STATE OF MICHIGAN

IN THE SUPREME COURT

WAYNE COUNTY EMPLOYEES RETIREMENT SYSTEM and WAYNE COUNTY RETIREMENT COMMISSION,

Plaintiffs-Counterdefendants-Appellees,

v

CHARTER COUNTY OF WAYNE,

Defendant-Counterplaintiff-Appellant,

and

WAYNE COUNTY BOARD OF COMMISSIONERS,

Defendant-Appellant.

Docket No. 147296

Court of Appeals No. 308096

Wayne County Circuit Court
LC No. 10-013013-AW
Hon. Michael F. Sapala

147296
reply

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APPELLANTS WAYNE COUNTY AND WAYNE COUNTY BOARD OF COMMISSIONERS' REPLY BRIEF IN SUPPORT OF THEIR APPLICATION FOR LEAVE TO APPEAL

FILED

SEP 1 9 2013

LARRY S. ROYSTER
CLERK

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I. ARGUMENT

A. Plaintiffs' response fails to provide any support for the Court of Appeals' interpretation of PERSIA's "exclusive benefit" rule.

Rife with factual distortions,[1] Plaintiffs' response fails to explain how the transfer of assets from the discretionary IEF back into the defined benefit plans resulted in the "assets" of the *retirement system* being used for anything other than the "exclusive benefit" of the participants and their beneficiaries. Despite Plaintiff's repeated assertion that the Court of Appeals' analysis is "sound," the Court of Appeals misconstrued MCL 38.1133(6) in a published opinion, and continually proclaiming otherwise is no substitute for reasoned analysis.

This Court needs to correct the Court of Appeals' error, which is premised on the Court of Appeals' flawed belief that somehow the assets of the *discretionary IEF* are to be treated separately from the rest of the assets in the retirement system and held inviolate, when in fact the IEF is merely a fund *within the retirement system*, just like the defined benefit plans and defined contribution plan (except, of course, that the IEF does not pay accrued benefits). The 2010

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[1] Space limitations allow highlighting only the most egregious instances. For one example, Plaintiffs state that when the retirement system's investments lose money, "the IEF shares in the losses." (Ps' Resp, p 10). This is contrary to Plaintiffs' own prior admission. (See Ps' Resp to Ds' First Set of Discovery, Requests for Admission Nos. 1 & 2, Tab C, Ex 19 to Wayne County's COA Br on Cross-Appeal) ("Plaintiffs/Counter-Defendants *admit that the IEF does not share in the investment losses of the Retirement System.*") (emphasis added). And, this is also contrary to undisputed facts. (See IEF Compared to Investment Income and County Contributions Wayne County Retirement System, Tab B, Ex 17 to Wayne County's COA Br on Cross-Appeal) (showing negative investment income for 2008 in the amount of over $155 million and over $22 million in 2009 and showing that the IEF did not share in any of these losses); see also Wayne County Employee's Retirement System Historical Data 1985 - 2009, Tab B, Ex 20 to Wayne County's COA Br on Cross-Appeal) (showing the funding value of the defined benefit plans declined from 81% to 73.6% in 2008 and dropped further in 2009 to 67%). Plaintiffs nevertheless claim that "generous early retirement incentives" contributed to the retirement system's underfunded status. (Ps' Resp, p 12). But Plaintiffs' own actuary "estimate[d] that the Wayne County Employees Retirement System would be approximately 90% funded . . . (as opposed to 67%) as of the last actuarial evaluation (September 30, 2009), if there had never been a 13th check program." (9/21/10 letter from J. Kermans) (Tab B, Ex 3 to Wayne County's COA Br on Cross-Appeal).

ordinance merely reallocated assets from the retirement system's IEF to the retirement system's defined benefit plans. At all times, those "assets" were used for the "exclusive" purpose of paying benefits to retirement system participants, and the Court of Appeals expressly conceded that even after the 2010 ordinance "the excess assets, once part of the IEF and now part of the defined benefit plan assets on the accounting records, *were still to be used for the benefit of participants and their beneficiaries in the form of regular pension payments*") (emphasis added). (*See* COA Op, p 18). As a result, there simply was no violation of the exclusive benefit rule.

The Court of Appeals nevertheless suggested that 13th checks deserve separate protection because they are something to which "retirees and their survivor beneficiaries" "as a group" have an "entitlement" such that they "could arguably be viewed as an accrued financial benefit." (See COA Op at 20 n 23 and 22). That fundamentally erroneous assertion plainly influenced the Court's strained analysis of the exclusive benefit rule and is directly contrary to *Studier v Mich Pub Sch Employees' Retirement Bd*, 472 Mich 642; 698 NW2d 350 (2005), and *In re Request for Advisory Opinion Regarding Constitutionality of 2011 PA 38*, 490 Mich 295; 806 NW2d 683 (2011).

After seven pages of misdirection,[2] Plaintiffs' response finally addresses the exclusive benefit rule on page 28. Yet, their argument is to merely repeat that the Court of Appeals was

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[2] Plaintiffs only begin to discuss the "exclusive benefit" rule on page 21 of their 42-page response, but it is not until page 28 that they actually consider the language of MCL 38.1133(6). Plaintiffs spend the first seven pages on an "overview" of PERSIA discussing cases completely unrelated to the exclusive benefit rule. (Ps' Resp, pp 21-27). This appeal is not about whether PERSIA supersedes local ordinances, whether a retirement system is a "separate and distinct trust fund," or whether the County may be a "participant in, [or] beneficiary of," the retirement system. (*Id.* at 21-23). Nor is there any dispute that the Retirement Commission is the investment fiduciary, that the Retirement Commission determines the County's annual required contribution or ARC, or that the retirement system's assets are "not the County's property." (*Id.* at 24-25). Likewise, this appeal is not about whether MCL 38.1140m authorizes the 2010 ordinance's credit and offset provision. (*Id.* at 25-26). Plaintiffs suggest that the credit and

Footnote continued on next page ...

right and Wayne County is wrong. Plaintiffs provide *no* statutory analysis for concluding that MCL 38.1133(6) can be violated where, as here, retirement system assets are used for the "exclusive" purpose of paying benefits. Instead, Plaintiffs claim that "exclusive benefit" has some other "natural meaning," but they never say what that is, or from what authority their definition originated.

Sifting through the murk, the shining flaw in Plaintiffs' and the Court of Appeals' reading of MCL 38.1133(6) is the failure to consider the term "exclusive benefit" in context. (*See* Wayne County's App, pp 23-25). MCL 38.1133(6) is straightforward in saying that "assets" of a *retirement system* shall be for the "exclusive benefit" of participants and their beneficiaries. That language means what it says, and nothing more: so long as the retirement system's "assets" are not "shared with others" (applying the Court of Appeals' own definition of "exclusive"), there is no violation of MCL 38.1133(6). That is precisely, and indisputably, what happened here. Wayne County did not use retirement system "assets" for its own "benefit" within the meaning of MCL 38.1133(6) because those assets were never used for any purpose other than to pay benefits to retirement system participants and their beneficiaries. Plaintiffs cannot re-write the statute by imploring this Court to read it in "the narrowest possible fashion." (P's Resp, pp 28-29).

Plaintiffs improperly focus on only half of the equation, i.e., receipt of some "benefit" by Wayne County, even though the ordinance did not make any use of the "assets" of the retirement

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offset provided under the 2010 ordinance is *only* permitted under MCL 38.1140m (*id.* at 25), but none of the cases that Plaintiffs spend two pages discussing even remotely support such an argument. Moreover, Plaintiffs ignore the fact that MCL 38.1140m undermines the Court of Appeals' assertion that *any* credit and offset would violate PERSIA's exclusive benefit rule. The credit and offset under the 2010 ordinance no more contravenes the "exclusive benefit" rule than the one that MCL 38.1140m authorizes.

system. Consequently, Plaintiffs assert (as did the Court of Appeals) that Wayne County still received a "benefit" of sorts because it "avoided paying $32 million that it owes to the Retirement System." (Ps Resp, p 30). But this misses the point entirely. First, Plaintiffs' misguided focus on the $32 million ARC offset ignores that *even without a direct ARC offset,* the Court of Appeals' interpretation of MCL 38.1133(6) would preclude *any* "debiting of the $32 million from the IEF and crediting of that amount to the defined benefit assets" (COA Op at 28 n 29), a conclusion that cannot even remotely be squared with the exclusive benefit rule.

More importantly, the 2010 ordinance *resulted in the payment of the 2011 ARC,* so the defined benefit plans were no less funded than they would have been without the 2010 ordinance. All that changed is that the discretionary IEF bonus fund was reduced. Moreover, and in any event, the exclusive benefit rule is simply not concerned with the retirement system's *funded status,* which is all that Plaintiffs' point goes to. (*Id.* at 29) (referring to Wayne County's "avoidance of millions in minimum funding obligation"). The 2010 ordinance provided for a one-time ARC offset, which helped to fill a budget gap that otherwise would have produced layoffs and reduced county services. As guarantor of last resort, Wayne County is responsible for making up any funding shortfalls because Wayne County is obligated to pay promised retirement benefits.[3]

From its plain language, MCL 38.1133(6)'s *only* concern is ensuring that the actual "assets" of a retirement system (i.e., the "total" of its "cash and investments") are for the

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[3] Thus, despite Plaintiffs' suggestion, the credit and offset provided by the 2010 ordinance in no way threatens the payment of promised retirement benefits, as the County's ARC was indisputably paid. While Plaintiffs' ability to dole out future 13th check bonus payments will surely be impacted given the reduction in the current size of the IEF and the caps placed on future IEF funding and disbursements (indeed that was the point of enacting the 2010 ordinance), *13th checks are not constitutionally-protected accrued financial benefits.*

"exclusive," or sole, "benefit" of the participants and their beneficiaries. Although the credit and offset provided under the 2010 ordinance reduced Wayne County's own contribution to the defined benefit plans, the temporary *savings* the County received has nothing do with the retirement system's "assets" under any meaning of that term. Wayne County did not "benefit" from the system's "assets" in any way, shape, or form. On the contrary, the "assets" in the retirement system have always been used – as even the Court of Appeals acknowledged – to pay benefits to retirement system participants and their beneficiaries. The assets may not have been used *to distribute 13th checks*, but MCL 38.1133(6) does not require that assets in the IEF be used for purposes specific *to the IEF*, i.e., to pay discretionary bonuses.[4] As long as the assets of the *retirement system* (of which the IEF is a part) remain completely intact and used to pay benefits, there can no violation of the exclusive benefit rule.

The United States Supreme Court made this very point in *Hughes Aircraft Co v Jacobson*, 525 US 432; 119 S Ct 755; 142 L Ed 2d 881 (1999), holding that because there was (as here) no claim that "Hughes used any of the assets for a purpose other than to pay its obligations to the Plan's beneficiaries, Hughes could not have violated [ERISA's exclusive benefit rule]." *Id.* at 442-443. Plaintiffs say that "avoidance of an employer's mandatory funding obligation" is not an "incidental benefit" like those described in *Hughes* (i.e., attracting and

[4] Plaintiffs say that they "disagree" with the County's characterization of 13th checks as "bonuses." Plaintiffs' desire to re-characterize reality is understandable given the recent media attention attributing Detroit's bankruptcy in large part to the $1 billion in "bonus cash payments . . . often referred to as a '13th check'" that were distributed by one of the City of Detroit's two pension funds from 1985 to 2008. *See* Borney, *Nearly $1 billion in bonuses paid from ailing Detroit pension fund*, Detroit Free Press, September 8, 2013, http://www.freep.com/article/20130908/NEWS01/309080062/Detroit-pension-13th-check-Chapter-9-bankruptcy-Kevyn-Orr (accessed September 17, 2013). *See also* Borney, *How Detroit went broke*, Detroit Free Press, September 15, 2013, http://www.freep.com/article/20130915/NEWS01/130801004/Detroit-Bankruptcy-history-1950-debt-pension-revenue (accessed September 17, 2013).

retaining employees, etc.) (Ps' Resp, pp 33, 35-36). Once again, Plaintiffs completely miss the point. *Hughes* simply held: "the [exclusive benefit rule] focuses exclusively on whether fund assets were used to pay pension benefits to plan participants." *Hughes*, 525 US at 442. Although *Hughes* also alluded to certain "incidental benefits" to an employer being a permissible result of operating a pension plan, *Hughes'* persuasive value does not depend on whether or not the $32 million ARC credit can be characterized as an "incidental benefit."[5] Under MCL 38.1133(6), and consistent with *Hughes*, the exclusive benefit rule is not violated so long as retirement system assets are not used "for a purpose other than to pay [the systems'] obligations to [its] beneficiaries."[6]

Plaintiffs also cannot distinguish *Claypool v Wilson*, 4 Cal App 4th 646; 6 Cal Rptr 2d 77 (1992). Like *Hughes*, *Claypool* held that California's exclusive benefit rule was not violated when the California legislature directed that former supplemental COLA funds be used to "offset contributions otherwise due from [public employers to the California Public Employees' Retirement System]." *Id.* at 652, 660-661. This is because the funds "continue[d] to be 'held for the exclusive purposes of providing benefits to participants.'" *Id.* at 674 (citation omitted). In an effort to avoid this commonsense holding, Plaintiffs try to distinguish *Claypool* by focusing on superficial factual distinctions. But *Claypool's* rationale is both compelling and consistent with the Supreme Court's decision in *Hughes*, and applies equally to this case. Like the California

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[5] Indeed, the "incidental benefits" were never even quantified in *Hughes* because their monetary value was irrelevant. But needless to say, the employer's savings that were deemed "incidental" in *Hughes* would likely have been millions of dollars.

[6] Plaintiffs also make much of the fact that *Hughes* involved a "pension surplus," but nowhere did *Hughes* suggest that its exclusive benefit rule analysis turned on whether the assets at issue are "surplus." Surplus assets are still plan assets and no less protected by the exclusive benefit rule.

legislature's action in *Claypool*, the 2010 ordinance did not in any way authorize the use of retirement system assets for the County's benefit. They were merely transferred from the IEF to the defined benefit plans (which, unlike the IEF, pay promised benefits) for the direct benefit of the plans' participants. Just as there was no violation of the exclusive benefit rule in *Claypool*, there was no violation here.

B. Plaintiffs similarly fail to provide any support for the Court of Appeals' conclusion that the 2010 ordinance constituted a prohibited "transaction."

Nor did the transfer of assets from the IEF to the defined benefit plans constitute a prohibited "transaction." MCL 38.1133(6)(c) prohibits three types of "transactions": (1) a "transfer" of assets from a retirement system "to" the system sponsor, (2) the "use" of retirement system assets "by" the system sponsor, and (3) the "use" of retirement system assets "for the benefit of" the system sponsor. Plaintiffs fail to provide *any* analysis to suggest that any of these three proscriptions were violated.

First, there was no "transfer" from the retirement system "to" the system sponsor. Plaintiffs state only that they "[do] not concede" that the "transfer of $32 million from the IEF reserve into the defined benefit assets [is] not a 'transfer.'" (Ps' Resp, p 39). But that is not the correct focus, as the only "transfer" prohibited in MCL 38.1133(6)(c) is a "transfer" *from the retirement system to the system sponsor*. No such transfer occurred here. The only transfer in this case was from the IEF fund into the defined benefit plans, which are both within the retirement system. The 2010 ordinance did not cause any funds to actually be transferred *from* the retirement system *to* Wayne County.

As for the "use" of retirement system assets "by" or "for the benefit of" the system sponsor, Plaintiffs merely conclude – again, without analysis – that those prohibited transactions occurred as well. (See Ps' Resp, p 39). But, just like the conclusory Court of Appeals opinion,

Plaintiffs cannot explain *how* the 2010 ordinance constituted a prohibited transaction. Wayne County neither used retirement system assets, nor were retirement system assets "used for the benefit of" the County, because the assets were "used" solely for the payment of benefits to retirement system participants and their beneficiaries.[7]

The essence of Plaintiffs' criticism of the County's textual analysis of PERSIA's prohibited transaction rule is that it "does not cite a single case and merely cites the PERSIA provision." (Ps' Resp, p 39). But it is axiomatic that "the search for legislative intent begins and ends in the language of the statute." *People v Morton*, 423 Mich 650, 655; 377 NW2d 798 (1985). Plaintiffs cite no authority in asserting that prohibited "transactions" can include purely *intra-system transfers* like that at issue.

Instead, Plaintiffs cite inapposite cases addressing true "transactions" between plans and plan sponsors that are in stark contrast to this case. In *Comm'r of Internal Revenue v Keystone Consol Indus, Inc*, 508 US 152; 113 S Ct 2006; 124 L Ed 2d 71 (1993), the employer exchanged certain truck terminals and real property to its defined benefit plan in lieu of satisfying its funding obligation. *Id.* at 154-155. Unlike this case, *Keystone* involved an *actual* transaction between the plan sponsor and plan, and one that was specifically precluded by 26 USC 4975(c)(1)(A), which prohibits a "sale or exchange . . . of any property between a plan and a disqualified person."

In *Baizer v Comm'r of Internal Revenue*, 204 F3d 1231 (CA 9, 2000), a plan fiduciary transferred accounts receivable to a defined benefit plan in lieu of satisfying the plan's funding obligation. *Id.* at 1233. The Ninth Circuit, citing *Keystone*, held that the transfer of accounts

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[7] The Court of Appeals opinion states that the 2010 ordinance caused an "effective" use of retirement system assets by or for the benefit of the County. But as explained in Wayne County's application at pages 43-44, MCL 38.1133(6)(c) addresses only the "actual" use of assets, and no actual "use" in violation of the statute occurred here.

receivable is a prohibited "sale or exchange, or leasing, of any property between a plan and a disqualified person." *Id.* at 1234. As in *Keystone*, *Baizer* involved an actual, and flatly prohibited, transaction between a plan and a plan fiduciary that bears no resemblance to this case.

Peek v Comm'r of Internal Revenue, 140 TC 12, 2013 US Tax Ct LEXIS 12 (2013), and *Rollins v Comm'r of Internal Revenue*, TC Memo 2004-260 (Memo Dec 2004), are equally unhelpful to Plaintiffs. *Peek* held that a loan or loan guarantee between a plan and a disqualified person, even if it goes through a third party proxy, constitutes a prohibited transaction. *Peek*, 2013 US Tax Ct LEXIS at *P16. *Rollins*, which involved loans from a plan to companies partially owned by a disqualified person, reached the same conclusion. *Rollins*, TC Memo 2004-260 at 29-30. These cases involved *actual* transactions between the respective plans and their plan sponsor, as opposed to this case in which there was no "transaction," either between the retirement system and Wayne County, or between the retirement system and a "third party proxy" for Wayne County.

To conclude that the 2010 ordinance does not involve a "prohibited transaction," one need only to examine at MCL 38.1140m, which explicitly provides for a similar credit and offset: "[i]n a plan year, any current service cost payment may be offset by a credit for amortization of accrued assets, if any, in excess of actuarial accrued liability." (*See* Wayne Court's App, pp 45-46). Wayne County does not argue that MCL 38.1140m authorizes the credit and offset. On the contrary, MCL 38.1140m does not apply at all, as the Court of Appeals acknowledged. (See COA Op at 30). But the point is that the credit and offset provided under the 2010 ordinance can no more be a prohibited "transaction" than the similar credit and offset provided for in MCL 38.1140m.

II. CONCLUSION

This Court should either grant leave to appeal or enter a peremptory order reversing the Court of Appeals' published decision and reinstate summary disposition to Wayne County.

Respectfully submitted,

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Dated: September 19, 2013

PROOF OF SERVICE

The undersigned certifies that the foregoing was caused to be served upon all parties to the above cause to each of the attorneys of record herein at their respective addresses as disclosed on the pleadings on September 19, 2013.

BY:	x	U.S. Mail	___	FAX
	___	Hand Delivered	___	Overnight Carrier
	___	Express Mail	___	Other

I declare under penalty of perjury that the statement above is true to the best of my information, knowledge and belief.

Signature: ______________________