

STATE OF MICHIGAN  
IN THE SUPREME COURT  
Appeal from the Michigan Court of Appeals  
Saad, P.J., and K.F. Kelly and Gleicher, JJ.

AFT MICHIGAN, AFT, AFL-CIO,  
ET AL,

Plaintiffs-Appellants,

v

THE STATE OF MICHIGAN,

Defendant-Appellee.

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Supreme Court No. 148748

Court of Appeals No. 313960

Court of Claims No. 12-104-MM

**THE STATE OF MICHIGAN'S RESPONSE TO  
THE BRIEF OF AMICUS CURIAE MICHIGAN EDUCATION ASSOCIATION**

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## INTRODUCTION

The Michigan Education Association supports Appellants in challenging, on various constitutional and common law grounds, the authority of the Legislature to change the statutory formula that applies to the *future* accrual of pension benefits, and retiree health care, neither of which is a vested right, under the Public School Employees Retirement Act, MCL 38.1301 *et seq.* But the statutory changes in question, which were enacted under 2012 PA 300, neither impact any vested interest nor violate substantive due process. To the contrary, PA 300 represents a reasonable solution to a \$15.6 billion problem – one that scrupulously preserves public school employees' constitutionally protected accrued financial benefits – and also secures the financial viability of the Michigan Public School Employees' Retirement System for current and future retirees in accordance with the state and federal constitutions.

## CLARIFICATION OF FACTS

During the 2011-2012 school fiscal year, local public school districts paid more than \$2.5 billion (25.8% of total payroll) to the Retirement System to fund pension and retiree health benefits for current and former public school employees. By the 2012-2013 school fiscal year, the annual payment was projected to increase to nearly \$3 billion. Without the changes PA 300 implements, the Retirement System would have been underfunded by more than \$48.3 billion (an amount equal to nearly 500% of the projected 2012-2013 payroll for all public school districts).

In September 2012, the Legislature enacted PA 300 to lessen this financial burden and its crippling impact on public school districts. Among other cost-saving and containment measures (e.g., instituting prefunding for retiree health care, capping the contribution rate for school districts, adjusting the amortization period for the funding of certain benefits, eliminating the retiree health care subsidy for new hires and reducing the maximum subsidy for eligible existing members, etc.), PA 300 amended the Retirement Act in a way that affected only non-vested benefits: it conditioned the future accrual of certain pension benefits, and participation in the retiree health care plan offered by the Retirement System, upon the payment of prescribed contributions.

In regard to retiree health care, PA 300 provided for members who wished to maintain eligibility for State-subsidized retiree health care premium coverage to pay 3% of their compensation as a condition of participation. MCL 38.1343e. Members who decided to participate in (and contribute to) the retiree health care plan will receive the value of their contributions, either in the form of subsidized retiree health care coverage, or as a separate retirement allowance, upon retirement. MCL 38.1391(1); MCL 38.1391a(8). Members who elected to opt out of making the 3% contribution (and forego subsidized retiree health care) instead receive up to 2% employer matching contributions in a portable 401(k) account. MCL 38.1391a(2). So they can choose not to make the contribution at all if they want.

In addition to providing members with options concerning retiree health care benefits, PA 300 also amended sections 59 and 84b of the Retirement Act, MCL 38.1359 and MCL 38.1384b, to provide members with a choice concerning their pension benefits. Significantly, PA 300 left intact the pension formula that applies to all service credited prior to February 1, 2013. The only pension benefits that were potentially affected, depending upon a member's election, were pension benefits for service that had not yet accrued. Specifically, section 59 of PA 300, MCL 38.1359, provided for members to elect whether to continue accruing service in the pension plan after February 1, 2013. Members who elected to continue accruing service beyond February 1, 2013, as provided by MCL 38.1359(1), and receive a 1.5% pension multiplier for future years of service, are required to pay the attendant contributions provided under MCL 38.1343g. Alternatively, MCL 38.1359(2) provides for members to retain the 1.5% pension multiplier for all service already accrued, but to receive a 1.25% pension multiplier for future years of service. See MCL 38.1359(2)(a). Finally, members were given the option to "freeze" their service accrued as of February 1, 2013 (using the 1.5% multiplier), and instead convert to a defined contribution, *i.e.*, 401(k), plan on a prospective basis.

In total, these reform measures not only diversified the Retirement System's benefit offerings, but also reduced the Retirement System's Unfunded Actuarial Accrued Liability (UAAL) by more than \$15.6 billion.

## ARGUMENT

### **I. The pension and health care reform measures provided under PA 300 are constitutional.**

MEA contends that, regardless of the cost and financial drain on the public school districts, members of the Retirement System have an inalterable and unconditional right to the future accrual of additional pension benefits, and to receive subsidized retiree health care upon retirement, under the terms of the Retirement Act as they existed prior to the enactment of PA 300. But as the Court of Appeals correctly held, members have no such inalterable right, and since PA 300 only impacted future benefits, and not benefits that had already accrued or vested, PA 300 was a valid, proper exercise of the Legislature's authority and discretion. Consequently, these sensible reform measures are constitutional and should be affirmed as such.

### **A. The retiree health care reforms do not result in an unconstitutional taking of property or violate due process.**

MEA contends that the retiree health care reforms encompassed in PA 300 are unconstitutional because they (1) reduce retiree health benefits for current and prospective retirees; and (2) condition participation in the retiree health care plan upon member contributions. MEA is essentially claiming that the State is required to provide, and public school employees are entitled to receive, retiree health care. But this argument overlooks the fact that retiree health care is not a "right"; rather, as this Court has held, it is a gratuity provided under the Retirement Act, the terms

of which are prescribed by the Legislature. *Studier v Michigan Public School Employees' Retirement Board*, 472 Mich 642, 668; 698 NW2d 350 (2005).

1. **The 3% retiree health care contribution is not a “taking” for which just compensation is owed.**

MEA claims that the 3% retiree health care contribution imposed on members who elect to participate in the retiree health care plan constitutes a “physical taking” in violation of article 10, § 2 of the Michigan Constitution and the Fifth Amendment of the United States Constitution. The thrust of MEA’s argument is that the State of Michigan is “physically taking” the earned wages of public school employees (in the form of 3% retiree health care contributions) and using that money for a public purpose, i.e., funding retiree health care for current and prospective retirees. (MEA Br, p 10.) But the restriction against the taking of property for public use without just compensation applies only to a taking against the will of the owner by authority of some statute; it has no application to the decision of a court on the relative rights of parties in property, which have been voluntarily created by contract. *Kunhardt & Co v US*, 266 US 537; 45 S Ct 158; 69 L Ed 428 (1925). Here, the Retirement System is not seizing or confiscating wages, but is simply collecting willing, uncompelled, contributions made by members to fund their own health care. MCL 38.1343e; see also MCL 38.2731 to MCL 38.2747.

The voluntary nature of the 3% contribution is what distinguishes this case from *Webb’s Fabulous Pharmacies, Inc v Beckwith*, 449 US 155; 101 S Ct 446; 66 L Ed 2d 358 (1980); *Ramey v Michigan Public Service Commission*, 296 Mich 449; 296

NW 323 (1941), *Association of Surrogates and Supreme Court Reporters within the City of New York v City of New York*, 79 NY2d 39; 588 NE 2d 51 (1992), and *AFT v Michigan* 297 Mich App 597; 825 NW2d 595 (2012), and renders MEA's reliance on those cases misplaced.

2. **Since the retiree health care reforms are rationally related to a legitimate government interest, and there is nothing "arbitrary" about requiring members to share the cost of funding future retirement benefits, PA 300 does not violate due process.**

MEA also claims that PA 300 violates due process because it "extracts" wages from public school employees in exchange for a lesser, illusory benefit. (MEA Br, pp 19-24.) But this claim too is without merit.

Under the Due Process Clauses of both the United States and Michigan Constitutions, no one may be deprived of property without due process of law. US Const, Am XIV, Const 1963, art 1, § 17. In regard to substantive due process, which is at issue here, the underlying purpose is to secure the individual from the arbitrary exercise of governmental power. *Electronic Data Systems Corp v Township of Flint*, 253 Mich App 538, 549; 656 NW2d (2002). The test for substantive due process is whether the law is rationally related to a legitimate governmental purpose. *Id.*

As mentioned, the 3% contribution required by section 43e of PA 300 is entirely voluntary.<sup>1</sup> On this basis alone the due-process claim must fail as there is

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<sup>1</sup> This rationale applies with equal force to MEA's arguments that the pension contributions under section 59g of PA 300 violate due process. (MEA Br, p 20.)

no mandatory or compelled “deprivation” of property. Members who, for whatever reason, wish to avoid participating in – and contributing to – the retiree health care plan can simply opt out.

Moreover, in any event, the contributions remitted by members who choose to participate in the retiree health care plan are used to fund the retiree health care benefits that contributing members will be eligible to receive in the future.<sup>2</sup> And, as discussed, all members who voluntarily choose to contribute will receive the value of their contributions upon retirement in the form of retiree health care or a pension benefit, as applicable. Thus, it can hardly be questioned that the conditional imposition of retiree health care contributions is rationally related to a legitimate governmental purpose.

Furthermore, although it is true that PA 300 does not establish a contract for the perpetual payment of any retiree health care subsidy, this concept is no different than workers paying into Social Security and Medicare today so that they may receive those benefits when they retire in five, ten, or thirty years, even though there is no constitutional or contractual guarantee that they will receive any benefit. In any event, PA 300 provides for members to receive the benefit of their contributions, either in the form of retiree health care or in a supplemental retirement allowance. In this sense, the health care contributions are no different than the pension contributions required of members who participate in the Member Investment Plan under MCL 38.1343a – or the contributions made by members

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<sup>2</sup> Likewise, the pension contribution under section 59g of PA 300 is used to “prefund” the pension benefits that contributing members will accrue in the *future*.

under section 59g of PA 300 to accrue future pension benefits on the basis of a 1.5% multiplier.

**B. Since members have no contractual right to future pension benefits, PA 300 does not impair the obligation of any contract in violation of either the state or federal constitution.**

Both the state and federal constitutions prohibit a law from impairing the obligations of contracts. See US Const, art I, § 10, cl 1; Const 1963, art 1, § 10. MEA contends that PA 300 impairs the contractual obligation to pay pension benefits to members. (MEA Br, p 25.) But the premise on which this contention is based is faulty as PA 300 only potentially impacts pension benefits that have not yet been accrued (i.e., benefits for *future* service), and neither the common law, the Retirement Act, nor the constitution, creates a contractual obligation to provide the same. Since there is no contractual obligation to provide for the continuing future accrual of pension benefits, PA 300 could not have unconstitutionally impaired such obligation.

**1. There is no common law contractual right to a pension provided by a public employer.**

At common law, public pensions were viewed as gratuitous allowances that could be revoked at will because of a lack of a vested right in their continuation. See, e.g., *Attorney General v Connolly*, 193 Mich 499; 160 NW 581 (1916). See also *Brown v Highland Park*, 320 Mich 108; 30 NW2d 798 (1948); *Van Coppenolle v Detroit*, 313 Mich 580; 21 NW2d 903 (1946). Accordingly, at common law, any pension provided to public employees would be considered terminable at the will of

the Legislature, and was, at best, merely an expectancy based upon the continuance of current law. Indeed, that was the reason the Michigan Constitution had to be amended to add the Pensions Clause to create a constitutional right to accrued financial benefits. MEA does not cite any binding cases that hold otherwise.

**2. The Retirement Act itself does not create a contractual right to the future accrual of pension benefits at issue.**

While members of the Retirement System may have had a subjective expectancy that the prior provisions of the Retirement Act would continue, that expectancy did not rise to the level of a contractual right.

There is a “strong presumption that statutes do not create contractual rights.” *Studier*, 472 Mich at 661. This presumption is based on the fact that the function of the Legislature is to establish policy, not make contracts, and the Legislature has the inherent power to change, revise, and repeal policies. *Id.* (internal citations omitted). It is only when the Legislature has clearly and unequivocally expressed an intent to surrender such legislative power, and enter into a contractual obligation, that the presumption will be overcome. *Id.* at 662-663.

Here, MEA offers no explanation as to how the Retirement Act expresses a clear, unequivocal intent to contractually bind the State in regard to the pension benefits at issue. Moreover, nothing in MCL 38.1384, or any other provision of the pre-PA 300 Retirement Act, even remotely suggests that the 1.5% multiplier was intended to apply in perpetuity without any conditions or limitations such as those imposed by PA 300. Had the Legislature intended to permanently and

unconditionally bind the State to apply the 1.5% multiplier to all “credited service,” regardless of when the service was actually performed, it would have expressly done so by employing terms such as “contract,” “covenant,” or “vested rights.” *Studier*, 472 Mich at 663-664. In the absence of such explicit language, a contractual relationship is simply not created. Consequently, PA 300 does not “amount to an impairment” of the “contractual rights” of public school employees in violation of Const 1963, art 1 § 10 or US Const, art 1.

**3. The constitution does not create a contractual right to pension benefits for the future service at issue.**

Contrary to MEA’s argument, Const 1963, art 9, § 24 neither protects, nor obligates the State to provide, pension benefits for *future* service that has not yet been rendered.<sup>3</sup> That constitutional provision protects only “accrued financial benefits,” i.e., *pensions*, which are “monetary payments for past services.” *Studier*, 472 Mich at 657-658. See also *Advisory Opinion re Constitutionality of 1972 PA 258*, 389 Mich 659, 663; 209 NW2d 200 (1973) (“the legislature cannot diminish or impair accrued financial benefits, but we think it may properly attach new conditions for earning financial benefits which have not yet accrued.”); *In re Request for Advisory Opinion Regarding Constitutionality of 2011 PA 38*, 490 Mich 295, 311; 806 NW2d 683 (2011) (“The obvious intent of § 24, however, was to ensure that

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<sup>3</sup> Although MEA acknowledges that *Studier* held that retiree health care benefits provided under the Retirement Act are not “accrued financial benefits,” it argues in passing that *Studier* was incorrectly decided and that PA 300 violates members’ “vested rights” to retiree health care under article 9, § 24. (MEA Br, p 47.) However, MEA offers no substantive basis for this Court to revisit, let alone overturn, its decision in *Studier*.

public pensions be treated as contractual obligations that, once earned, could not be diminished.”). Therefore, it is constitutionally permissible for the Legislature to impose new conditions on pension benefit payments related to future service.

Here, PA 300 merely adds conditions as to the future accrual of pension benefits.<sup>4</sup> Significantly, however, it does not impose any new conditions on the receipt of already accrued financial benefits. Simply put, PA 300 in no way affects “monetary payments for past services,” or benefits “related to services rendered in the past.” *Studier*, 472 Mich at 657-658; *Association of Professional and Technical Employees*, 154 Mich App 440, 445-446; 398 NW2d 436 (1987).

**C. The retirement contributions added by PA 300 are properly applied toward the prefunding of members’ pension benefits in accordance with the constitutional mandate to do the same.**

The second clause of article 9, § 24 of the Michigan Constitution provides that “[f]inancial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities.” MEA contends that PA 300 violates this “prefunding” requirement by using current service contributions to finance the UAAL of the Retirement System. (MEA Br, p 37.) In support, MEA cites the House Fiscal Analysis that estimates PA 300 will reduce the Retirement System’s UAAL by \$15.6 billion. But MEA’s contention is based upon a fundamental misunderstanding of the prefunding requirement and the implementation of PA 300.

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<sup>4</sup> As discussed, PA 300 similarly adds conditions as to the participation in – and receipt of benefits from – the retiree health care plan offered by the Retirement System.

The prefunding requirement must be read in connection with the first clause of article 9, § 24, which, as discussed, provides that “accrued financial benefits” of the Retirement System are a contractual obligation that may not be diminished. In totality, article 9, § 24 was intended not only to ensure that public pension benefits are fully paid, but also that they are fully *funded* “to a level which includes unfunded accrued liabilities.” *Shelby Twp Police and Fire Retirement Bd v Shelby Twp*, 438 Mich 247, 255-256; 475 NW2d 249 (1991).

Further, the fact that the implementation of PA 300 results in a \$15.6 billion reduction in the Retirement System’s UAAL does not, as MEA contends, mean that PA 300 is unconstitutional. The reduction is simply an actuarial byproduct of the changes to the manner in which future pension benefits accrue, and the manner in which retiree health care is funded and paid, and members’ choices regarding the same. Significantly, \$14 billion of that reduction is attributable to the changes to the retiree health care plan that are not, in any event, subject to the prefunding requirement of article 9, § 24. *Studier*, 472 Mich at 658-659. The remaining \$1.6 billion savings is derived solely from the actuarial impact of members’ voluntary choices regarding their pension benefits for *future* service.

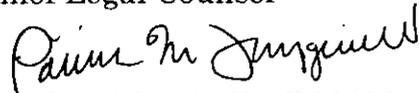
**RELIEF REQUESTED**

The State respectfully requests that the Court affirm the constitutionality of  
2012 PA 300.

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