. 4, *Interrog. No. 5*). The average participation rate has been under 8% per year and has trended downward since its peak in 2006. *Id.*

⁸ Classified employees who participate in the ORP have 4.49% of their compensation allocated to their respective retirement accounts. ORP participants are not subject to the 0.30% contribution to the disability plan trust.

⁹ The DC Plan and ORP had an additional 743 and 587 people, respectively, who were no longer contributing or who had withdrawn their contributions. (Dkt. No. 43, Ex. 4, *Interrog. Nos. 1 & 2*).

Participation in ORP has been even lower. *Id.* (Interrog. No. 6). The participation rate peaked at 3.21% in 2003, the year ORP was first available to MUS classified employees. *Id.* Other than 2003, the participation rate has never exceeded 3% and has averaged just 2.3%. *Id.*

Funds deposited in the DB Plan through the Plan Choice Rate are relatively insignificant. Between July 1, 2002, and March 22, 2013, \$21.68 million had been collected through the Plan Choice Rate and deposited in the DB Plan. (Dkt. No. 43, Ex. 4, *Interrog. No. 3*). During a similar period, July 1, 2003, through June 30, 2013, the State and participating employers contributed nearly \$749 million to the DB Plan. (Dkt. No. 50, Ex. 7 at 192-93). Total contributions to the DB Plan during that time, which include employee contributions, were \$1.48 *billion*. *Id.* As of June 30, 2013, the DB Plan had total assets of nearly \$4.5 billion. (Dkt. No. 43, Ex. 5 at 28). Thus, the total amount paid into the DB Plan through the Plan Choice Rate is less than one-half of one percent of the DB Plan's total assets.¹⁰

While the impact of the Plan Choice Rate on the DB Plan is small, the impact on DC Plan and ORP participants is enormous. The Plan Choice Rate and the 1% contribution compromise 41% of the total employer contribution. In real-life terms, this will leave DC Plan participants with significantly less money for

¹⁰ Because the State's discovery responses pre-dated the effective date of the 1% contribution, these figures do not include amounts allocated to the DB Plan through the 1% contribution.

retirement than they would have if they received the full value of their employer contributions.

To put numbers into the equation, as of March 31, 2014, Ms. Van Grinsven's DC Plan account had a balance of approximately \$60,000, with \$37,579 allocated to "employee" and \$22,562 to "employer." (Dkt. No. 43, Ex. A to Ex. 1). The difference between the "employee" and "employer" figures is the approximate additional amount Ms. Van Grinsven would have in her retirement account but-for the Plan Choice Rate and the 1% contribution. For Ms. Van Grinsven, the difference is approximately \$15,000, which is nearly 25% of the total value of her account. *Id.*

Ms. Ashton's and Mr. Wrzesien's situations are no different. As of March 31, 2014, Ms. Ashton's DC Plan account balance was approximately \$89,000, while Mr. Wrzesien had approximately \$49,000 in his ORP account. (Dkt. No. 43, Ex. A to Ex. 2); (Dkt. No. 43, Ex. A to Ex. 3). Ms. Ashton's account allocated \$53,564 to "employee" and \$32,351 to "employer." (Dkt. No. 43, Ex. A to Ex. 1). Mr. Wrzesien's account allocated \$29,926 to employee and \$19,244 to employer. (Dkt. No. 43, Ex. A to Ex. 3). The approximately \$21,000 difference in Ms. Ashton's account is nearly 25% of her account's total value. The approximately \$10,000 difference in Mr. Wrzesien's account is nearly 20% of his account's total value.

The impacts of the Plan Choice Rate on Participants' retirement accounts are significant now and will likely compound greatly over time. Assuming a conservative 6% annual rate of return, the current deficits in Ms. Van Grinsven's, Ms. Ashton's, and Mr. Wrzesien's accounts would grow to around \$86,000, \$120,000, and \$57,000, respectively. Using a 7.75% annual rate of return, the assumed rate of return applied to the DB Plan, the deficits would grow to around \$140,000, \$197,000, and \$93,000, respectively.¹¹ These figures are based solely on withholdings under the Plan Choice Rate and the 1% contribution as of March 31, 2014, amounts that have certainly grown since. As these figures demonstrate, while the Plan Choice Rate's contribution to the DB Plan is relatively insignificant, it has collectively cost Participants thousands upon thousands of dollars in contributions and potential investment gains, money that would otherwise – and should – be available to help fund their respective retirements. When considering DC Plan participants as a whole, the costs are in the millions.

¹¹ These figures were calculated based on a 30-year investment period with the stated rate of return compounded annually. Thirty years was used because, at the time, Participants were all in their 30s. The State did not challenge these calculations. Regardless, the Court can take judicial notice of the respective figures because calculation of investment returns is "capable of accurate and ready determination by resort to sources whose accuracy cannot be reasonably questioned." Mont. R. Evid. 201(b)(2).

D. Changes during the 2015 Legislature.

Despite the State's dire warning to the district court that ending the Plan Choice Rate could lead to a Detroit-style bankruptcy, the 2015 Legislature effectively did just that and has re-directed all employer contributions previously withheld under the Plan Choice Rate and the 1% contribution to DC Plan participants' individual accounts. *See* Mont. H.B. 107, 64 Leg., Reg. Sess. (March 27, 2015) (hereinafter "HB 107"), App., Tab 4. HB 107 was introduced by Representative Rob Cook at the request of the Public Employee's Retirement Board and amended § 19-3-2117, MCA, to redirect Plan Choice Rate funds and the 1% contribution "to the member's retirement account."¹² HB 107 at 9-10; Mont. Code Ann. § 19-3-2117(2)(d), (4). This change will occur when "the plan choice rate unfunded actuarial liability in the defined benefit plan is fully paid." Mont. Code Ann. § 19-3-2117(2)(d); *see also* Mont. Code Ann. § 19-3-2117(4). The Montana Public Employee Retirement Administration recently estimated that the alleged debt will be "fully paid off in the first quarter of 2016." Mont. Admin. R.

¹² A companion bill, Senate Bill 42, was introduced in the Senate by Senator Sue Malek. As originally introduced, each bill would have redirected Plan Choice Rate contributions to individual retirement accounts. The bills had some differences, but through the committee process were amended to be identical. SB 42 had a provision that it would be void if HB 107 became law. Mont. Sen. B. 42, 64th Leg., Reg. Sess. 11 (March 25, 2015), App., Tab 5. Like HB 107, SB 42 was supported by the Montana Public Employees Retirement Administration even in its original form. Mont. Sen. State Admin. Comm., Sen. B. 42, 64th Leg., Reg. Sess. (Jan. 14, 2015)(testimony of Dore Schwinden, Executive Director of Montana Public Employee's Retirement Administration).

Not. No. 2-43-536 2179, 2180 (Dec. 24, 2015), App., Tab 3. Thus, by the time the Court considers this appeal, employer contributions that previously had been directed to the DB Plan through the Plan Choice Rate and the 1% contribution likely will have been redirected to the individual accounts of DC Plan participants.¹³

IV. SUMMARY OF THE ARGUMENT

In 1999, the Montana Legislature opted to add a defined contribution plan to PERS, a system that previously had only a defined benefit plan. Beginning July 1, 2002, PERS members could choose between the DB Plan and the DC Plan. The two plans are supposed to be entirely separate.

Only for DC Plan participants, the plans are not entirely separate. Though not eligible to receive any benefit from the DB Plan, over 40% of DC Plan participants' employer contribution is allocated to the DB Plan. Since inception of the DC Plan, this has resulted in millions of dollars being diverted from the retirement accounts of DC Plan participants, individuals who fund their respective retirements as a known and fixed cost to the State and other public employers rather than requiring ongoing injections of funds.

¹³ This change in the law does not moot the appeal. In addition to a declaration that the Plan Choice Rate and the 1% contribution are unconstitutional, Participants seek the return of all amounts allocated to the DB Plan rather than the accounts of DC Plan participants.

Far from being a case of “buyer’s regret,” as the State argued in the district court, this is a case of fundamental fairness. Rather than fund the DB Plan in its own right, the State has burdened DC Plan participants with helping fund a plan from which they are legally precluded from obtaining any benefit. This has real consequences, as it leaves each DC Plan participant without tens, if not hundreds, of thousands of dollars that would otherwise be available for retirement. This system is fundamentally unfair, has no rational basis, and violates Participants and other DC Plan participants’ respective rights to equal protection and due process and the district court erred when it held otherwise. The Court should reverse the district court and remand this case for further proceedings.

V. ARGUMENT

The constitutionality of a statute is a question of law over which the Court exercises plenary review. *Jaksha v. Butte-Silver Bow County*, 2009 MT 263, ¶13, 352 Mont. 46, 214 P.3d 1248. While the party challenging a statute bears the burden of proving it unconstitutional, in an equal protection challenge, “the State must show that the objective of [the statute] is legitimate and rationally related to the classification used by the Legislature.” *See id.*, ¶¶13, 21.

A. The Plan Choice Rate and the 1% contribution violate Participants rights to equal protection.

Montana’s Constitution mandates that “[n]o person shall be denied the equal protection of the laws.” Mont. Const., Art. 2, § 4. “Equal protection provides a

check on governmental action that treats similarly situated persons in an unlike manner.” *Caldwell v. MACo Workers’ Comp. Trust*, 2011 MT 162, ¶14, 361 Mont. 140, 256 P.3d 923. Analyzing an equal protection challenge requires a three-step process through which the Court must: (1) determine whether the challenged statute creates similarly situated classes; (2) determine the appropriate level of scrutiny; and (3) apply the level of scrutiny to evaluate the constitutionality of the challenged statute. *Id.*, ¶¶14-15, 20-22.

1. The district court incorrectly concluded that DB Plan participants and DC Plan participants are not members of similarly situated classes.

Persons who are similarly situated regarding a legitimate government purpose must receive like treatment. *Oberson v. U.S. Dept. of Agric.*, 2007 MT 293, ¶19, 339 Mont. 519, 171 P.3d 715. When addressing an equal protection challenge, courts “must first identify the classes involved and determine whether they are similarly situated.” *Powell v. State Comp. Ins. Fund*, 2000 MT 321, ¶22, 302 Mont. 518, 15 P.3d 877. Courts “do not operate on a blank slate regarding the appropriate classification for [] equal protection analysis.” *Caldwell*, ¶19. Courts instead consider “the statute’s purpose in order to determine the threshold question of whether the statute created a discriminatory classification – i.e. a classification that treats two or more similarly situated groups in an unequal manner.” *Id. quoting Oberson*, ¶19.

The Court has found similarly situated classes in a wide variety of situations and should do the same here. In *Reesor v. Montana State Fund*, for example, the plaintiff challenged the constitutionality of a statute that placed an age limitation on eligibility for permanent partial disability (PPD) payments through the state's workers' compensation scheme. 2004 MT 370, ¶1, 325 Mont. 1, 103 P.3d 1019. Under the statute at issue, an injured worker who was retired was ineligible for PPD payments. A person was considered retired if he was receiving or was eligible to receive full social security retirement benefits. *Id.*, ¶¶8-9.

The plaintiff argued that the statute created two similarly situated classes: (1) persons eligible for PPD benefits who receive or are eligible for social security retirement benefits; and (2) persons eligible for PPD benefits who do not receive and are not eligible to receive social security retirement benefits. *Id.*, ¶10. The State Fund argued that the classes were not similarly situated, but the Court disagreed. *Id.*, ¶12. Specifically, the Court found "both classes have suffered work-related injuries, are unable to return to their time of injury jobs, have permanent physical impairment ratings, and must rely on § 39-71-703, MCA, as their exclusive remedy under Montana law." *Id.* As such, the classes were similarly situated.

Henry v. State Compensation Insurance Fund is also instructive. In *Henry*, the plaintiff challenged the unavailability of rehabilitation benefits under the

Occupational Disease Act. 1999 MT 126, ¶9, 294 Mont. 449, 982 P.2d 456. The plaintiff argued that it was a violation of equal protection for the Legislature to provide vocational rehabilitation benefits to injured workers covered under the Workers' Compensation Act, while denying the same benefits to injured workers covered under the Occupational Disease Act. *Id.*, ¶1. Generally, a worker who sustained an acute on-the-job injury would be covered under the Workers' Compensation Act, while a worker who developed a condition over two or more work shifts would be covered through the Occupational Disease Act. *Id.*, ¶¶18-21.

The plaintiff in *Henry* argued that the two acts created two similarly situated classes: (1) workers who suffered a work-related injury on one work shift; and (2) workers who suffered a work-related injury on more than one work shift. *Id.*, ¶27. The State Fund countered "that the two classes are not similarly situated because each class is required to seek benefits under a separate legislative enactment." *Id.*, ¶28. The Court concluded that the State Fund "misse[d] the point," as the important facts were that both classes of individuals suffered work-related injuries, were unable to perform their former jobs, needed rehabilitation benefits to return to work, and had their sole source of redress under the Workers' Compensation Act or Occupational Disease Act. *Id.* The Court, therefore, concluded that the classes were similarly situated for purposes of equal protection. *Id.*

Like the statutes in *Reesor* and *Henry*, the Plan Choice Rate creates two similarly situated classes: (1) public employees who are eligible to participate in PERS, participate in the DB Plan, and have the full amount of their employer contribution paid into the retirement plan in which they participate; and (2) public employees who are eligible to participate in PERS, participate in the DC Plan or ORP, and do not have the full amount of their employer contribution paid into the retirement plan in which they participate. The classes are similarly situated because both are made up of public employees, both participate in retirement plans available to PERS members, and both receive an employer contribution equal to 8.17% of salary. Only DC Plan and ORP participants see over 40% of their employer contributions allocated to the DB Plan, a plan from which they are precluded from receiving any benefit. DB Plan participants, on the other hand, see the full value of their employer contributions paid into the plan in which they participate.

The district court defined the classes differently and, for equal protection analysis, incorrectly. Specifically, the district court defined the classes as:

risk-adverse state employees who wish to forego any potential investment gain in favor of a known, guaranteed retirement benefit, and risk-accepting state employees who wish to maintain control over how their retirement funds are invested.

(Dkt. No. 53 at 16). While this may or may not accurately describe PERS members' risk acceptance, it does not address the classifications *created by the*

statute. The district court's classifications focus on the perceived differences in acceptance of risk and, to a lesser extent, differences in benefits conferred by the DB Plan and the DC Plan. But Participants' claims are not based on differences in benefits, differences in risk, or differences in the structures of the two plans. The claims challenge how employer contributions are allocated for members of each plan. All PERS members participate in the same retirement system. Mont. Code Ann. § 19-3-103(3). All PERS members receive the same employer contribution. All PERS members should see their entire employer contribution paid to the plan in which they participate. Yet, only DC Plan participants have part of their employer contribution allocated to a plan from which they cannot benefit.

The district court also concluded that the 8.17% employer contribution "is not the employee's money." (Dkt. No. 53 at 16). In reaching this conclusion, the district court relied on the statement in § 19-3-316, MCA, that "[e]ach employer shall contribute to the system." *Id.* While employer contributions are not paid directly to the employee, they are made on the employee's behalf. *See e.g.* Mont. Code Ann. § 19-3-316(1) ("[e]mployer contributions *for members under the defined contribution* plan must be allocated as provided in 19-3-2117 (emphasis added)).

Furthermore, if the employer contribution is not a benefit conferred to each employee, there would be no reason for the Plan Choice Rate to exist. Instead, the

Legislature would have directed that DC Plan participants receive a 4.17% employer contribution and required the State and other participating employers to pay a larger contribution for DB Plan participants. There would be no reason to create the appearance of “costs” incurred by DC Plan participants and a “fee” to repay those costs. The district court’s conclusion effectively renders the Plan Choice Rate a nullity.

The district court’s conclusion also disregarded evidence before it that the State represents that all PERS members receive the same employer contribution as a benefit conferred to the employee. *See e.g.* (Dkt. No. 35, Ex. 4A at 9) (noting that both the employer and the employee make contributions to fund future retirement income from the DB Plan and that the “Employer Contributions” are 6.9% of compensation); (*id.* at 16) (noting that with the DC Plan, “both the employer and the employee make contributions to fund a future retirement account balance for the participant and that the gross employer contribution is 6.9% of compensation); (*id.* at 99) (referencing the “Allocation of 6.9% Employer Contribution”). Evidence before the district court also established that the State credits Ms. Ashton and Ms. Van Grinsven with a full 8.17% employer-paid retirement contribution each time they are paid. There would be no reason for the State to discuss “gross” and “net” employer contributions, nor would there be any reason for the full 8.17% employer

contribution to show up on a paystub, if the employer contribution is not a benefit conferred upon each employee.

As in the district court, the State will likely rely on *Bean v. State* to urge the Court to affirm the district court. While *Bean* involved an equal protection challenge to a retirement plan statute, the similarities end there. In *Bean*, the Legislature sought to correct a “longstanding inequity” between Montana Air National Guard firefighters and other firefighters in Montana. 2008 MT 67, ¶¶2-3, 342 Mont. 85, 179 P.3d 524. As a result, Guard firefighters hired after October 1, 2001, were enrolled in the Firefighters’ Unified Retirement System while Guard firefighters hired before October 1, 2001, remained in PERS. *Id.* ¶7. As a Guard firefighter hired before October 1, 2001, the plaintiff in *Bean* was required to remain in PERS, which he contended offered inferior benefits. *Id.*, ¶¶8-10.

In addressing the plaintiff’s equal protection challenge, the Court determined that the statute at issue in *Bean* created *two separate retirement systems* for Guard firefighters: one for those hired before October 1, 2001, and one for those hired after October 1, 2001. *Id.*, ¶17. The Court concluded that, while there was inequity between the classes, the statutory change “operate[d] equally upon members of each class of firefighters.” *Id.*, ¶20.

Bean does not apply here because the Legislature did not create a new retirement *system* when it created the DC Plan and allowed MUS classified

employees to participate in ORP. Rather, the Legislature created a new retirement *plan* within the same system. See Mont. Code Ann. § 19-3-103 (“The public employees’ retirement *system* consists of the defined benefit plan and the defined contribution plan” (emphasis added)). As in *Bean*, the Legislature could have required all public employees hired after July 1, 2002, to enroll in the DC Plan. It also could have altered the employer contribution for all employees hired after July 1, 2002. The Legislature chose not to do so, and instead created a new retirement plan within the same system. The Legislature was, therefore, obligated to treat participants in the two plans similarly, yet, through the Plan Choice Rate, the Legislature attempted to do indirectly what it could not do directly: grant those who participate in the DC Plan a lesser employer contribution. To be sure, the Legislature would not be able to create a statutory scheme under which DB Plan participants receive an 8.17% employer contribution while DC Plan participants receive something less. Yet that is precisely what the Legislature did indirectly through the Plan Choice Rate.

In ruling that the two classes are not similarly situated, the district court addressed matters other than the classifications created by statute. Type and payment of benefits are not issues in this case. The issue is allocation of employer contributions, for which there can be no question the classes are similarly situated. Accordingly, the district court erred when it concluded otherwise.

2. State action is not lacking because the State enacted the scheme that allows employer contributions of DC Plan participants to be paid into a plan from which they can receive no benefit.

The district court concluded that state action is lacking because the State's action "is limited to providing options, educating employees as to the benefits and consequences of each option, and placing all employees into the same class if they do not decide for themselves." (Dkt. No. 53 at 13). This ignores that the State established the DC Plan, the Plan Choice Rate, the 1% contribution, and the system that directs contributions to a retirement plan from which Participants are statutorily precluded from benefiting. That the State gives PERS members the opportunity to choose their retirement plan does not eliminate state action.

By focusing on the decision to participate in the DC Plan rather than the way employer contributions are allocated, the Court gives an unfair system a pass. Participants did not create the system that allows some members to receive the full benefit of their employer contribution while others see a significant portion of their employer contribution paid into a plan from which they will see no benefit. Participants simply made an election the State required them to make.

Under the district court's rationale, the concept of equal protection could be thrown out the window, as almost every statute involves some element of choice. For example, the State could pass a law making it illegal for women to vote in Billings. Because people choose where to live, there would be no state action.

More germane to this case, if the focus is on the choice of an employee rather than the effect of the law, the State could arbitrarily require some DC Plan participants to pay a higher Plan Choice rate without running afoul of equal protection. That public employees are required to choose a retirement plan, either directly or indirectly, does not insulate the State from treating employees in a fair and consistent manner.

The Court has found statutes violate equal protection even when some element of choice is involved. In *Oberson*, for example, the court found portions of Montana's snowmobile liability statute violated equal protection, though riding a snowmobile is undoubtedly a choice. *Oberson*, ¶22. In *Brewer v. Ski-Lift, Inc.*, the court concluded that portions of Montana's skier responsibility statutes violated equal protection. 234 Mont. 109, 116, 762 P.2d 226, 231 (1988). Like snowmobiling, skiing is a choice. See also e.g. *Lugar v. Edmondson Oil Co., Inc.*, 457 U.S. 922, 941 (1982) ("While private misuse of a state statute does not describe conduct that can be attributed to the State, *the procedural scheme created by the statute obviously is the product of state action*" (emphasis added)).

The district court dismissed analogies to *Oberson* and *Brewer* because "the nature of the choice in those cases is quite different than the nature of the choice here." (Dkt. No. 53 at 13). The district court did not explain this statement. And, yet, there is no difference. In *Oberson* and *Brewer*, as here, the Legislature created

a statutory scheme that has been challenged. Like Participants, who could have opted to participate in the DB Plan, the plaintiffs in *Oberson* and *Brewer* could have chosen to participate in activities that were not governed by a heightened liability standard. They did not do so, yet the Court still held the statutes violated equal protection. Because Participants challenge how the State allocates employer contributions of DC Plan participants, a decision made solely by the State, Participants decision to participate in the DC Plan rather than the DB Plan is irrelevant and does not eliminate state action.

3. While ensuring the DB Plan is actuarially sound is a legitimate state interest, the Plan Choice Rate is not rationally related to achieving that interest.¹⁴

To satisfy rational basis, a statute must bear a rational relationship to a legitimate governmental interest. *Caldwell*, ¶23. It is the State's obligation to show that the objective of a statute "is legitimate and rationally related to the classification used by the Legislature." *See Jaksha*, ¶21 ("In order to survive rational basis review, the State must show that the objective of §7-33-4107, MCA, is legitimate and rationally related to the classification used by the Legislature"). Cost containment presents a legitimate state interest, however, it cannot be the sole

¹⁴ Because the district court concluded that state action was lacking and the classes are not similarly situated, it did not address whether the Plan Choice Rate and the 1% contribution are rationally related to achieving an actuarially sound DB Plan. If the Court concludes there was state action and the classes are similarly situated, it should remand the case to the district court. Participants include this argument in case the Court decides to consider the issue.

reason for disparate treatment. *Caldwell*, ¶34. Cost alone is insufficient to justify the disparate treatment of similar classes.” *Id.*, ¶48 quoting *Satterlee v. Lumberman’s Mut. Cas. Co.*, 2009 MT 368, ¶29, 353 Mont. 265, 222 P.3d 566. If courts were to allow otherwise, “‘cost containment’ alone could justify nearly every legislative enactment without regard for the guarantee of equal protection of the law.” *Caldwell*, ¶34. Though stated in the context of workers’ compensation benefits, the following pronouncement applies equally to retirement plans:

Not surprisingly, discrimination in the form of “offering services to some while excluding others for any arbitrary reason, will *always* result in lower costs.” We must scrutinize attempts to disguise violations of equal protection as legislative attempts to “contain the costs” or “improve the viability” of the worker’s compensation system. Cost alone does not justify the disparate treatment of similar classes.

Id., ¶35 (citations omitted).

In *Caldwell*, the Court addressed the constitutionality of §39-71-710, which denied access to rehabilitation benefits based solely on the claimant’s age-based eligibility for social security benefits. *Id.*, ¶¶7, 10. The defendant, MACo Workers’ Compensation Trust (“MACo”), and amicus Montana State Fund (“MSF”) offered seven “interests” to support the categorical elimination of rehabilitation benefits. *Id.*, ¶37. The Court addressed each and concluded that they “either (1) duplicate the cost-containment interest or (2) bear no relation to the elimination of rehabilitation benefits in §39-71-710, MCA.” *Id.*, ¶48. Ultimately, the Court

concluded that the categorical elimination of benefits “serve[d] no legitimate governmental interest, other than cost-containment, and therefore violate[d] equal protection.” *Id.*

Among the seven “interests” put forth by MACo and MSF were “assisting the worker at a reasonable cost to the employer”; “controlling the costs of the workers’ compensation program in order to continue providing benefits”; and “creating reasonably constant rates for employers.” *Id.*, ¶37. The Court specifically found that each of these purported interests simply duplicated the interest in cost-containment. *Id.*, ¶¶39-40, 43. The Court rejected the notion that the legislature could “eliminate benefits from one class of people *in order to* continue providing benefits to another class of similarly situated people.” *Id.*, ¶43 (emphasis in original).

Caldwell makes clear that it is bedrock law in Montana that cost containment cannot be the sole reason for disparate treatment. And yet, the sole reason the State offered to justify the Plan Choice Rate was “to ensure the actuarial soundness of the DB Plan.” (Dkt. No. 34 at 28). Participants agree that ensuring the actuarial soundness of the DB Plan is a legitimate state interest. The State’s means of doing so – the Plan Choice Rate – simply is not rationally related to that interest and is nothing more than cost containment dressed up as a different interest.

Before the district court, the State asserted two reasons the Plan Choice Rate is necessary: (1) to pay past unfunded liability obligations and (2) to compensate the DB Plan for increased costs that result from PERS members selecting the DC Plan. (*Id.* at 29). The State never explained or otherwise supported either assertion, and the latter turned out to be wrong. *See* H.B. 107 at 2 (“WHEREAS, the normal cost of benefits in the PERS-DBRP *has never significantly changed* because of PERS members selecting the PERS-DCRP” (emphasis added)).

To the extent the State claimed the Plan Choice Rate is necessary to compensate the DB Plan for “past unfunded liability obligations,” this was taken into account when the DC Plan was created. People who were active members of PERS “the day before the effective date of the defined contribution plan” who elected to transfer to the DC Plan were permitted to transfer only a portion of their employer contributions. Mont. Code Ann. §19-3-2114(1). The amount eligible for transfer depended upon years of service, with the maximum amount capped at 65.53% for those with fewer than five years of service. Mont. Code Ann. §19-3-2114(1)(b). Those with longer terms of service were allowed to transfer an even smaller percentage of their employer contributions. *Id.*

The various percentages were based upon “the contribution amount historically available to pay unfunded liabilities in the defined benefit plan.” *Id.* In other words, PERS members who elected to transfer to the DC Plan when it went

into effect had their employer contributions reduced *to take into account unfunded liabilities in the defined benefit plan*. PERS members hired after the DC Plan went into effect cannot have contributed to, and therefore cannot be responsible for, unfunded liabilities in the DB Plan that pre-date their employment. To the extent the State claimed that paying past unfunded liability obligations is a rational basis for the Plan Choice Rate, it was incorrect.

Though contradicted by subsequent legislation in which it was involved, the State also failed to explain its contention that the Plan Choice rate is necessary to compensate the DB Plan for increased costs created by participants in the DC Plan. The State did not identify any costs that the DB Plan incurred. Indeed, it would be difficult to conclude that DC Plan participants cause the DB Plan to incur costs when they receive no benefits from the DB Plan.

The only conceivable argument would be that DC Plan participants “cost” the DB Plan by not paying into it. The Plan Choice Rate is purportedly designed to reimburse the DB Plan for “normal cost rate changes . . . resulting from member selection of the defined contribution plan.” Mont. Code Ann. §19-2-303. The normal cost is “an amount calculated under an actuarial cost method required to fund accruing benefits for members of a defined benefit retirement plan during any year in the future.” Mont. Code Ann. §19-2-303(34). The change in the normal cost rate is:

an amount equal to the difference between the normal cost contribution rate in the defined benefit plan that would have resulted if all system members remained in the defined benefit plan and the normal cost contribution rate in the defined benefit plan for the actual members of the defined benefit plan, multiplied by the compensation paid to all of the members in the defined benefit plan, divided by the compensation paid to all of the members in the defined contribution plan.

Mont. Code Ann. §19-3-2121(3).

In plain English, the normal cost is the amount necessary to fund benefits for participants in the DB Plan. The Plan Choice Rate holds DC Plan participants responsible for changes to the normal cost, which is the difference between what the normal cost actually is and what it would be if all PERS members participated in the DB Plan. The problem with this analysis, and this justification for the Plan Choice Rate, is it does not take into account that DC Plan participants do not obtain benefits from the DB Plan. In other words, the Plan Choice Rate counts the lack of contributions from DC Plan participants as a “cost,” but does not take into account savings that accrue from not being obligated to pay benefits to DC Plan participants.

This exposes the Plan Choice Rate for what it is: a cost containment measure. The Plan Choice Rate was concocted, not to assess costs to those who caused them to be incurred, but to offer additional funding for the DB Plan without increasing the cost to DB Plan participants, the State, or other public employers. The State could have chosen to fund the DB Plan by requiring additional

contributions from employers, appropriations from the general fund, or any number of methods, something it has done on more than one occasion. *See e.g.* Mont. H.B. 454, 63d Leg. (*eff.* July 1, 2013) (appropriating up to \$36 million in funds annually for PERS through unallocated portions of coal tax severance collections and interest income from the coal tax permanent fund); Mont. H.B. 1, 59th Leg. Spec. Session (*eff.* July 1, 2006) (appropriating \$25 million from the general fund to the public employee's retirement system pension trust fund). Instead, it chose to make employees who are statutorily precluded from receiving benefits pay into the DB Plan, with the sole reason being to eliminate additional costs. This is precisely what Montana's Equal Protection Clause is designed to prevent. *See Caldwell*, ¶¶33-48.

There is even less justification for allocating the 1% contribution to the DB Plan. The 2013 Legislature enacted the 1% contribution and allocated all funds to the DB Plan solely to provide additional funds for the DB Plan. The only conceivable justification for requiring DC Plan participants to contribute this amount rather than enacting some other method of "shoring up" the DB Plan is cost containment. Like the Plan Choice Rate itself, there is no rational basis for allocating the 1% contribution to the DB Plan rather than to DC Plan participants.

As in the district court, the State will likely rely on *Farrier v. Teacher's Retirement Board* to support its position that the Plan Choice Rate is rationally

related to the State's interest in keeping the DB Plan actuarially sound. The State construed *Farrier* in a simplistic and overly broad manner.

In *Farrier*, the plaintiff challenged a law that precluded him from receiving benefits from the Teachers Retirements System while he was also employed by the University of Montana and was contributing to the University System's Optional Retirement Program. 2005 MT 229, ¶¶7-9, 328 Mont. 375, 120 P.3d 390. The issue before the Court was whether it was rational for the Legislature to preclude a person from drawing benefits from one public pension, while at the same time drawing a public salary and accruing a second public pension. *See id.*, ¶20. The Court determined it was rational to do so. *Id.*, ¶21.

This case does not involve payment or receipt of benefits, nor does it involve eligibility to participate in a second public pension plan. The issue, instead, is whether all PERS members are entitled to have the full value of their employer contributions paid into the retirement plan in which they participate. *Farrier* and the generalized language the State relies upon do not determine these issues.

There is no rational basis for allocating money from employer contributions to DC Plan participants to the DB Plan. Consequently, the Plan Choice Rate and the allocation of the 1% contribution violate Participants' rights to equal protection under the Montana Constitution.

B. The Plan Choice Rate and the 1% contribution violate due process because they are unreasonable and arbitrary and are not rationally related to keeping the DB Plan actuarially sound.

The Montana Constitution guarantees that no person shall be deprived of life, liberty, or property without due process of law. Mont. Const., Art II, §17. The due process guarantee has both a procedural and substantive component. *State v. Egdorf*, 2003 MT 264, ¶19, 317 Mont. 436, 77 P.3d 517. “Substantive due process bars arbitrary governmental actions regardless of the procedures used to implement them and serves as a check on oppressive governmental action.” *Id.*; *see also Hardy v. Progressive Specialty Ins. Co.*, 2003 MT 85, ¶35, 315 Mont. 107, 67 P.3d 892 (“Substantive due process prohibits the state from taking unreasonable, arbitrary or capricious action”). As the Court has often recognized:

The theory underlying substantive due process reaffirms the fundamental concept that the due process clause contains a substantive component which bars arbitrary governmental actions regardless of the procedures used to implement them, and serves as a check on oppressive governmental action.... Substantive due process primarily examines underlying substantive rights and remedies to determine whether restrictions are unreasonable or arbitrary when balanced against the purpose of the legislature in enacting the statute.

Egdorf quoting *Newville v. State*, 267 Mont. 237, 249, 883 P.2d 793, 800 (1994).

Substantive due process analysis measures the reasonableness of a statute versus the State’s power to enact the legislation. *Egdorf*, ¶21. To survive a substantive due process challenge, a statute (1) must be related to a legitimate

government concern and (2) “the means chosen by the Legislature to accomplish its objective [must be] reasonably related to the result sought to be obtained.”

Walters v. Flathead Concrete Products, Inc., 2011 MT 45, ¶17, 359 Mont. 346, 249 P.3d 913. The Court has “adopted a three-part test for determining whether a statute has exceeded the restraints imposed upon it by substantive due process.”

Town Pump, Inc. v. City of Red Lodge, 1998 MT 294, ¶19, 292 Mont. 6, 971 P.2d 349. Specifically, the legislation must:

(a) seek to achieve a legitimate governmental purpose; (b) use means that are rationally related thereto; and (c) be neither arbitrary nor unreasonable in its effects.

Id.

In both *Newville* and *Hardy*, the Court determined that statutes ran afoul of substantive due process guarantees. In *Newville*, the plaintiff challenged the constitutionality of Montana’s comparative negligence statute, which at the time permitted a jury to apportion negligence to non-parties. 267 Mont. at 247, 883 P.2d at 799. While the Court recognized that “reasons for enactment of comparative negligence tort reform legislation are valid governmental purposes,” the Court nevertheless determined that the Montana Legislature acted “arbitrarily and unreasonably” in the way it responded to the need. *Id.* at 254-55, 883 P.2d at 803. The Court found the statute imposed a burden on plaintiffs to anticipate defendants’ attempts to apportion blame up to the time of submission of the verdict

form to the jury. *Id.* at 252, 883 P.2d at 802. Ultimately, the Court concluded that the statute violated the substantive due process rights of plaintiffs in negligence actions. *Id.*

In *Hardy*, the Court also concluded that the state had a legitimate interest in the purpose asserted to support a statute, but held that the statute violated substantive due process. In *Hardy*, the plaintiff challenged the constitutionality of an “anti-stacking” statute. *Hardy*, ¶¶30-31. The defendants argued that the statute was “reasonably related to making and keeping insurance premiums affordable for all Montanans.” *Id.*, ¶36. The Court acknowledged that lower insurance rates may constitute a legitimate state interest, but concluded that the anti-stacking statute simply allowed insurers to charge premiums for non-existent coverage, which was “the antithesis of affordable coverage.” *Id.*, ¶37. Thus, even though the government’s interest was legitimate, the Court concluded that the anti-stacking statute was “not rationally related to the stated objective of maintaining affordable insurance in Montana, nor any other ‘permissible legislative objective.’” *Id.*, ¶38.

Like the comparative negligence statute in *Newville* and the anti-stacking statute in *Hardy*, the Plan Choice Rate fails substantive due process analysis. Participants agree that maintaining an actuarially sound DB Plan is a legitimate state interest. The Plan Choice Rate simply is not rationally related to that interest. The Plan Choice Rate directs nearly half of DC Plan participants’ employer

contribution to the DB Plan, a plan from which they are statutory precluded from participating. This effectively reduces the employer contribution of DC Plan participants, while DB Plan participants see their entire employer contribution paid to the retirement plan in which they participate and from which they benefit. This effectively “deprive[s] Montanans of their hard earned money for no consideration.” *See id.*, ¶37.

In addition to not being rationally related to ensuring an actuarially sound DB Plan, the Plan Choice rate is arbitrary and unreasonable in its effects. All public employees must choose a retirement plan, but only those who decide to participate in the DC Plan see part of their employer contribution diverted to another plan. DB Plan participants benefit from their entire employer contribution, as the full amount is paid into the retirement plan in which they participate. DC Plan participants, contrarily, benefit only from the portion of the employer contribution that is paid into their individual accounts. The remainder is paid into the DB Plan, from which DC Plan participants are statutorily forbidden from receiving benefits.

The district court’s decision was based, in part, on its conclusion that the employer contribution “is not the employee’s money” but is simply “an allocation of state funds.” (Dkt. No. 53 at 18). The district court went so far as to state that DC Plan member “receive more than DB Plan members because they are

personally entitled to an employer contribution equal to 4.19 percent of their salary” while DB Plan members “are not personally entitled to any of the employer contribution.” (Dkt. No. 53 at 16). While the employer contribution is not paid directly to the employee, it is absolutely a benefit paid on the employee’s behalf. And, contrary to the district court’s conclusion, DB Plan participants receive the full benefit of their employer contribution, as it funds the retirement plan that will provide them with a guaranteed lifetime benefit, regardless of the performance of DB Plan investments. Without the employer contribution, the benefits offered to DB Plan participants would undoubtedly need to be lower than currently offered, as there would be less money being paid into the DB Plan.

The district court further concluded that:

[t]he Plan Choice Rate and additional 1.0 percent are rationally related to the interest of maintaining the soundness of the DB trust fund because they account for the amount not being paid into the fund due to the employee’s choice to participate in the DC plan or ORP.

Id. at 19. This conclusion is contradicted by statutory language. As discussed above, the unfunded liability chargeable to those who left the DB Plan for the DC Plan was taken into account because those who left the DB Plan were allowed to transfer only a portion of their respective employer contributions to the DC Plan. As for ongoing costs, this ignores that DC Plan participants save the DB Plan by not receiving benefits. The alleged costs do not take this into account. The State did not offer any evidence or legal argument to refute this. And in the bill

subsequently introduced at the request of the Montana Public Employee Retirement Administration, the Legislature found that costs to the DB Plan “never significantly changed because of PERS members selecting the PERS-DCRP.” H.B. 107 at 2. It was error for the district court to conclude otherwise.

The district court’s decision gives the State carte blanche to do as it pleases with the employer contribution, regardless of the impact on DC Plan participants, so long as the State is ensuring the DB Plan is actuarially sound. The State could go so far as directing all employer contribution for all PERS members to the DB Plan and leave DC Plan participants with nothing. But this cannot happen, because the district court was incorrect when it concluded that the Plan Choice Rate does not violate Participants’ rights to substantive due process.

VI. CONCLUSION

To paraphrase *Caldwell*, the Court should scrutinize attempts to disguise equal protection and due process violations as legislative attempts to ensure the DB Plan is actuarially sound. The Plan Choice Rate and the 1% contribution direct a significant portion of DC Plan participants’ employer contribution to a plan from which they can receive no benefit. In this way, the Plan Choice Rate and the 1% contribution are unreasonable and arbitrary and are not rationally related to keeping the DB Plan actuarially sound. Accordingly, the Court should reverse the district court and remand this case for further proceedings.

DATED this 19th day of January, 2016.

Travis Dye
KALKSTEIN, JOHNSON
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CERTIFICATE OF COMPLIANCE

The undersigned certifies, under Rule 11(4), Mont. R. App. P, that the *Appellant's Opening Brief* is printed with a proportionately-spaced Times New Roman text typeface of 14 points, is double-spaced, and contains 8,970 words, excluding the caption, table of contents, table of authorities, certificate of service, and certificate of compliance.

Travis Dye

CERTIFICATE OF SERVICE

Pursuant to Rule 10(4), Mont. R. App. P., the undersigned hereby certifies that on January 19, 2016, *Appellant's Opening Brief* was served via First-Class

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APPENDIX

Order on Cross-Motions for Summary Judgment,
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Case Register Report,
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Mont. Admin. R. Not. No. 2-43-536 2179 (Dec. 24, 2015) TAB 3

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