IN THE SUPREME COURT OF FLORIDA

Case No. SC12-520
L.T. Case Nos.: 2011 CA 1584, ID12-1269

RICK SCOTT, et al.,

Appellants,

vs.

GEORGE WILLIAMS, et al.,

Appellees.

On Appeal From a Decision of the Second Judicial Circuit,
Certified by the First District Court of Appeal

Amicus Curiae Brief from Florida TaxWatch in Support of the Appellants

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SUMMARY OF THE ARGUMENT

The prospective reforms to the FRS under Chapter 2011-68, Laws of Florida ("Chapter 2011-68"), are consistent with this Court's previous rulings. Similar to the case at bar, the plaintiffs in Fla. Sheriffs Ass'n v. Dep't of Mgmt Servs., 408 So. 2d 1033 (Fla. 1981) ("Sheriffs") challenged a prospective change in FRS benefits. This Court held that the preservation of rights provision and the terms of the FRS created contractual rights only to benefits already earned under the terms of the FRS. Since the changes made to the FRS under Chapter 2011-68 are only prospective, they are not unlawful.

From a public policy standpoint, preventing the legislature from making prospective changes to the FRS would negatively affect Florida taxpayers. The Legislature relied on Sheriffs in passing Chapter 2011-68 and the subsequent state budgets were based on the revenue assumptions from those changes; thus, voiding the changes would create a significant budget shortfall to the detriment of Florida taxpayers. Additionally, Florida's credit rating and the cost of borrowing could be adversely affected if this Court voids the FRS changes in Chapter 2011-68. Should Florida's credit rating be downgraded, it would cost the state more money to finance its borrowing. Overall, the Legislature must have flexibility in budgeting to best address the needs of Floridians.

Viewing Florida's policy decisions regarding the FRS from a national perspective, the changes to the FRS in Chapter 2011-68 are reasonable in the context of public policy decisions around the county. Florida was an outlier nationally by not requiring any contribution. Given that nearly all states require an employee contribution, and that Florida required a contribution before 1975, it is not unreasonable to require an employee contribution for future benefits earned under the FRS. Furthermore, most states require a larger contribution than 3 percent, some require well over 10 percent from some employees, and many have increased employee contribute rates in the last two years; thus, Florida's 3 percent employee contribution is relatively low. Likewise, many states have made other reforms to reduce the cost of state-run pension systems, including changes to the COLA.

Finally, private employee pension plans are protected only from changes affecting benefits already earned, and affirming the precedent allowing prospective changes to the FRS keeps public employees on equal footing with private employees.

1. FRS MEMBERS' CONTRACTUAL RIGHTS APPLY ONLY TO BENEFITS THAT HAVE ALREADY BEEN EARNED AND DO NOT PREVENT THE LEGISLATURE FROM MAKING CHANGES TO THE PENSION SYSTEM PROSPECTIVELY

Florida Retirement System (FRS) members do not have a contractual right to benefits earned prospectively that can prevent the Florida Legislature from making changes to the state's retirement system prospectively. In the case at bar, Plaintiffs' Contract Clause claims arise out of Fla. Stat. 121.011(3)(d) (the "preservation of rights" provision) which provides:

> The rights of members of the retirement system established by this chapter shall not be impaired by virtue of the conversion of the Florida Retirement System to an employee noncontributory system. As of July 1, 1974, the rights of members of the retirement system established by this chapter are declared to be of a contractual nature, entered into between the member and the state, and such rights shall be legally enforceable as valid contract rights and shall not be abridged in any way.

More than three decades ago this Court defined exactly what "contract rights" statutorily exist based on the "preservation of rights" provision in <u>Fla. Sheriffs Ass'n v. Dep't of Mgmt Servs.</u>, 408 So. 2d 1033 (Fla. 1981) ("<u>Sheriffs</u>"), wherein the plaintiffs challenged a prospective one-third reduction in the amount of benefits that they would earn,[1] just as Appellees here challenge the prospective application of the employee contribution requirement and Cost of Living Adjustment (COLA) amendment provisions of Chapter 2011-68, Laws of Florida ("Chapter 2011-68"). This Court held that the preservation of rights provision and the terms of the FRS created contractual rights only to benefits already earned under the terms of the FRS and that there is not a contractual right to have such terms apply to employees for all future service.

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[1] As this Court noted in <u>Sheriffs</u>, the legislation challenged in that case "reduc[ed] prospectively the special risk credit from three to two percent." 408 So. 2d at 1034.

In Sheriffs, this Court summarized its decisions prior to the 1974 enactment of the preservation of rights section as holding "that the legislature can alter retirement benefits of active employees," but that "once a participating member reaches retirement status, the benefits under the terms of the act in effect at the time of the employee's retirement vest. The contractual relationship may not thereafter be affected or adversely altered by subsequent statutory enactments." Id.

In deciding how the preservation of rights section should be interpreted in Sheriffs, the Court began by considering the decisions that permitted changes to FRS benefits even after they had been earned (so long as the employee had not yet retired). The employee plaintiffs in Sheriffs, similar to the Appellees in the case at bar, argued "that the 1974 enactment of the 'preservation of rights' provision changed the case law and made Florida's retirement system an absolute and binding contractual relationship between employees and the state" and that, through the preservation of rights provision, "the legislature agreed that it would not abridge those rights by unilateral action at any future time." 408 So. 2d at 1036.

While recognizing that the preservation of rights provision changed the extent to which the Legislature could make changes to employee benefits, the Court did not read the preservation of rights provision as broadly as the employees sought. Instead, the Court held that "the 'preservation of rights' section. . .vests all rights and benefits already earned under the present retirement plan so that the Legislature may now only alter retirement benefits prospectively." 408 So. 2d at 1037.

The Court specifically rejected the position that the preservation of rights section was intended to preclude the Legislature from even prospectively modifying benefits, holding:

> We stress that the rights provision was not intended to bind future legislatures from prospectively altering benefits which accrue for future state service. To hold otherwise would mean that no future legislature could in any way alter future benefits of active employees for future services, except in a manner favorable to the employee.

Id. (emphasis added). The Court thus concluded that the employees' "contention is not in accordance with the intent of the legislature and concluded that the legislature has the authority to modify or alter prospectively the mandatory, noncontributory retirement plan for active state employees." Id.

Applying the principle that the Legislature could prospectively modify benefits, the Court then turned to the facts of the case before it, in which "special risk employees received two percent special risk credit prior to October 1, 1974. From October 1, 1974, to October 1, 1978, they received a special risk credit of three percent. The legislature then changed the credit back to two percent." Id. The court held that "[b]ecause of the preservation of rights statutory provision, the legislature could not take away the additional one percent earned from October 1, 1974, to October 1, 1978, but it could change the rate from future services subsequent to October 1, 1978." Id.

The changes at issue in Sheriffs are analogous to the changes contained in Chapter 2011-68. Much like the special risk at issue in that case, the Legislature had previously required an employee contribution from FRS members.[2] Prior to October 1, 1974, the special risk credit at issue in Sheriffs was two percent; from October 1, 1974 to October 1, 1978 the credit was three percent; and as of October 1, 1978, the Legislature was free to prospectively "change the rate for future services subsequent to October 1, 1978." Id. at 1037. The same is true for the changes to the FRS in the case at bar. The FRS required employee contributions prior to January 1, 1975; contributions were phased out through the late 1970s; by the early-1980s the system was fully non-contributory; and contributions became required again as of July 1, 2011. Sheriffs clearly establishes that, so long as the Legislature does not require contributions for any benefits earned between January 1, 1975 and June 30, 2011, the Legislature is free to prospectively modify FRS to require such contributions again. Chapter 2011-68 is consistent with this ruling because it requires no contribution for any benefits earned prior to its effective date; it requires contributions only for additional benefits earned by service performed after July 1, 2011.

[2] As the Sheriffs Court noted, "[o]n January 1, 1975, the requirement plan changed from a contributory to a noncontributory plan." Id. at 1034.

Likewise, the COLA has previously been modified. A fixed three percent COLA only came about in 1987 whereas, prior to 1987, the COLA was merely capped at three percent and was calculated based upon a cost-of-living index. Under Chapter 2011-68, each member receives all COLA benefits earned as of June 30, 2011 and the COLA is only changed prospectively, similar to the employee contribution and as required by the precedent set by this Court in Sheriffs.

The changes made to the FRS under Chapter 2011-68 are only prospective, while the contractual rights of FRS members provided under the "preservation of rights" provision as recognized by the Court in Sheriffs are applicable only to benefits already earned and do not prevent the Legislature from making future changes, therefore, the changes at issue in this case are not unlawful.

I. PREVENTING THE LEGISLATURE FROM MAKING PROSPECTIVE CHANGES TO THE FRS WOULD NEGATIVELY AFFECT FLORIDA TAXPAYERS

The Legislature Relied on this Court's Decision in Sheriffs When Passing the Prospective Changes to the FRS as Well as Two Subsequent State Budgets, and Voiding These Changes Would Result in a Significant Budget Shortfall

Reliance interests weigh in favor of upholding the ability of the Legislature to prospectively adjust retirement benefits as found in Sheriffs. The Legislature relied specifically on Sheriffs in passing Chapter 2011-68. For example, the House of Representatives staff analysis of the bill that became Chapter 2011-68 specifically cited Sheriffs, summarizing that, "[t]he Florida Supreme Court has held that the Florida Legislature may only alter the benefits structure of the FRS prospectively," before stating that the changes in the proposed bill were consistent with the Legislature's authority because "[t]he prospective application would only alter future benefits." FLORIDA HOUSE OF REP., HOUSE OF REP. STAFF ANALYSIS, CS/CS/HB 1405—RETIREMENT, at 12 (2011), available at http://www.myfloridahouse.gov/Sections/Documents/loaddoc.aspx?FileName=h1405e.APC.DOCX& DocumentType=Analysis&BillNumber=1405&Session=2011. Clearly, the Legislature relied on this Court's previous rulings, including Sheriffs, in passing the prospective benefits changes to the FRS at issue in the case.

Revenue generated from the changes made under Chapter 2011-68 was a significant part of the FY 2011-12 and FY 2012-13 General Appropriations Acts. Both state budgets assume that $1.2 billion of the cost of state employee pensions would be offset by employee contributions in the fiscal year. FLORIDA HOUSE OF REP., FINAL BILL ANALYSIS, SB 2100, at 10 (2011), available at http://www.myfloridahouse.gov/Sections/Documents/loaddoc.aspx?FileName=h1405z.SAC.DOCX&DocumentType=Analysis&BillNumber=1405&Session=2011. Thus, if those contributions are negated, the Legislature would not only have to replace or cut that $1.2 billion in spending, $1 billion of which is general revenue, but would also be required to reimburse those funds contributed by FRS members with interest. If such a decision were rendered, the budget shortfall would double in size to $2.4 billion, assuming the state is required to reimburse the contributions paid in FY 2011-12. Such a budget shortfall would be too large to address with only reserves.

In the short term, most of the $2.4 billion shortfall—approximately $2.0 billion—would be in general revenue, which makes up $24.8 billion (35 percent) of the state's $70.0 billion budget for FY 2012-13. A loss of approximately $2 billion in employee contributions would create an 8 percent general revenue shortfall. Additionally, the long-term fiscal impact on the state will be significant: more than $12 billion over 10 years.

The Legislature relied on Sheriffs in passing Chapter 2011-68 and the subsequent state budgets were based on the revenue assumptions from those changes, thus voiding the changes would create a significant budget shortfall to the detriment of Florida taxpayers.

B. Florida's Credit Rating and The Cost Of State Borrowing Could be Adversely Affected By Voiding the FRS Changes

The state uses bonding to fund a number of projects and programs, including transportation improvements, education facilities, prison construction, and environmental programs. As of June 30, 2011, Florida had a direct debt balance of $27.7 billion, $23.0 billion of which is tax-supported debt. DIVISION OF BOND FINANCE, STATE BOARD OF ADMINISTRATION, 2011 DEBT AFFORDABILITY REPORT

9 (2011), available at https://www.sbafla.com/bondfinance/LinkClick.aspx?fileticket=lrTCob4-FOo%3d&tabid=1055. The state's annual debt service payment for its tax-supported debt is approximately $2.2 billion. Id. at 15.

Florida's credit rating is a rank-ordering assessment of the state's ability and willingness to timely repay debt obligations issued by the state. "Credit ratings play an integral role in the municipal bond market and are one factor that affects the State's cost of funds on debt offerings." Id. at 25.

The principal credit rating agencies in the U.S. are Fitch Ratings (Fitch), Moody's Investors Service (Moody's) and Standard and Poor's Rating Services (S&P). Each of these agencies regularly evaluate the credit ratings of the state and its local governments based on several factors including its debt and liability profile; budget and financial management practices and performance; and short- and long-term economic conditions. The state's "General Obligation Credit Ratings" are high. Id. High credit ratings allow access to the lowest available costs of borrowing.

The reforms to the FRS were a factor in Florida's current credit rating. The Florida Division of Bond Finance wrote that Florida's credit rating position was strengthened by the implementation of "legislative changes to the pension system to contain future liabilities." Id.

Another important factor in the credit ratings is the state's level of reserves. The credit rating agencies have looked favorably on the Legislature's actions regarding the balanced budget and the increasing level of state reserves in the state budget.[3] Tapping reserves to make up the difference if the reforms under Chapter 2011-68 were voided would almost certainly cause the state's situation to be reassessed and could cause a decrease in the state's credit rating. In fact, as evidence of this possibility, Fitch Ratings revised Florida's rating outlook from 'stable' to 'negative' in April 2012 citing the possibility of "an unfavorable resolution of the pension lawsuit, resulting in a material reduction in reserves" as a trigger for rating action and one of the primary drivers for the negative outlook. Fitch Affirms Florida's GO Bonds at 'AAA'; Outlook Negative, BUSINESS WIRE, April 11, 2012 available at http://www.businesswire.com/news/home/ 20120411006252/en/Fitch-Affirms-Floridas-Bonds-AAA-Outlook-Negative.

Should Florida's credit rating be downgraded, it would cost the state more money to finance its borrowing to the detriment of the taxpayer, who would

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3 For example, in July 2011, Standard and Poor's revised Florida's credit rating outlook upward, from 'negative' to 'stable,' primarily based on Florida's commitment to maintaining reserves and closing the budget gap. STANDARD AND POOR'S, Outlook On Florida Revised To Stable From Negative On Progress In Budget Balance, 2011C Refunding Bonds Rated 'AAA'. July 12, 2011, available at: http://www.standardandpoors.com/prot/ratings/articles/en/us/?articleType=HTML&assetID=1245314814029 ("Standard & Poor's Ratings Services has revised its outlook on the state of Florida to stable from negative….'The outlook revision reflects our view of the progress the state has made in addressing its structural imbalance through significant cost-cutting measures adopted in fiscal 2012 and maintenance of strong reserves,' said Standard & Poor's credit analyst John Sugden-Castillo….Reserves, which have been greatly depleted over the past few years but are being replenished and when coupled with trust fund reserves, continue to be at levels that we consider strong.")

shoulder the burden of paying more for the same set of services for several years to come. While it is imprecise science to estimate exactly how much a credit rating downgrade would cost taxpayers, only slight variations in the credit spread would incur significant additional costs when issuing bonds and could amount to hundreds of millions over time.[4]

C. The Legislature Must Have Flexibility in Budgeting to Best Address The Needs of Floridians

As the Court held in Sheriffs, a contrary result would actually be a negative result because it would "impose on the state the permanent responsibility for maintaining a retirement plan which could never be amended or repealed irrespective of the fiscal condition of this state. Such a decision could lead to fiscal irresponsibility." 408 So. 2d at 1037.

Since the payment of benefit obligations takes statutory precedent over all other government functions, a constraint on legislative flexibility could lead to the

[4] For example, last year the Division of Bond Finance estimated the additional cost of a downgrade in the state's credit rating at the request of Florida Chief Financial Officer Jeff Atwater. The estimate showed that a downgrade of a single level (from AAA to AA) would add more than $200 million in cost to borrow $7 billion and that a downgrade of two levels (to A) could add more than $900 million. BEN WILKINS, DIVISION OF BOND FINANCE OF THE STATE BOARD OF ADMINISTRATION, LETTER TO THE HONORABLE JEFF ATWATER, BUDD KNEIP, ABBY VAIL RE: CREDIT RATING CHANGE, February 16, 2011 ("You asked us to estimate the potential cost of a downgrade to the State's credit rating….These estimates [in the letter] are not intended to be projections but to demonstrate the magnitude of total increased interest cost which could result from a change in the State's credit rating." (emphasis added))

reduction of other public services, or could induce lawmakers into raising taxes on Florida citizens in order to fund the programs. These reductions would likely affect the funding available for core functions of government, such as: education; health and social services; the judicial functions, including Florida's State Courts System, the State Attorneys and Public Defenders (and other components of ensuring the rule of law); public safety, including the Departments of Corrections and Juvenile Justice; infrastructure and environmental needs; and the state's regulatory system. In other words, the shared sacrifice will be substantially smaller for a relatively small group of citizens, who, while honorably serving their state in public service positions, are asking to be treated much differently than their private sector counterparts.

B. FLORIDA'S POLICIES UNDER CHAPTER 2011-68 ARE REASONABLE IN THE CONTEXT OF PUBLIC POLICY DECISIONS AROUND THE COUNTRY

A. Florida is Currently In Line with Nearly Every Other State in Requiring Some Level of Contribution from at Least Some Employees

Florida is not an outlier in requiring contribution from employees participating in the pension system, as most other states require at least some form of employee contribution. An analysis of the "major public employee retirement systems in the United States" by the Wisconsin Legislative Council (WLC)[5] found

[5] The WLC is a "nonpartisan legislative service agenc[y] of the Wisconsin Legislature….The duties of the Legislative Council [include]…[t]o provide

"most public employee pension plans at least nominally require employees to contribute a certain percentage of their salary to the plan, although some public employee pension plans provide for employer 'pick-up' of the employee contribution." DANIEL SCHMIDT, WIS. LEGISLATIVE COUNCIL, 2010 COMPARATIVE STUDY OF MAJOR PUBLIC EMPLOYEE RETIREMENT SYSTEMS 18 (2011), available at http://legis.wisconsin.gov/lc/publications/crs/2010_retirement.pdf.[6] In fact, all states require some level of contribution to their state-run pension system from some or all public employees. See, e.g., Id. at page 22.[7] Given that nearly all states require an employee contribution, and that Florida required a contribution prior to 1975, it is not unreasonable to require an employee contribution for future benefits earned under FRS.

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nonpartisan legal, scientific and other research services [to legislative entities]." Wisconsin Legislative Council Website at http://legis.wisconsin.gov/lc/.

[6] The report "compares retirement benefits provided to general employees and teachers, rather than benefits applicable only to narrower categories of employees such as police, firefighters, or elected officials. Generally, the report has been prepared every two years since 1982 by the Wisconsin Retirement Research Committee…Although this report does not cover all major public employee retirement systems, it includes at least one statewide plan from each state." Id. at 3.

[7] The WLC analysis shows that Michigan, Tennessee, and Utah do not require a contribution to their major state employee retirement plans; however: Michigan does require a contribution from some government employees, which can be as high as 10 percent, and requires a 3 percent or more contribution from teachers to the state plan; Tennessee requires some political subdivision employees to contribute; and Utah recently adopted a contributory plan similar to Florida's, with the same effective date.

B. Most States Require a Larger Contribution than 3 Percent; Some Require Well Over 10 Percent

Florida is also not an outlier in prospectively requiring a contribution of 3 percent from FRS members under Chapter 2011-68. Many states require a larger employee contribution to the pension funds than the 3 percent contribution in this case. The comparative analysis by the WLC shows that 40 state employee pension plans require more than a 3 percent contribution, while four states (including Florida) require 3 percent contribution. Id. Furthermore, twenty-two of the plans for state employees require at least 6 percent, five states require at least 9 percent from state employees, and three states require more than a 10 percent contribution from state employees. Id. Given the employee contribution rates from other states, Florida's 3 percent employee contribution is relatively low.

C. Many States Have Increased Employee Contribution Rates in the Last Two Years

More than half of the states increased the required employee contribution rates in 2010 or 2011. According to the National Conference of State Legislatures:

> Eighteen legislatures enacted increased employee contribution requirements in 2011 (compared to 11 states in 2010). The 2011 increases applied to at least some, and in most cases all, current employees in 13 states and only to new employees in three states....In eight of the 18 states that increased employee contribution requirements, they will be offset, in part or wholly, by reduced employer contributions. Thus these changes are a shift toward

> equalization of employee and employer retirement contributions, and testimony to continuing pressure on state budgets.

RONALD SNELL, NAT'L CONF. OF ST. LEG., PENSIONS AND RETIREMENT PLAN ENACTMENTS IN 2011 STATE LEGISLATURES 2 (2012), available at http://www.ncsl.org/documents/employ/2011EnactmentsFinalReport.pdf.

D. Many States Made Other Reforms to Reduce the Cost of State-Run Pension Systems

In the past two years, many states made changes to the requirements employees needed to meet in order to be eligible for normal retirement as well as the system by which retirement benefits are calculated. In 2011, "[s]ixteen legislatures increased age and service requirements for normal retirement for state employees, teachers, or both groups….Minimum eligibility requirements, or vesting, also increased in eight states in 2011 (five state in 2010). The changes generally were from five or six year vesting to eight or ten year vesting." Id. Six states (including Florida) also "lengthened the period over which final average salary is averaged to provide the base on which pension benefits are calculated. Eight states made similar changes in 2010."[8] Id.

[8] "Florida changed its provision from the highest five to the highest eight." Id.

E. Other States Have Also Made Changes to the Cost Of Living Adjustment Increases.

"In 2011, 10 states revised their provisions for automatic cost-of-living adjustments, as eight other states had done in 2010…In all cases in 2011, as in 2010, state action reduced future commitments." Id. at 3

Given the analysis of other states' major employee pension systems, the requirement that FRS participants contribute three percent to the pension system and COLA adjustments are not inconsistent with requirements other states have in place for pension plan funding.

C. AFFIRMING THE PRECEDENT ALLOWING PROSPECTIVE CHANGES TO THE FRS KEEPS PUBLIC EMPLOYEES ON EQUAL FOOTING WITH PRIVATE EMPLOYEES

The result reached by this Court in Sheriffs places public employees on equal footing with those employed by private companies. Generally, retirement plans sponsored by private employers are governed by the Employee Retirement Income Security Act of 1974, as amended, 29 U.S.C. §§ 1001, et seq. ("ERISA"). ERISA contains an "anti-cutback rule" that precludes only "accrued benefits" from being reduced. See ERISA § 204(g)(1), 29 U.S.C. § 1054(g)(1) ("The accrued benefit of a participant under a plan may not be decreased by an amendment of the plan . . ."). Thus, the position of the lower court would provide greater rights to public employees—and impose greater restrictions on public employers—than restrictions applicable to private employees.

In deciding whether ERISA's anti-cutback rule has been violated, courts look to a determination of whether the benefits that a participant receives are less than that which the participant would have received without the amendment. See, e.g., Central Laborers' Pension Fund v. Heinz, 541 U.S. 739, 750 n. 6 (2004) (in which the Supreme Court of the United States held that it would determine whether or not benefits had been retroactively reduced by assessing "the actuarial value of a beneficiary's package"). Applying the anti-cutback rule contained in ERISA § 204(g)(1), the United States Court of Appeals for the Eleventh Circuit recently described how to differentiate between accrued and future benefits, holding that "[t]he key to identifying an accrued benefit at a specific point . . . is to calculate what benefit a participant . . . would be entitled to under the Plan if the participant ceased employment at that time." Cinotto v. Delta Airlines Inc., __ F. 3d ___, 2012 WL 967356, *11 (11th Cir. Mar. 23, 2012).

Under this standard, Chapter 2011-68 would be upheld if it were applied to nongovernmental employees because the employee contribution requirement only applies to benefits earned on and after July 1, 2011 and the COLA is only eliminated for benefits earned after that date. No FRS member will retire with fewer benefits than s/he would have obtained had s/he ceased employment on June 30, 2011.

CONCLUSION

For the reasons stated above, Florida TaxWatch believes that the prospective reforms to the FRS under Chapter 2011-68, which are consistent with this Court's past decisions, vital to the future fiscal wellbeing of the state, in line with the policies and reforms of a supermajority of other states, and equal to the rights protected by ERISA for private sector employees, should be upheld by this Court.

Respectfully submitted,

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I HEREBY CERTIFY that the foregoing brief complies with the font requirements of Florida Rule of Appellate Procedure 9.210(a)(2).

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