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State Capitol North, 325 Don Gaspar, Suite 200
Santa Fe, New Mexico 87501
Phone: (505) 986-4591 Fax: (505) 986-4338
<http://www.nmlegis.gov/lcs/lesc/lescdefault.aspx>



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August 19, 2013

MEMORANDUM

TO: Legislative Education Study Committee

FR: Kevin Force and Ian Kleats

RE: STAFF BRIEF: SUMMARY OF LEGAL CHALLENGE TO EDUCATIONAL RETIREMENT BOARD (ERB) REFORM LEGISLATION

INTRODUCTION

During the 2012 interim, the Legislative Education Study Committee (LESC) considered a pension reform proposal endorsed by the Educational Retirement Board (ERB) and approved by ERB stakeholders. The LESL unanimously endorsed the proposal on January 14, 2013, and a version of it was introduced in each chamber as House Bill (HB) 64 and Senate Bill (SB) 115.

SB 115 was amended during the committee process to include changes to the pension's cost-of-living adjustment (COLA) for current and future retirees, a feature not present in the proposal endorsed by the LESL. The amended bill passed both chambers and was signed into law as Laws 2013, Chapter 61.

On June 24, 2013, in the matter of *Bartlett, et al v. Cameron, et al*, Petitioners¹ filed an original proceeding in mandamus in the Supreme Court of New Mexico², seeking an order compelling Respondents to pay Petitioners the COLA benefits that were in law prior to the 2013 legislative session and the enactment of Laws 2013, Chapter 61, which effected a reduction in COLA for all

¹ Petitioners are four retired New Mexico employees with vested rights in their pension plan, all of whom are seniors and three of whom suffer from ill health.

² The New Mexico Supreme Court has original jurisdiction of all proceedings in mandamus against state officers, boards, and commissions.

existing members and current retirees beginning July 1, 2013. Respondents³ replied on July 17, 2013, declaring that they had no clear legal duty not to comply with the decrease in COLA benefits and, further, that mandamus was an inappropriate remedy for the Petitioners' alleged harm.

SUMMARY OF FACTS

- The arguments in this case depend mainly upon interpretation of Article XX, Section 22 of the New Mexico Constitution:

“Sec. 22. [Public employees and educational retirement systems trust funds; expenditures and encumbrances prohibited; administration; vesting of property rights.]

D. Upon meeting the minimum service requirements of an applicable retirement plan created by law for employees of the state or any of its political subdivisions or institutions, a member of a plan shall acquire a vested property right with due process protections under the applicable provisions of the New Mexico and United States constitutions.

E. Nothing in this section shall be construed to prohibit modifications to retirement plans that enhance or preserve the actuarial soundness of an affected trust fund or individual retirement plan. (As added November 3, 1998.)”

- Under the current statute, Petitioners' COLA benefits are determined as follows:

“The annuity shall be adjusted by applying an adjustment factor that results in an adjustment equal to one-half of the percentage increase of the consumer price index between the next preceding calendar year and the preceding calendar year, except that adjustment shall not exceed four percent, in absolute value. In the event that the percentage increase of the consumer price index is less than two percent, in absolute value, the adjustment factor shall be the same as the percentage increase of the consumer price index...”⁴

- Senate Bill 155 modified this formula so that:
 - COLA is immediately reduced for all retirees until the plan is 100 percent funded;
 - COLA reduction is based on the median retirement benefit (about \$18,000 for FY 12) of all retirees, including those with disabilities;
 - retirees with benefits at or below the median *and* 25 or more years of service will have a 10 percent COLA reduction, resulting in an average COLA of 1.8 percent; and
 - all other retirees will have a 20 percent COLA reduction, resulting in an average COLA of 1.6 percent.

³ Respondents are the Board of Trustees and the Executive Director of the New Mexico Educational Retirement Board.

⁴ § 22-11-31(B) NMSA 1978

- On August 17, 2012, stakeholders to the ERB presented a proposed plan change to the board that would not affect current retirees' COLA, which the board adopted the following month, which was likewise endorsed by the interim Investments and Pensions Oversight Committee and the Legislative Education Study Committee.
- After SB 115 passed the Senate Education Committee and its companion bill, HB 64, passed the House, the Senate Finance Committee amended the bill to make the COLA formula dependent upon the funded ratio of the ERB fund, after which the bill passed both houses and was signed by the Governor.

LEGAL ARGUMENTS

According to Petitioners:

- This mandamus proceeding presents urgent questions regarding the interpretation of the New Mexico Constitution, Article XX, Section 22, which states, in part, that a member of a state retirement plan acquires a “vested property right with due process protections.” (NM Const. Art. XX § 22(D)).
- According to the court, details of vested property rights are to be determined by statutes in effect at the time of maturity.⁵
- Petitioners are retired New Mexico employees with vested property rights in the educational retirement plan, and the statutes that were in effect at the time of maturation of petitioners' benefits included an annual COLA adjustment.
- Senate Bill 115 would reduce the COLA for all members *and* existing retirees as of the beginning of Fiscal Year 2014, leading to a reduction in the COLA benefit to all current retirees over the age of 65, including Petitioners, in violation of Article XX, Section 22 of the Constitution of New Mexico.
- Intervention in the instant case represents an appropriate exercise of the court's original jurisdiction because:
 - the issue present a fundamental question of great public concern;
 - the facts are undisputed;
 - the legal issues would eventually have come before the Supreme Court; and
 - Petitioners require an early resolution to the dispute.
- Emergency action is needed to prevent Respondents from violating Petitioners' rights as of the new fiscal year.
- While COLA reductions take effect immediately, the full impact of compounding loss will come in 15-25 years, when retirees are older, more fragile, and possibly infirm.
- Constitutional protections require due process and the payment of just compensation for the taking of Petitioners' vested property rights.

⁵ *Pierce v. State of New Mexico*, 121 N.M. 212, 910 P.2d 288 (1995)

- COLA rights are constitutionally protected, vested property rights, as has been held in a number of analogous cases⁶, and thus must be afforded due process and just compensation.
- Respondents argue that Article XX, Section 22(E) allows modification to retirement plans so long as the modifications enhance or preserve the actuarial soundness of an affected individual retirement plan (see Respondents’ arguments, *infra*), however, the legislative history of paragraph (E) shows that these potential modifications were to be applied only to unvested benefits.
- Due process protections would require that the Legislature provide employees and retirees with “notice and opportunity to respond.”⁷
- While stakeholders presented ERB with proposed changes to the retirement plan, which they adopted, in advance of the legislative session, the Legislature, and the legislative process, failed to adequately apprise Petitioners of their intention to reduce COLA benefits by approving SB 115, as amended, thus violating due process.
- Mandamus is an appropriate exercise of the Court’s authority to prohibit an unlawful or unconstitutional official action.⁸

According to Respondents:

- Petitioners fail to consider adequately paragraph (E) of Article XX, Section 22 of the New Mexico Constitution, which allows alteration to retirement plans that enhance or preserve their actuarial soundness.
- The Petition fails because:
 - mandamus is not appropriate where, as here, Respondents have no non-discretionary duty to act. Rather, the Petition is a request for a declaratory judgment that the COLA change violates Article XX, Section 22;
 - Petitioners ask the Court to substitute its judgment for the Legislature’s in the formulation of public policy; and
 - the COLA change was made for the purpose of enhancing and protecting the actuarial soundness of the ERB Fund; balancing Petitioners’ property rights against the Fund’s actuarial soundness weighs in favor of the change’s constitutionality.
- Mandamus is inappropriate because:
 - Mandamus is only applied to enforce a clear legal right against someone having a clear legal duty to act, and Article XX, Section 22(D) does not mandate any duty for ERB.
 - The New Mexico Supreme Court previously has held that not even statements of legislators are considered competent evidence in the determination of legislative

⁶ See, e.g.: *Calabro v. City of Omaha*, 247 Neb.955, 531 N.W. 541 (1995) (holding Omaha’s elimination of a cost-of-living supplemental plan was unconstitutional). See also: *Williams v. Rohm and Haas Pension Plan*, 497 F.3d 710 (7th Cir. 2007), *cert. denied* March 17, 2008 (US Supreme Court letting stand the 7th Circuit’s decision holding that COLAs for retirees whose pensions were governed by the *Employee Retirement Income Act of 1974* were an accrued benefit.

⁷ *Pierce*

⁸ *State ex rel. Clark v. Johnson*, 120 N.M. 562, 904 P.2d 11 (1995).

- intent, thus much of Petitioners’ argument regarding the intended purpose of Article XX, Sections 22(D) and (E) is unpersuasive.
- Mandamus cannot lie where an allegedly clear duty can be determined only after a close examination of two constitutional provisions.
 - While Petitioners desire an early resolution via mandamus, they have had several months, since at least the signing of SB 115, to seek an appropriate remedy, and cannot manufacture urgency by waiting until just before the effective date of the statute to file their petition.
 - Mandamus typically is only appropriate when there is no other clear, speedy, and adequate remedy available in the ordinary course of the law, such as money damages.⁹
- The Legislature is the proper body to make these public policy decisions, not the Court, because policy decisions regarding how best to protect the Fund for its members is best made by the Legislature, and the Court defers to its judgment in such matters.¹⁰
 - The COLA change was an appropriate and constitutional change to the Fund made to enhance and protect its actuarial soundness:
 - Petitioners’ reading of Article XX, Section 22 largely ignores the implications of paragraph (E), arguing that:
 - permitting the taking of property rights without compensation would defeat the entirety of the section; and
 - legislative history of Section 22(E) shows that it was not intended to permit the lowering of benefits.
 - While Petitioners argue that Section 22(D) prohibits modification or COLA benefits, the interplay between both paragraph (D) and (E) actually guarantees vested members due process, which requires a balancing of members’ rights against any action taken to preserve or enhance the Fund.
 - As with any due process claim, the Court must apply the appropriate level of scrutiny to the statute purporting to affect petitioners’ property rights, which in this case is rational basis review, which presumes constitutionality.¹¹
 - In New Mexico, the rational basis test requires:
 - a factual foundation in the record to support the basis of the challenged law; or
 - a firm legal rationale to support the basis of the law.
 - There is both factual support and a firm legal basis for the change to the COLA benefit at issue:

⁹ *El Dorado at Santa Fe, Inc. v. Board of County Commissioners*, 89 N.M.313, 551 P.2d 1360 (1976)

¹⁰ See, e.g.: *State ex rel. Hudgins v. Public Employees Retirement Board*, 58 N.M. 543. 273 P.2d, 743 (1954) (holding that determining the rate of employee contributions to the retirement plan was appropriately within legislative discretion).

¹¹ The three levels of Constitutional scrutiny which may be applied to any alleged due process violation are strict scrutiny, intermediate scrutiny and the rational basis review. The latter is applicable when the challenged action does not affect a fundamental right, create a suspect class, nor impinge upon an important individual interest.

- Reduced COLA means decreased outflows from the Fund, which over time helps achieve the goal of improving the funded ratio.
 - A higher funded ratio protects the fund against economic downturns and may mitigate the need for other, more drastic changes in the future.
 - The Petitioners do not demonstrate any failure to satisfy the rational basis framework arising from the change in COLA benefits.
- The change to the COLA benefit does not violate Petitioners' procedural due process rights:
- Relying on *Pierce*, Petitioners allege that the Legislature was required to provide Fund members with adequate notice and opportunity to respond to the changes enacted by SB 115, as amended.
 - The *Pierce* Court found that publicity in local newspapers and the fact that the legislative committee meetings are open to the public satisfied any due process claims in that case.
 - The particular language from *Pierce* upon which Petitioners rely is dicta; that is, it is neither central to, nor necessary for, the Court's holding, and thus is not precedential.
 - Any other reading would allow for an improper judicial intrusion into legislative powers and process, as the Legislature may be required to halt its normal committee process when considering any provision or amendment that might affect pension benefits, forcing a de facto process more appropriate to administrative rulemaking.
 - Other courts have found that general statutory changes do not require individual notice and opportunity to be heard.¹²
- The COLA change does not constitute a compensable taking of a property right:¹³
- A reasonable reduction of in the rate of increase from a COLA will not be a taking if it:
 - ✓ is reasonably related to a proper purpose; and
 - ✓ does not unreasonably deprive Petitioners of all, or substantially all, of the beneficial use of their property.¹⁴
 - The impact of the change is shared by other retirees, as well as active members through their higher contributions to the Fund and additional conditions imposed upon new members.

¹² See, e.g.: *Atkins v. Parker*, 472 U.S. 115 (1985) (altering eligibility requirements for food stamps did not violate due process or require notice and opportunity to be heard). See also: *McKierny v. Public Employees' Retirement Association*, 976 P.2d, 348 (Colo. Ct. App. 1998), *cert. denied* (failure to provide notice of legislative changes to retirement benefits did not violate due process).

¹³ To determine if a law is a regulatory taking, the Court must consider the economic impact on Petitioners, the extent to which the change interfered with Petitioners' investment-backed expectations and the character of the Legislature's action.

¹⁴ *New Mexicans for Free Enterprise v. City of Santa Fe*, 138 N.M 785, 126 P.2d 1149.