

MAJOR POLICY SHIFTS

2011

S.B. 1614

(partially overturned by an Arizona superior court; subsequently repealed by H.B. 2264)

For ASRS, the Arizona Legislature changed the member-employer contribution formula from a 50-50 share to a 53% (members) and 47% (employers) split. A trial court found the legislation unconstitutional (Barnes v. Ariz. State Retirement Sys.) and the legislature subsequently repealed the statute.

2011

S.B. 1609

(partially overturned by the Arizona Supreme Court)

For CORP, EORP, and PSPRS, the Arizona Legislature changed the formula for calculating retired member permanent benefit increases (formally called "PBlis") paid out of a reserve fund with the intent, in part, to provide protection against inflation. The Arizona Supreme Court held the changes to calculating benefit increases were unconstitutional (Fields v. Elected Officials' Retirement Plan).

2013

H.B. 2608

The Arizona Legislature closed the EORP Defined Benefit Plan to new members as of January 1, 2014, and established for new hires the Elected Officials' Defined Contribution Retirement System.

2013

H.B. 2057

For ASRS members joining on or after September 13, 2013, the Arizona Legislature eliminated access to the "permanent benefit increases" program that adjusts benefits in retirement.

2016

S.B. 1428 and Proposition 124

For PSPRS members joining on or after July 1, 2017, the Arizona Legislature created a choice of retirement plans, including (1) a Defined Contribution Plan and (2) a defined benefit hybrid plan with a graded multiplier based on years of service and higher retirement age (55 years old, up from 52.5 for previous members). For all PSPRS members the Arizona Legislature also replaced the "permanent benefit increase" program linked to investment performance and a reserve fund with a 2% maximum "cost-of-living adjustment" (COLA) linked to inflation and funded status. The Arizona electorate amended the state constitution to allow for the COLA changes in S.B. 1428 to amend already accrued benefits for active PSPRS members and retirees.

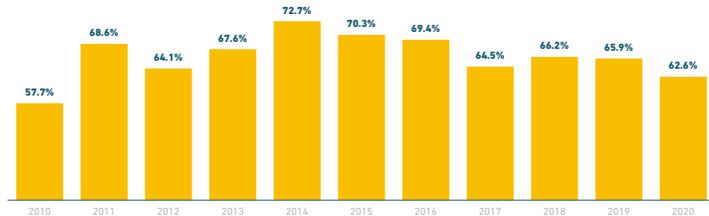
2018

S.B. 1442 and H.B. 2545

For all CORP members (S.B. 1442) and EORP members (H.B. 2545), the Arizona Legislature adopted similar changes to 2016 changes to PSPRS. The Arizona electorate amended the state constitution to allow for the COLA changes in S.B. 1442 and H.B. 2545 to amend already accrued benefits for active CORP and EORP members and retirees.

FUNDED RATIO

The graphic below covers the following retirement systems: the Arizona State Retirement System (ASRS), the Arizona Corrections Officer Retirement Plan (CORP), the Arizona Elected Officials' Retirement Plan (EORP), and the Arizona Public Safety Personnel Retirement System (PSPRS).

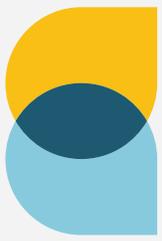


LEGAL ENVIRONMENT FOR FUTURE POLICY EFFORTS

Legislative efforts confined to new hires are excluded from analysis because they rarely face significant legal challenges.

What are some policy options?	Were there relevant policy shifts for active employees or retirees?	Have there been legal challenges?	What are the legal prospects for future changes?*
INCREASE EMPLOYEE CONTRIBUTIONS	YES S.B. 1614 (2011) (ASRS) S.B. 1609 (2011) (EORP)	YES S.B. 1614 did not survive legal challenge in <i>Barnes v. Ariz. State Retirement Sys.</i> (2012) S.B. 1609 did not survive legal challenge in <i>Hall v. Elected Officials' Retirement Plan</i> (2016)	<ul style="list-style-type: none"> FAVORABLE as to active ASRS employees UNDEVELOPED as to active Tier 1 and Tier 2 PSPRS and CORP employees FAVORABLE as to active Tier 3 PSPRS and COPR employees (based on annual actuarial calculation) UNFAVORABLE as to active EORP employees (closed to new members) N/A as to retirees
DECREASE OR ELIMINATE COST-OF-LIVING ADJUSTMENTS	YES See Major Policy Shifts, 2016 and 2018, to the left	YES Prior to constitutional amendments, S.B. 1609 did not survive legal challenge in <i>Hall v. Elected Officials' Retirement Plan</i> (2016)	<ul style="list-style-type: none"> UNDEVELOPED as to ASRS active employees or retirees FAVORABLE as to active employees and retirees of EORP, PSPRS, and CORP (see reverse side)
CHANGE VESTING PERIOD	NO	YES Did not survive legal challenge in <i>Yeazell v. Copins</i> (1965)	<ul style="list-style-type: none"> UNFAVORABLE as to active employees except by constitutional amendment N/A as to retirees
CHANGE BENEFIT CALCULATION	YES S.B. 1609 (2011) (EORP, PSPRS, and CORP)	YES S.B. 1609 did not survive legal challenge in <i>Hall v. Elected Officials' Retirement Plan</i> (2016)	<ul style="list-style-type: none"> UNFAVORABLE as to active employees and retirees except by constitutional amendment

* **FAVORABLE** indicates that the issue survived litigation in the past and/or there is a permissive legal environment for the change.
* **UNFAVORABLE** indicates that the issue did not survive litigation in the past and/or there is a non-permissive legal environment for the change.
* **UNDEVELOPED** indicates that the issue has not been litigated and/or the current legal environment is unclear as to what the outcome would be.



ARIZONA STATE LAW CONTEXT

State Provisions

ARIZONA CONSTITUTION ARTICLE II, SECTION 25: "No bill of attainder, ex-post-facto law, or law impairing the obligation of a contract, shall ever be enacted."

ARIZONA CONSTITUTION ARTICLE XXIX, SECTION 1(C): "[M]embership in a public retirement system is a contractual relationship . . . and public retirement system benefits shall not be diminished or impaired."

ARIZONA CONSTITUTION ARTICLE XXIX, SECTION 1(D):

"D. Public retirement system benefits shall not be diminished or impaired, except that:

1. Certain adjustments to the public safety personnel retirement system may be made as provided in S.B. 1428, as enacted by the fifty-second legislature, second regular session.
2. Certain adjustments to the corrections officer retirement plan may be made as provided in S.B. 1442, as enacted by the fifty-third legislature, first regular session.
3. Certain adjustments to the elected officials' retirement plan may be made as provided in H.B. 2545, as enacted by the fifty-third legislature, second regular session."

ARIZONA REVISED CODE SECTION 38.714(E)(1): The ASRS board may "[d]etermine the rights, benefits or obligations of any person under this article and any member under articles 2.1 and 7 of this chapter . . ." (Affecting ASRS only)

ARIZONA REVISED CODE SECTION 38.736(A): "Beginning July 1, 2011, member contributions are a percentage of a member's compensation equal to the employer contribution required pursuant to section 38-737." (Affecting ASRS only)

ARIZONA REVISED CODE SECTION 38.737(C): "The required employer contributions shall be determined on an annual basis by an actuary who is selected by the board and who is a fellow of the society of actuaries." (Affecting ASRS only)

Key Opinions

YEAZELL V. COPINS, 402 P.2D 541 (1965)

A retired policeman brought an action against the city's pension board, arguing that the board should compute his retirement in accordance with the act as it was in place at the time he joined the police department instead of based on a change made 10 years later. The Arizona Supreme Court held that pension rights are deferred compensation protected under the Arizona Constitution's Contracts Clause (Article II, Section 25). The court held that public employees are entitled to the terms of the policy in place when they accept employment. The court reasoned that (1) public pension plans are "a valuable part of the consideration for the entrance into and continuation in public employment"; and (2) a party to a contract cannot alter the terms without the assent of the other party. *Yeazell v. Copins*, 402 P.2d 541 at 545. The court signaled that if a plan became "actuarially unsound," a "mutual mistake" defense could be raised because neither party anticipated that the plan would become financially unsound; however, in a later decision, the court rejected this defense at least with respect to a Defined Benefit Plan. (See discussion of *Hall v. Elected Officials' Retirement Plan*, 383 P.3d 1107 (2016), below.)

BARNES V. ARIZONA STATE RETIREMENT SYSTEM, CV 2011-011638 (ARIZ. SUPER. CT. MARICOPA CNTY. FEB. 1, 2012)

Teachers who were ASRS members filed a class action, arguing that S.B. 1614 (2011) unlawfully impaired their contractual rights under the state constitution's Contract Clause and Pension Clause by increasing employee contribution rates as a percentage of the total employee-employer annual contribution. The bill raised contribution rates for active employees by changing the employee-employer contribution formula from 50-50 to a 53% (employees) and 47% (employers) split. The court held that increases in employee contribution rates as a percentage of the total employee-employer annual contribution were unconstitutional because (1) the retirement benefits in place at the time they were hired were "a valuable part of the consideration" for employment; and (2) the unilateral increase to the employees' contribution rate was a substantial impairment of the contract with "no significant and legitimate public purpose." *Barnes v. Arizona State Retirement System*, CV 2011-011638 at 3. The court did not elaborate on what, if any, public purposes the state had asserted or what purposes might be "significant and legitimate" enough to sustain a legislative change to the contract terms.

FIELDS V. ELECTED OFFICIALS' RETIREMENT PLAN, 320 P.3D 1160 (2014)

Retired judges brought a class action against the EORP, arguing that several changes to EORP's formula for future benefit calculation enacted in S.B. 1609 (2011) violated the state constitution's Contract Clause and Pension Clause. The Arizona Supreme Court held that the changes to the future benefit formula were unconstitutional because (1) the statutory formula used to calculate future benefits itself constitutes a "benefit" under the Pension Clause; and (2) the changes to that formula would "diminish and impair" retired members' benefits. *Fields v. Elected Officials' Retirement Plan*, 320 P.3d 1160 at 1166, 1167.

HALL V. ELECTED OFFICIALS' RETIREMENT PLAN, 383 P.3D 1107 (2016)

Active judges who were EORP members brought a class action challenging the constitutionality of S.B. 1609 (2011), which increased the employee contribution rate from 10% (for FY11-12) to 11.5% (for FY12-13) and then to at least 13% (for FY13-14). It also changed the future benefit calculation for active and retired members of the EORP. Plaintiffs argued that the changes violated (1) the Arizona Constitution's Pension Clause, (2) the Arizona Constitution's Judicial Salary Clause, and (3) both the state and federal Contract Clauses. The court held that even though the plan's funded ratio had declined from 121% in 1998 to 62.1% in 2011, the increases to the employee contribution rate and the changes to the formula for calculating future benefits "diminish and impair" the employees' pension benefits in violation of the Pension Clause and the employees' contractual rights. *Hall v. Elected Officials' Retirement Plan*, 383 P.3d 1107 at 1110.

With respect to the future benefit formula, the court held that its ruling in *Fields* applied to active employees equally as to retired employees. *Id.* at 1113. With respect to increases in the employee contribution rates — which had not been at issue for the retired judges in *Fields* — the court relied on *Yeazell* to hold that pension rights are a form of deferred compensation and that employees have a contractual interest in the terms "as they existed when the employees began their services." *Id.* at 1115 (citing *Yeazell v. Copins*, 402 P.2d 541 at 546). Thus, the unilateral legislative increases to employee contribution rates constituted an impairment of plaintiffs' contractual rights.

It is significant that the court rejected the state's "mutual mistake" defense that the benefits terms should no longer be binding because neither party anticipated that the plan would become financially unsound. The *Yeazell* decision had signaled that the law of mistakes of fact would apply if a plan became "actuarially unsound." *Id.* In effect, the court in *Hall* rejected the mutual mistake defense as it related to a plan's financial unsoundness, reasoning that the nature of a Defined Benefit Plan puts the financial risk on the state. Employees do not benefit when a Defined Benefit Plan earns higher than expected returns and thus should not bear the risk if it underperforms. *Hall v. Elected Officials' Retirement Plan*, 383 P.3d 1107 at 1116.

FOR MORE INFORMATION

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