STATE OF MICHIGAN

IN THE SUPREME COURT

**WAYNE COUNTY RETIREMENT COMMISSION and WAYNE COUNTY EMPLOYEES' RETIREMENT SYSTEM,**

*Plaintiffs/Appellees*

v

**CHARTER COUNTY OF WAYNE and WAYNE COUNTY BOARD OF COMMISSIONERS,**

*Defendants/Appellants,*

Supreme Court
No. 147296

COA No. 308096
L/C No. 10-013013AW
Hon. Michael F. Sapala

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147296

# RESPONSE OPPOSING LEAVE TO APPEAL

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## COUNTER-STATEMENT OF QUESTIONS PRESENTED

**I.**

Has the County identified any adequate reason under MCR 7.302(B) for this Court to grant leave to appeal or other relief from the Court of Appeals' carefully and thoroughly reasoned opinion, which correctly identifies the portions of the 2010 Ordinance that violate the Public Employee Retirement System Investment Act by authorizing the County to avoid paying $32 million of its minimum funding obligation?

The circuit court did not address the MCR 7.302(B) question.
The Court of Appeals would say no.
The Retirement System says no.

The following two questions track the structure used by the County in its application:

**II.**

Did the Court of Appeals correctly determine that the 2010 Ordinance violated MCL 38.1133(8), the "exclusive benefit" rule, by enabling the County to pay $32 million less than its minimum funding obligation, which underpayment was the purpose of the Ordinance, when (a) the Ordinance is not saved merely because the County did not keep the $32 million it diverted, (b) MCL 38.1140m does not help the County when there is no surplus, (c) the Court of Appeals' reasoning is consistent with federal precedent and ERISA, and (d) the Court of Appeals did not decide the Const 1963, art 9, §24 "accrued financial benefit" question?

The circuit court did not address the MCL 38.1133(8) question.
The Court of Appeals would say yes.
The Retirement System says yes.

**III.**

Did the Court of Appeals correctly determine that the 2010 Ordinance violated MCL 38.1133(8)(c), the "prohibited transaction" rule, by enabling the County to pay $32 million less than its minimum funding obligation, which was the purpose of the Ordinance, when (a) there was a "transfer" "for the benefit of" the County, (b) "indirect" transfers are also prohibited, and (c) MCL 38.1140m does not help the County when there is no surplus?

The circuit court did not address the MCL 38.1133(8)(c) question.
The Court of Appeals would say yes.
The Retirement System says yes.

## SUMMARY OF REASONS TO DENY LEAVE TO APPEAL

The County opens its application with a seven-page "introduction" and summary of reasons why it thinks this Court should be interested in conducting a plenary review of the exhaustively thorough and well-reasoned decision of the Court of Appeals (**Tab A**). Here, the Retirement System summarizes briefly why this Court should not expend its limited time and resources on reinventing this wheel, which is a very fine wheel indeed.

- This Court, the County says, has not decided a case under MCL 38.1133, the PERSIA provision that sets forth the "exclusive benefit" and "prohibited transaction" rules governing public pension systems (Application at 1). True, there were only four decisions from the Court of Appeals, but now there are five. This Court takes cases in infrequently-litigated areas of the law not because there are few cases, but because the bench and bar need definitive guidance on debatable questions of law. There is no debate concerning what PERSIA prohibits and that enacting an ordinance to avoid paying $32 million in mandatory ARC (annual required contributions) is prohibited.[1]

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[1] After one sentence concerning the dearth of PERSIA-related case law, the County begins attacking the Retirement System's exercise of its fiduciary responsibilities with regard to the IEF ("Inflation Equity Fund") (Application at 1-2). That was the subject of Count III of the County's counterclaim in the trial court and its cross-appeal in the Court of Appeals. The County lost, deservedly, in both courts and wisely has decided not to seek this Court's review. Unwisely, however, it cannot resist continuing to flog this horse, even after the body has been removed from the track. The County misleadingly stresses that the System's own actuary opined that the defined benefit plans would be much more fully funded if there had *never* been an IEF program (Application at 2)—a program created in the 1980s by the County, not the System—but neglects to mention that by the time the County enacted the 2010 Ordinance, the $32 million in "repurposed" trust assets resulted in "a miniscule change in the underfunded status of the defined benefit plans" (**Tab A** at 38). The County pointlessly references its former counterclaim (which was Tab B, Ex 3, to its brief of cross-appellant in the Court of Appeals), but the only issues before this Court concern the 2010 Ordinance itself, not the Retirement System's conduct of the IEF program. The County claims it enacted the Ordinance to "correct" the unwise administration of the program, but the plain truth is that it enacted the Ordinance to reduce its ARC by $32 million.

- The Court of Appeals decision, the County says, clearly erred in finding a violation of PERSIA's exclusive benefit rule (Application at 3-5). The Retirement System rebuts this contention in detail in the Argument portion of this response, below. Briefly, however, there was a blatant $32 million violation, so there was no error. The County argues over and over that it cannot have taken Trust assets from the System because it never handled the money itself, like a magician misdirecting the audience's attention to hide what he is up to elsewhere. The County writes only about the wrong $32 million—the money that was "moved" rather than the money that was never paid. The County underpaid its minimum funding obligation by $32 million, using the 2010 Ordinance as cover. The County cannot even consistently assert that it did not benefit[2] from relieving itself of the duty to pay $32 million. When it *does* admit the benefit, the County calls it "incidental." Nonsense. It was the *only* purpose of the 2010 Ordinance.
- The County similarly alleges clear error as to the Court of Appeals' ruling on the "prohibited transaction" requirement of MCL 38.1133(8)(c)[3] (Application at 6), which again the Retirement System rebuts in detail in the Argument below. Briefly, however, the County's argument requires it to pretend that a $32 million transaction is not a "transaction" and that its hands are clean because the Trustees of the Retirement System,

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[2] Although the County protested vigorously in the lower courts that it was not motivated to enact the 2010 Ordinance by an inability to meet its annual funding obligation, it now apparently concedes the point. It acknowledges that the so-called "design change" effected by the 2010 Ordinance "helped to fill a budget gap that otherwise would have produced layoffs and reduced county services" (Application at 2).

[3] This section of PERSIA was amended by PA 2012, No. 347, effective March 28, 2013. One effect of the amendment is that the citation to the "exclusive benefit" subrule mentioned extensively in the County's Application and in the Court of Appeals Opinion changed from MCL 38.1133(6) to MCL 38.1133(8). The Court of Appeals also noted this change (**Tab A**, Opinion at 17 n.18). The statutory language at issue in this case did not change.

not the County, had to "repurpose" the money over their opposition and contrary to their duty to the beneficiaries of the System. But the Trustees' action was compelled by the 2010 Ordinance just as it was prohibited by PERSIA. This was the County's doing.

- The County's four asserted MCR 7.302(B) grounds do not apply in this case:
    - MCR 7.302(B)(1), substantial question as to the validity of a legislative act (Application at 7). There was a substantial question, but the Retirement System raised it and the Court of Appeals has settled it. There is nothing more to be done.
    - MCR 7.302(B)(2), significant public interest and governmental involvement (Application at 7). This one applies, no question, but is not itself a reason to grant plenary review when there already is a published appellate opinion, binding as precedent state-wide under MCR 7.215(C)(2), that correctly nails the legal questions raised in the application.[4]
    - MCR 7.302(B)(3), legal principles of major significance (Application at 7). The County says this one applies because the Court of Appeals' analysis of the "exclusive benefit" and "prohibited transaction" rules in PERSIA was "critically flawed" (*id.*). If the premise were true, the conclusion might follow, but the premise is false. The Court of Appeals decision is not "critically flawed" or flawed at all. It uses correctly stated principles of statutory and ordinance interpretation (**Tab A**, Opinion at 15, citing *Bonner v City of Brighton*, 298 Mich App 693, 696 (2012)), to reach a correct conclusion.
    - MCR 7.302(B)(5), clear error plus either material injustice or conflict with existing precedent (Application at 7). The County states this as a ground but does not argue it (*id*). In any event, there is no inconsistency and this Court will seldom read a Court of Appeals opinion that is as carefully reasoned and free of error as this one.

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4 As an example, the County offers the newly-filed case, *General Retirement System v City of Detroit*, Wayne Cir No. 13-002368-CZ (Application at 6 n.6 and Ex 2), but that case is very different. It concerns an inflation program created by pension system resolution, not by City ordinance, and the City is not trying to use the program assets to reduce its annual funding obligation.

# COUNTER-STATEMENT OF FACTS

**Background**

The identity, composition and nature of the parties is not disputed in this case and is carefully detailed in the opinion of the Court of Appeals (**Tab A**, Opinion at 4-5) and the parties' briefs in the Court of Appeals. The Wayne County Employees' Retirement System is a public body established to provide retirement income and benefits to eligible Charter County of Wayne employees and their survivors. The Wayne County Retirement Commission, a public body empowered by charter and ordinance, is solely responsible for administering and managing the Retirement System. The Commission has eight members, six of whom are elected—four active County employees and two retired employees. The remaining two are ex-officio County members—the Commission Chair and the Wayne County Executive or his designee.

The Retirement Commission is the trustee of the Retirement System's assets, vested with fiduciary responsibility for the operations of the Retirement System. The Retirement System is comprised of a defined contribution plan and several defined benefit plans. The defined benefit plans include a County-created benefit provision that provides a measure of post-retirement relief from the effects of inflation on a fixed pension over time, namely the Inflation Equity Fund, from which are paid the annual "13th checks," explained in detail by the Court of Appeals (**Tab A** at 7-10). All members of the defined benefit plans are eligible for the 13th check unless the benefit was bargained away through collective bargaining. An example of the language used in most CBAs is this: "Employees in the Hybrid Retirement Plan shall be eligible for post retirement cost-of-living adjustments in the form of distributions from the Reserve for Inflation Equity" (System SD Motion, Ex 25 at ¶30.06(B)(8), p. 59; Ex 26 at ¶37.06(B)(9), p.100).

The Retirement System disagrees with the County's description of 13th checks as "discretionary bonus checks" (Application at 8). The word "bonus" does not appear in the Retirement Ordinance itself, or in any of the collective bargaining agreements, or in any Retirement System summaries or reports. The word "bonus" appears to have been coined by the County specifically for this dispute, and concurrently by the County Executive for press releases concerning the litigation. In the same vein, the County tells this Court that these "bonus" checks are to be paid with "excess investment earnings generated during economic boom times" (Application at 8). This is pure fiction, with no basis in any version of the IEF Ordinance ever adopted. The County supports the "boom times" assertion by citing page 7 of the Court of Appeals opinion, but nothing anywhere in the opinion supports the assertion. Words like "bonus" and "boom times" are political spin and nothing more.

Additionally, "bonus" is not an apt label because the 13th check is not a reward for superior service but, as the Court of Appeals noted, a program "to address the impact of inflation on the buying power of pension income" (**Tab A** at 7). The County notes that, although the Court of Appeals "implied" this purpose, the purpose is irrelevant (Application at 8 n.8). Irrelevant or not, the County has thought it important throughout this litigation to use and stress the term "bonus" at every opportunity. It continues to do so in this Court.

As for the "discretionary" nature of the 13th check program, there has never been a dispute about that, although the County has tried mightily to create a dispute, and continues to do so in this Court (*e.g.*, Application at 14). Discretion is built into the IEF Ordinance (**Tab C**), but the Retirement Commission has *invariably* exercised it in favor of distributing a 13th check, consistent with the limits imposed by its fiduciary duties under PERSIA. The County wishes to

use this discretion as evidence that the 13th check is not an "accrued financial benefit," but that is not a PERSIA issue and not an issue presented by the County's application.[5]

While the Court of Appeals did a thorough job of explaining the IEF and its unbroken string of annual 13th checks from 1986 to date (**Tab A** at 7-10), some additional information on how those checks are calculated will be helpful in explaining why the program is not a "bonus" and instead a program to protect retirees from the effects of inflation.

**The 13th check provides inflation protection to those who need it most**

The Retirement System determines the total amount to be distributed in a given year in 13th checks. That number is divided by the total number of "units" (a unit is a year of service or a year of retirement) attributable to all beneficiaries to provide a dollar figure for the "unit value," *i.e.*, the value of each unit. In 2004 the unit value was $28.20 and in 2005 it was $23.36 (County's COA Cross Brief at Tab B, Ex 9). In 2006 and 2007 it was $19.48 and $19.66 (*id.*, Ex 10). In 2008 it was $20.43 (*id.*, Ex 11). The 13th check for each beneficiary is then calculated by multiplying the unit value times the number of units (*id.* Tab C, Ex 5). Thus, the longer an employee has been retired, the more units he or she will have and the larger that employee's 13th check will be. Because the fixed pensions of long-retired employees tend to be lower (their final compensation generally having been lower), and the buying power of their pension checks having been eroded over the years, the 13th check is proportionately greater for precisely those who need it most.

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[5] The Retirement System would like to point out—as it did in the circuit court—that the County's attempted use of the Retirement Commission minutes of June 30, 2003 (Application at 14) is extremely misleading. Those minutes are not "proof" of any kind and show only that the Retirement Commission disagreed with some retirees who wished to keep the Ordinance requirement that at least 20% of the IEF reserve be distributed each year. *See* Retirement System Response to Summary Disposition Motion at 4-5; Affidavit of long-time Trustee, Deputy Director and Director Ronald Yee, System's SD Motion, Ex 3.

**Brief history of the County's inflation equity program**

The County says that the Court of Appeals "implied that the IEF was developed during inflationary times and originally intended to replace cost-of-living adjustments (COLAs)" (Application at 8 n.8), but dismisses the fact as "irrelevant" (*id.*). Rather than being an "implication," however, the Court of Appeals stated it as a fact about which there was no dispute (**Tab A**, Opinion at 7). The circuit court stated it as the County's position in its two summary disposition opinions (County Ex 5, 9/29/2011 Opinion at 3; System's COA Brief of Appellant, Tab B, 12/20/2011 Opinion at 3). This always has been the Retirement System's position too, and it introduced extensive evidence in the circuit court to establish the fact (summarized at length, with supporting record references, in the System's COA briefs). While the circuit court ultimately concluded—erroneously, but now irrelevantly—under MCR 2.116(C)(10) that there was "insufficient evidence" of this purpose underlying enactment of the IEF program (County Ex 5 at 4), the County presumably now views that as "irrelevant."

Briefly, in the mid-1980s the County was looking for cost saving measures and sought to have its retirees forgo retiree cost of living adjustments, then popular and increasingly prevalent in the County. The Sheriffs' union was the first to negotiate an agreement to forgo COLA in exchange for the 13th check. After input from the County, the unions and the Retirement System, all parties arrived at a compromise and, effective November 1985, the County enacted the inflation equity fund ordinance. Retirement Ordinance §141-32 and §141-36 (**Tab B**, Retirement Ordinance, before the 2010 amendment, the "IEF Ordinance). Unlike a typical COLA plan, the IEF program did not permanently increase the base pension of retirees and their beneficiaries.[6]

[6] Yee Affidavit, System's SD Motion, Ex 3, at ¶¶14-17; *see also id.* Ex 5, 1985 Gabriel Roeder Report to the System, explaining cost differences between COLA and IEF benefits with sample calculations; *id.* Ex 4, July 10, 1986 Wayne County Commission meeting minutes at 713-714).

The IEF Ordinance required the Retirement System to establish a reserve for inflation equity and to credit it annually with a portion of the earnings on defined benefit assets, but only in years when earnings exceeded a threshold percentage to be determined by the System trustees (**Tab B** §141-32(a), (b)). Under the IEF Ordinance, the trustees determine what percentage of the inflation equity funds should be distributed to retirees and their survivors in an annual payment known as the "13th check" (*id.* §141-32(c)). The IEF Ordinance specifies the formula to be used in calculating individual checks, based upon each retiree's period of service and length of time retired (*id.* §141-32(e)).

The County makes a point of asserting that all money received by the IEF was "transferred" from the System's defined benefit plans (Application at 8-9). To clarify, *no* money was ever provided by the County to fund the IEF and *no* transfer from existing defined benefit plan assets was ever made. The IEF was established initially and adjusted at all times thereafter by a portion of the Retirement System's investment earnings. When the County speaks of "additional transfers from the defined benefit plans" (*id.* 9), it really means a portion of excess investment earnings from the System's common pool of investments (defined benefit *and* IEF reserve).

The Retirement Ordinance directs that a portion of investment earnings above a threshold to be determined by the Retirement System—generally between 8 and 10% over the years[7]—be allocated to the IEF reserve for accounting purposes. Not more than once a year, the Retirement Commission determines how much of the accumulated IEF reserve should be distributed to retirees and survivors. Recognizing that in some years no money will be added to the reserve, when investments *do* substantially exceed the threshold, not all of the money entering the reserve

[7] The threshold was increased to 11% in 2000 when earnings were 17.06%.

in that year is distributed, so that the reserve will grow and provide a cushion for years in which there are no earnings (System's SD Motion, Ex 5, 1985 Gabriel Roeder Report at 2).

The circuit court was provided with summary figures for the IEF from 1985 through 2009, in chart form (*id.*, Ex 10). In the first year, the actual return on the funding value of System assets was 13 percent, the threshold was set at 10 percent, and a portion of the excess earnings ($12.18 million) were used to create the fund (*id.*). In 1986, investment returns were 11.7 percent, adding another $7.14 million to the reserve, less the distribution made that year in the first of the 13th checks (*id.*). The average 13th check in 1986 was $677.

Every year thereafter, for 27 years, there has been a 13th check distributed to retirees and their survivors in late fall to assist them during the year-end holidays. In most years there have been excess earnings (but not for 1990 or seven recent years, 2002-2005 and 2008-2010). The average 13th check has increased over the years to a high of $2,953 in 2003. Since 2003, the IEF reserve has had an allocation only twice, in 2006 and 2007. With no money allocated in most recent years, but distributions continuing, the trustees of the Retirement System have distributed smaller amounts annually to manage prudently the IEF reserve. Overall from 1986 through 2009, individual distributions averaged $1,859.83 per 13th check (**Tab D**). Due to the distribution cap in the 2010 Ordinance, in 2010 the average 13th check was only $889, by far the lowest total since the IEF program's third year and less than half the average annual check (*id.*).

Assets in the IEF reserve, which is segregated only in an accounting sense under Retirement Ordinance §141-37(g), are combined and invested together, with the System's other defined benefit assets (**Tab G**, Kermans' deposition excerpt). Only the defined contribution assets (contributed by employees) are invested separately from the System's general trust funds. The County Retirement Ordinance specifically explains reserve accounting, which has nothing to

do with the County's attempted "excess" or "surplus" labels.[8] Although the IEF reserve exists as a distinct accounting record, the assets themselves are in the Retirement System's general trust funds, with all the defined benefit funds, held for the sole benefit of the System's retirees and their survivors, and under the exclusive control of the System's trustees (SD Motion, Ex 14, Hutting deposition at 34; **Tab E**, Kermans affidavit at ¶¶40-41).

In years when investment earnings do not reach the 8-10% threshold, the IEF is not allocated anything. In years when the System's investments lose money, the IEF shares in the losses. In all years, when the System's actuaries calculate the County's ARC, the IEF reserve is not included, because inclusion would not impact the amount of the ARC.[9] Again, the County has never made a contribution to the IEF (*id.*, Kermans at ¶39; System SD Motion, Ex 3, Yee at ¶50; *id.*, Ex 9, Affidavit of Augustus Hutting, longtime trustee and former chair of the Retirement Commission, at ¶44). The IEF program is commonly called a "gain sharing plan" (**Tab E** at ¶51; System SD Motion, Ex 12, at 39).

From 1994 to 2000, the IEF Ordinance *required* distribution of not less than 20% or more

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8 Retirement Ordinance §141-37(g) ("Reserve Accounting") reads: "*Asset Segregation.* The descriptions of the reserve accounts shall be interpreted to refer to the accounting records of the retirement system and not to the segregation of assets by reserve account." In addition to the IEF, the Retirement System has about 6 other reserves, all of which hold trust assets that are the property of the Retirement System, not the County.

9 *See generally*, **Tab E**, System SD Motion, Ex 6, Affidavit of Judith Kermans of Gabriel Roeder Smith and Co., actuaries for the Retirement System. In accounting terms, the IEF reserve is both an asset and a liability of the defined benefit plans. If the amount in the IEF reserve were added when calculating the ARC because the IEF is a defined benefit asset, it would also have to be subtracted because it is an equal liability. The ARC calculation would not change by even a penny. That is why the actuaries do not factor in the IEF reserve when calculating the County's ARC.

In the 2010 report (**Tab F**), for example, when the "Funding Value of Assets" is listed in a chart showing historical data (*id.* at page A-4), a footnote explains that the totals do not include the IEF (*id.*: "Reserve for inflation equity not included in this schedule"). It is the "funding value," not the "market value," that is used by the System's actuaries in calculating the County's annual contribution.

than 50% of the IEF reserve. These limits were removed by an Ordinance amendment in 2000. Contrary to what the County tells this Court (Application at 11), there was *never* a maximum on individual 13th checks. The System proposed to the County that the limits be removed to preserve the IEF reserve and assure that annual 13th check payments would always be made, even during lean investment years (System SD Motion, Ex 3, Yee at ¶¶31-32; *id.* Ex 9, Hutting at ¶¶24-25). The change in no way altered the Retirement System's dedication to providing a 13th check every year; it simply increased the likelihood that the System would be able to do so.[10]

The County has always been fully apprised of the Retirement System's administration of the IEF program, since the County Commission and the County Executive each have a Trustee on the Retirement Commission. Until 2010, year after year, unless absent, the County trustees on the Retirement Commission voted in favor of every motion establishing the investment earnings threshold and every motion establishing the amount to be distributed annually as 13th checks.

**Adoption of the 2010 Ordinance**

In 2009, Matthew Schenk[11] was the County Executive's designee to serve as a trustee on the Retirement Commission. (Like every System trustee, he was in that capacity a fiduciary for the System's members, retirees and their survivors.) While on the Retirement Commission, Schenk became focused on the 13th check benefit because of the underlying IEF reserve of about $44 million. At the same time, wearing his County hat, Schenk knew in 2010 of the County's

[10] The IEF Ordinance (**Tab B**) also required minimum permanent pension payments to retirees whose pensions were at very low levels. There was a small one-time accounting entry to allocate funds from the IEF reserve for this purpose in 1986 (the $13,137 entry on System SD Motion, Ex 11), but none thereafter.

[11] Matthew Schenk's own retirement situation aptly illustrates the adverse effects of the County Executive's 2011 retirement incentives on the Retirement System's funding levels. While not in the record, newspaper reports on July 29, 2013 may be of interest to the Court. *See* http://www.freep.com/apps/pbcs.dll/article?AID=2013307290019, http://www.detroitnews.com/article/20130729/METRO01/307290059, and http://www.detroitnews.com/article/20130729/METRO01/307290008 ( accessed 8/19/13).

difficulties in coming up with a balanced budget for Commission approval by the end of September for the upcoming fiscal year, *i.e.*, October 1, 2010 through September 30, 2011.

The County's financial difficulties were also evident to the Retirement System. In June 2010 the County asked the Retirement System to permit its actuary to calculate the ARC using an amortization period of 30 years (rather than the then-authorized 20-year period), the maximum allowed by PERSIA.[12] Earlier the County had requested a lengthier "smoothing period" for the actuarial calculations, another change that provided the County with ARC relief (System SD Motion, Ex 9, Hutting at ¶18). The Retirement Commission worked to accommodate the County, to the extent permitted by its fiduciary obligations.

The County, which had been making regular installment payments of its ARC as often as every two weeks, started holding onto the ARC funds for longer. Payments became quarterly by mid-2008 and, in fiscal year 2010-2011, after the 2010 Ordinance, only one payment was made. Postponing payment to fiscal year end (the last date permitted) increases the amount of the ARC because the original actuary calculations are based upon assumptions of periodic payments throughout the year.

In 2002 and 2003, the Retirement System was overfunded (106% and 103% respectively). Since 2003 (when Robert Ficano became County Executive), the System's funding level has gone down every year (System SD Motion, Ex 2, column 4). The reduction is partially due to reduced investment earnings, particularly in 2008 and 2009. But benefit changes that have been implemented since 2003 and the County's generous early retirement incentives have substantial costs associated with them that have further depressed the funding level.

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[12] A longer amortization period provides the County with more time to fund its obligations, thereby reducing the amount of the ARC each year. The change in June 2010 reduced the County's ARC by approximately $5 million (System SD Motion, Ex 9, Hutting at ¶18).

In August of each year the Retirement System's actuary determines the County's contribution rate for the next fiscal year. The ARC is determined by applying the contribution rate to the County's payroll.[13] On August 24, 2010, the County sent a letter to its employees, describing a County proposal to "temporarily suspend" what the letter termed "the so-called 'thirteenth (13th) bonus check'" until the Retirement System "returns to fully funded status" (System SD Motion, Ex 9, Hutting at ¶15 and attached letters; especially the third one, an August 24, 2010 letter). This proposal had been rejected by the County Commission earlier in August, according to the letter. The County letter warned that not suspending the so-called "bonus" 13th check would likely result in 400-500 additional layoffs five weeks hence, endangering the employment of County workers with less than 15 years seniority (*id.*).

A few days after this letter, Hutting responded to it in a writing addressed to all County employees and retirees (System SD Motion, Ex 9, Hutting at ¶15, 2nd attached letter). Hutting warned that the threatened layoffs were a ruse, as was the alleged impact of the 13th check distribution on the County's ARC for the year (*id.*). He explained that the 13th check was a COLA substitute, not a bonus (*id.*). He predicted that the County's real intent was to use the System's IEF reserve to "pay" the majority of its 2010 ARC.

On September 30, 2010, the deadline for adoption of a budget, the newly amended IEF Ordinance (**Tab C**, the "2010 Ordinance") became effective and the County presented a 2010-2011 budget that allocated to the Retirement System only a fraction of the amount required to pay its ARC that year. Between that year and the next, the County underpaid its ARC by about

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[13] To illustrate with non-record but undisputed figures, the County's contribution rate increased from 30.26% for the fiscal year commencing October 1, 2010 (resulting in an ARC of about $36.3 million) to 39.68% for the fiscal year commencing October 1, 2012 (resulting in an ARC of over $47.8 million). A generous early retirement incentive offered in April 2011—typical of changes made over the last decade—caused much of this increase.

$32 million, relying on the transfer from the IEF reserve mandated by the 2010 Ordinance.

**The immediate and long-term effects of the 2010 Ordinance**

(i) **Effect of the 2010 Ordinance on the IEF Ordinance**

The circuit court had before it an "IEF Ordinance Comparison Chart" (**Tab H**, System SD Motion, Ex 17), comparing the provisions of the IEF Ordinance, §§141-32 and 141-36, before the 2010 Ordinance (*id.* left column) with the provisions in the amending Enrolled Ordinance 2010-514 (*id.* middle column). (For the ordinance text, before and after, *compare* the IEF Ordinance (**Tab B**) *with* the 2010 Ordinance (**Tab C**).)

In the §141-32 amendments, the 2010 Ordinance imposed a cap of $12 million on the IEF reserve, where before no cap had existed. The 2010 Ordinance provided that every dollar above the new cap, about $32 million, could be used by the County to offset its ARC payment (**Tab C**). In that fiscal year and the next, the County used more than $32 million of Retirement System trust assets to diminish its ARC. In an inconsistency that speaks volumes, the 2010 Ordinance contains *both* a $12 million cap and a promise to consider reimbursing the IEF for the $32 million underpayment of the County's minimum funding obligation:

> (f) Within 9 months of first annual distribution from this fund, the [County] CFO shall explore and report to the Wayne County Commission whether it is advantageous to issue bonds as a strategy to fully fund the retirement system ***and reimburse the Inflation Equity fund of $32 million dollars.*** (**Tab C**; emphasis added.)

In the §141-36 amendments, the 2010 Ordinance dictates to the System's actuaries that a 35-year amortization schedule must be used to determine the ARC, contrary to MCL 38.1140m. PERSIA, at MCL 38.1140m, requires that amortization periods not exceed 30 years (**Tab E** at ¶¶44-45).[14] The effect of a longer amortization period—including a period longer than is lawful

[14] Carla Sledge, County Chief Financial Officer, who together with Schenk proposed the 2010 Ordinance, testified that she was aware of the 30-year limit under PERSIA but *unaware* that the 2010 Ordinance provided for a 35-year amortization period (SD Motion, Ex 19, Sledge

under PERSIA—is to extend the County's time to pay its obligation and thereby lower the ARC each year. Also, as adopted, the §141-36 amendment requires the Retirement System's actuary to utilize data for employee compensation from the early 1980s that is no longer maintained or available.

(ii) **The County avoids paying $32 million of its minimum funding obligation**

On the deadline of September 30, 2010, the County Commission enacted the 2010 Ordinance by a vote of 8 to 7, and then immediately adopted the County's Budget, which had been initially presented on June 24, 2010 (using IEF funds to pay the ARC), as a "balanced budget." But for the 2010 Ordinance, the County's budget would have been out of balance by millions and noncompliant with the Uniform Budgeting and Accounting Act, MCL 141.421.

(iii) **The financial benefits of retirees and beneficiaries are diminished**

From the perspective of the Retirement System's members, retirees and their survivors, the 13th checks approved on October 1, 2010 were less than half what they otherwise would have been and, on average, less than 13th checks had been since 1988. The same was true in 2011 and 2012. The IEF reserve would now be exhausted, except that the trustees held back a portion in case the County prevailed on its counterclaim, which requested that the Retirement System pay its attorney fees from the IEF reserve. Even without that now-abandoned threat, the reserve remains on the brink of exhaustion because the County has not complied with any portion of the Court of Appeals' ruling. There has been no reimbursement.

At this writing, the IEF reserve balance is about $3.25 million. The $12 million balance after enactment of the 2010 Ordinance has been reduced by two annual 13th check distributions

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deposition at 100). For his part, Schenk testified that he did not know what the maximum lawful period was (SD Motion, Ex 20, Schenk deposition at 205).

and no investment earnings have been added to the reserve. Preliminary steps have been taken to distribute less than half of the reserve balance in what will be unusually small 13th checks later in 2013. Unless there are investment earnings above the threshold this fiscal year, there will be no increase in the IEF reserve.

**Procedural history**

The Retirement System filed a verified complaint for mandamus, declaratory judgment and injunctive relief on November 8, 2010, at the same time seeking a temporary restraining order, show cause and preliminary injunction. A temporary restraining order was entered but, after three days of hearings, it was lifted. The County responded to the System's complaint with an answer and affirmative defenses. In December 2010 the County's then-counsel (Clark Hill) sought leave to withdraw. The parties stipulated to the withdrawal and the court stayed proceedings to afford the County time to obtain new counsel and to permit the System (on December 23) to file an amended and restated verified complaint (the "Amended Complaint").

The County answered the Amended Complaint in late January 2011 and at the same time filed a counter-complaint, which the Retirement System answered in February. Count III of the counterclaim asserted that the Retirement Commission had breached its fiduciary duties in various respects outlined by the circuit court in its opinion dismissing that claim and in the portion of the Court of Appeals opinion that discusses the cross-appeal (**Tab A** at 33-41).

Cross motions for summary disposition were filed in August 2011 and heard on September 7, 2011. On September 29, the circuit court denied the System's motion and granted the County's motion as to the System's Amended Complaint (Application, Ex 5). The court held that if the 13th check program was an "accrued financial benefit," the offset would violate Michigan Const., Art. IX, §24, but "after a review of the evidence submitted" the court found that it was not an accrued financial benefit (*id.*, Ex 5 at 3; quotation at Application 17).

The circuit court then briefly addressed one aspect of the Retirement System's PERSIA argument, ruling that the 2010 Ordinance did not violate MCL 38.1140m, and dismissed the System's other claims and arguments for the reasons argued by the County (Application at 18 and Ex 5 at 4). The circuit court did not discuss in its opinion the Retirement System's arguments concerning MCL 38.1133(8) and the "exclusive benefit" rule or MCL 38.1133(8)(c) and the "prohibited transaction" rule. Reconsideration was denied on November 28, 2011.

On December 20, 2011 the circuit court held that the System's trustees had not breached their fiduciary duties or otherwise acted unlawfully, and dismissed Count III of the County's counterclaim. After the parties' competing reconsideration motions were denied, the Retirement System timely appealed the September 29, 2011 decision and the County cross-appealed the dismissal of its Count III. The Court of Appeals reversed in part and affirmed in part (**Tab A**), as discussed in this brief. The County has dropped its counterclaim and does not appeal the ruling that the 2010 Ordinance's amortization provision is invalid.

The County continues to insist in its statement of facts to this Court that the Retirement System's PERSIA argument in both the circuit court and the Court of Appeals was focused on a violation of MCL 38.1140m (Application at 19). This is not accurate.[15] Although the circuit court chose to focus on that provision in its opinion, the Retirement System always has argued that the 2010 Ordinance violated PERSIA's exclusive benefit rule and other PERSIA provisions as well. The County also tells this Court that the Court of Appeals "strained" to reach the result it

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[15] The Retirement System's Court of Appeals briefs carefully explained that the question was not whether MCL 38.1140m *prohibited* the transfer but whether it *permitted* the transfer. The transfer already was presumptively prohibited by the exclusive benefit rule, MCL 38.1133(6) [now (8), *see* fn 14], and the question was whether the limited exception in MCL 38.1140m for surplus situations applied (Retirement System COA Brief of Appellant at 36).

did (Application at 19), but there was no strain involved, since the PERSIA violations in this case are not close calls. The statute and the violations are clear.

# ARGUMENT

## I. THIS COURT SHOULD DENY LEAVE TO APPEAL BECAUSE THE COURT OF APPEALS DECISION IS COMPLETE AND CORRECT AND PROVIDES THE PRECEDENT NEEDED TO GUIDE THE BENCH AND BAR ON THE "EXCLUSIVE BENEFIT" AND "PROHIBITED TRANSACTION" ISSUES PRESENTED IN THIS CASE

### A. No standard of review applies to this issue

This Court applies MCR 7.302(B) as a guideline in determining whether to grant leave to appeal. Unlike the Court of Appeals, this Court is not obliged to hear and decide the legal issues presented. In the Court of Appeals, of course, the standard of review for the legal issues presented, which the Retirement System discusses in the next two arguments, is de novo. Ultimately, however, this Court exercises its own discretion as an original matter, not as a review of a previous decision, but based on considerations that arise for the first time when an application for leave to appeal is filed. It is up to this Court, and this Court alone, to decide whether its scarce resources warrant a grant of leave in a case where this Court's opinion would substantially track the published opinion of the Court of Appeals.

### B. Leave to appeal should be denied promptly to avoid the adverse consequences of delay in enforcement of the Court of Appeals decision

Earlier, in the "Summary of reasons to deny leave to appeal," the Retirement System outlined why none of the subsections of MCR 7.302(B) furnish this Court with an adequate reason to grant leave to appeal. Although several subsections *potentially* apply, on closer examination none of them is persuasive. The alleged paucity of precedent is answered by the Court of Appeals opinion itself, which is all the precedent needed on the issues presented. The same is true regarding the alleged question as to the validity of a legislative act. Certainly the

legal principles here are of major significance, but again there is now no lack of precedent to inform the bench and bar. There is no conflict with existing precedent and no material injustice. Indeed, it was the 2010 Ordinance itself that was materially unjust.

The Retirement System acknowledges that the preceding statements are conclusions. The proof is in the next two arguments in this brief, and of course in the Court of Appeals opinion itself. There is one more reason to deny leave in this case, however, and it derives from the rule regarding when a Court of Appeals decision is "effective," MCR 7.215(F)(1)(a), and the timing of 13th checks to the retirees and beneficiaries served by the Retirement System.

The Retirement System cannot replenish the IEF reserve with the $32 million removed from it by the 2010 Ordinance until the Court of Appeals decision is "effective." Currently, there is only $3.25 million in the IEF reserve. In July and August, the Retirement System determines how much to distribute in the annual year-end 13th check program. There has been a distribution every year since the program began in 1986. This year, that decision will have to be made based on the current balance in the IEF reserve. Absent a level of investment earnings that the System has not enjoyed in years, even a very small distribution this year will leave very little remaining with which to fund another distribution in 2014, unless the Court of Appeals decision becomes effective by next July. The process of determining the amount to be distributed involves actuarial work that requires time to complete. Moreover, since the actuaries determine the amount of the County's annual required contribution in complex calculations that are based in part on the existing balance of defined benefit assets, excluding the IEF reserve, it is necessary for the actuaries to know whether the $32 million is or is not in the IEF reserve.

If this Court agrees with the Retirement System that the Court of Appeals opinion furnishes a sound and fully adequate precedent on the issues presented here, the issuance of a

13th check distribution in 2014 will be greatly facilitated by a denial of leave to appeal. While in theory it might be possible to grant leave to appeal and affirm the Court of Appeals in an opinion released during the Court's upcoming October 2013 term, in practice the likelihood is that the prolonged uncertainty resulting from a grant of leave will adversely impact the 2014 distribution. The determination of the County's ARC likewise will be compromised or at least complicated by the uncertainty.

Denying leave to appeal also will avoid a possible constitutional issue. The Court of Appeals did not decide the Const 1963, art 9, §24 issue, *i.e.*, whether the 13th check program was an accrued financial benefit.[16] When retirees and beneficiaries are considered together as a group, the Court of Appeals saw a constitutional issue under Const 1963, art 9, §24, because the IEF reserve had $44 million earmarked to serve as a specific benefit and for no other purpose. Removing $32 million from that reserve was "arguably" unconstitutional, although the PERSIA resolution made it unnecessary to reach that issue (**Tab A**, Opinion at 20 n.23). There is no error in the Court's PERSIA ruling, but hypothetically, if there were, this Court would have to remand to the Court of Appeals for its consideration of this question of Michigan constitutional law (unless the Court reviewed the issue itself). It is unnecessary to reach that issue here, however, and the constitutional question should be deferred to another case by this Court, just as it was by the Court of Appeals.

Leave to appeal should be denied now.

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16 The Retirement System argued in the Court of Appeals and the trial court that the 2010 Ordinance violated both sections of Const 1963, art 9, §24.

## II. THE 2010 ORDINANCE VIOLATES PERSIA'S EXCLUSIVE BENEFIT RULE BECAUSE ITS EFFECT AND PURPOSE WAS TO ENABLE THE COUNTY TO WITHHOLD PAYMENT OF $32 MILLION IN MINIMUM, MANDATORY FUNDING OBLIGATION

### A. The standard of review is de novo

As the Court of Appeals explained, "rulings on motions for summary disposition, issues of statutory construction, matters concerning the interpretation and application of municipal ordinances, and questions of constitutional law" are all reviewed de novo (**Tab A**, Opinion at 14, citing *Midland Cogeneration Venture Ltd P'shp v Naftaly*, 489 Mich 83, 89 (2011), *Spiek v Dep't of Transp*, 456 Mich 331, 338 (1998), and other cases). The County agrees that the standard of review is de novo (Application at 20-21), as did the Court of Appeals in earlier pension appeals. *E.g., Board of Trs of the Policemen & Firemen Ret Sys v City of Detroit*, 270 Mich App 74, 77, *lv den* 477 Mich 892 (2006).

### B. Overview of PERSIA and the exclusive benefit rule

The Public Employee Retirement System Investment Act (PERSIA) establishes controlling law with respect to the investment, use and disposition of Retirement System assets. There is no dispute between the Retirement System and the County whether PERSIA applies or controls here. The parties agree that it does. The question on which they disagree is whether the 2010 Ordinance offends PERSIA.

The provisions of PERSIA "supersede any investment authority previously granted to a system under any other law of this state." MCL 38.1133(1). PERSIA supersedes all local ordinances *and any other* investment authority under Michigan law. *Board of Trustees v Detroit*, 143 Mich App 651, 656 (1985), *lv den* 424 Mich 875 (1986) (*City of Detroit-1985*).

PERSIA controls the investment, use and disposition of all Retirement System assets. Those assets include "the total of the cash and investments of a system valued at market." MCL

38.1132a. PERSIA also dictates that all these assets be held in *trust* for the exclusive benefit of System participants and their beneficiaries. Section 13 states: "The system shall be a separate and distinct trust fund and the assets of the system shall be for the exclusive benefit of the participants and their beneficiaries and for defraying reasonable expenses of investing the assets of the system." MCL 38.1133(8). Therefore, all the Retirement System's cash and investments are required by PERSIA to be held in trust for two limited uses: (1) the exclusive benefit of the participants and their beneficiaries and (2) defraying the reasonable expenses of investing the assets of the system. MCL 38.1133(8); *City of Detroit-1985*, 143 Mich App at 654 ("We feel that the language of this statute is unambiguous on its face").

Section 13(8) requires that the system *shall* be a separate and distinct trust fund and the assets of the system *shall* be for the *exclusive benefit* of the participants and beneficiaries. MCL 38.1133(8) (the "exclusive benefit rule"). The County is not a participant in, nor beneficiary of, the Retirement System; rather, it is expressly defined as a "party in interest." In order to ensure that Retirement System's trust assets are not diverted or improperly used by a "party in interest," Section 13(8) expressly restricts the investment fiduciary's discretion in an important manner. Specifically, the Retirement System's trust assets cannot be used to lend money or extend credit to the County, nor can the Retirement System allow those trust assets to be used by or for the benefit of the County, unless certain express criteria are first met:

> With respect to [the Retirement System], [the Retirement Commission] shall not cause the system to engage in a transaction if he or she knows or should know that the transaction is any of the following, either directly or indirectly:
>
> ***
>
> (b) A lending of money or other extension of credit from the system to [the County] without the receipt of adequate security and a reasonable rate of interest...
>
> (c) A transfer to, or use by or for the benefit of, the [County] of any assets of the system for less than adequate consideration.

MCL 38.1133(8)(b),(c) (the "prohibited transaction rule"). The Retirement System's trust assets are not the County's property and cannot be used by the County for any purpose, *unless* the County pays a reasonable rate of return or provides other adequate consideration. PERSIA expressly protects a system's participants and their beneficiaries from the political subdivision sponsoring the system. The Retirement Commission is *prohibited* from engaging in any transaction that would constitute a "use" "for the benefit of" the County.

Because all of the Retirement System's assets are held in trust for the exclusive benefit of participants and their beneficiaries (and certain prescribed expenses), the trust fund must be administered by appropriate fiduciaries. The "exclusive benefit" rule is a manifestation of the duty of loyalty that underlies trust law. The "prohibited transaction" rule is a specific application of this general duty, barring self-dealing and other conflicts of interest. PERSIA's preamble states that one of the purposes of the act is "to prescribe the powers and duties of investment fiduciaries and certain state departments and officers." An "investment fiduciary" is defined to mean any person (other than a participant directing the investment of the assets of his or her individual account) who exercises any discretionary authority or control in the investment of system assets. MCL 38.1132c. The Retirement Commission is the "investment fiduciary" for the Retirement System under PERSIA. *City of Detroit-1985*, 143 Mich App at 654.

In 2002, PERSIA was amended to add additional protections to the systems' participants and their beneficiaries by expressly precluding involvement of sponsoring political subdivisions (*e.g.*, the County) in certain financial determinations. MCL 38.1140m. *See Board of Tr of the Policemen/Firemen Ret Sys v City of Detroit*, 2005 Mich App LEXIS 1387 (Mich App 2005), *lv den* 474 Mich 1068 (2005) ("*City of Detroit-2005*") **(Tab I)**; *Board of Trs of the Policemen & Firemen Ret Sys v City of Detroit*, 270 Mich App 74, 77, *lv den* 477 Mich 892 (2006) (*City of*

*Detroit-2006*"); *Retired Detroit Police & Fire Fighters Ass'n v Detroit Police Officers Ass'n*, 2010 Mich App LEXIS 2414, 2010 WL 5129841 (Mich App 2010), *lv den* 489 Mich 934 (2011) ("*Detroit Police Officers Ass'n*") (**Tab J**).

The Retirement Commission is accorded broad discretionary powers as the investment fiduciary, limited only by PERSIA itself. *City of Detroit-2006,* 270 Mich App at 84-85. Section 13 provides that the "assets of a system may be invested, reinvested, held in nominee form, and managed by an investment fiduciary *subject to the terms, conditions, and limitations provided in this act.*" MCL 38.1133(1) (emphasis added). *City of Detroit-1985,* 143 Mich App at 654 ("This language is not ambiguous because it grants the investment fiduciary broad powers.") The Retirement Commission is "vested with the general administration, management, and operation" of the system, as well as for "implementation and supervision" of the system. MCL 38.1140m; *City of Detroit-2006,* 270 Mich App at 75. It also is responsible for establishing, with its actuary, the annual required employer contribution. *City of Detroit-2006,* 270 Mich App at 81-85.

Under MCL 38.1140m, the County's minimum annual funding obligation—also referred to as its annual required contribution or ARC—is determined by the Retirement Commission, acting upon the recommendation of an actuary using sanctioned actuarial standards. The ARC is the sum of the amount needed to fund the System's current-year financial needs plus an amount calculated to reduce accrued unfunded liabilities.

Discretion with respect to the ARC determination rests with the Retirement Commission, not the County. *City of Detroit-2006,* 270 Mich App at 81-85. PERSIA does, however, restrict this discretion by limiting the amortization period to no more than 30 years. MCL 38.1140m. This limit protects participants by preventing parties like the County from stretching out the payment of unfunded liabilities unreasonably to reduce current ARC payments.

PERSIA places certain additional restrictions on the Retirement Commission's discretion when dealing with a "party in interest." Parties in interest include certain insiders, fiduciaries, vendors, and various other entities and persons who are in the position to influence or take advantage of the trust. MCL 38.1132d(4). Under Section 12d, a "party in interest" includes the "political subdivision sponsoring the system." MCL 38.1132d. The "political subdivision sponsoring" the Retirement System is the County, which is thus a "party in interest."

Although the Retirement Commission's obligations are owed solely to the System's participants, MCL 38.1133(3), there is a narrowly defined situation in which the Commission has discretion to act in a way that benefits the sponsoring government, here the County. If the System were *overfunded*—by no means the case here—then the Retirement Commission would have discretion to offset, by a credit against trust assets, a corresponding portion of the County's annual required contribution. *City of Detroit-2006, supra.* Section 20m states: "[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." Because the Retirement System has been underfunded since 2004, the Commission had no such discretion at the time the 2010 Ordinance was adopted. Instead, PERSIA's general rule was in effect, meaning that a trustee of the System "shall not cause the system to engage in a transaction if he or she knows or should know that the transaction" either "directly or indirectly" would result in a "use by or for the benefit of, the [County] of any assets of the system for less than adequate consideration." MCL 38.1133(8). The Retirement System's trust assets are not the County's property, and the County cannot unilaterally use the Retirement System's trust assets for any purpose, without adequate

consideration and a reasonable rate of interest.[17]

### C. Prior case law under PERSIA

In *City of Detroit-2005* (**Tab I**), the plaintiff Board of Trustees of the Policemen/Firemen Retirement System of the City of Detroit ("Board") brought an action against the City of Detroit for unpaid ARC payments. The City of Detroit, like the County here, had unilaterally taken a credit against its ARC payment based on a local ordinance. As noted by the Court of Appeals, before enactment of MCL 38.1140m in 2002, the applicable city code and charter provisions governed how contributions were determined and provided the employer with greater authority (**Tab I** at 3). Thereafter, however, "the plain language of MCL 38.1140m specifies the manner in which the governing board is to determine the employer contribution." The statute mandates "what an employer contribution must include, how an employer contribution amount is determined, and what action is required of the governing board and actuary in making this determination" (*id* at 3-4). But in *City of Detroit-2005*, even without the additional protections of MCL 38.1140m, the Court of Appeals rejected the credit, based in part on Const 1963, art 9, § 24. Discretion regarding credits resided with the Board, not the City (**Tab I** at 10-11).

Within months, the City was back in court over another attempt to reduce its financial obligations to its retirement system. In *City of Detroit-2006*, 270 Mich App 74 (2006), the Board again sued the City in another dispute involving the underfunded retirement plan. This time, instead of issuing itself a credit against the ARC, the City sought to direct the Board via ordinance to use certain amortization assumptions in calculating the ARC (much like the 2010 Ordinance did here). But in *City of Detroit-2006,* MCL 38.1140m applied.

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[17] Although the System can consider the County's citizens when making investment decisions, trust assets may be used only if the proposed investment offers the safety and a rate of return comparable to other permitted investments. MCL 38.1133(e).

As summarized by the Court of Appeals, the "plan was underfunded and, therefore, one component of the pension contribution [turned on] the amount of time necessary for Detroit to meet the system's unfunded accrued liabilities." *City of Detroit-2006*, 270 Mich App at 74-75. The Board had adopted a 14-year amortization period but the City maintained that the period should be 20 years under its ordinance. The Board then sought declaratory relief (*id* 76), based on both Const 1963, art 9, §24 and PERSIA. The City was granted summary disposition and the Board appealed. The Court of Appeals reversed based on PERSIA's plain language:

> Thus, the statutory language is unequivocal that the Board determines the amount the employer (Detroit) contributes annually to the Retirement System and that the employer, in turn, is "required" to make the contribution. The Board's determination also necessarily includes the amount of time in which Detroit must pay the unfunded accrued pension liabilities because the period directly affects the amount Detroit must contribute to the plan each year.

*City of Detroit-2006*, 270 Mich App at 80-81. Under MCL 38.1140m, while the amortization period was capped at no greater than 30 years, it was the actuary and the Board who had the discretion to set the period within that limit (*id.* 82). The City's ordinance interfered with that discretion (*id.* 84), and the statute (PERSIA) prevailed over the ordinance. *Accord, City of Detroit-1985*, 143 Mich App at 654, 656 ("This language is not ambiguous because it grants the investment fiduciary broad powers" and "supersedes any investment authority previously granted to a system under any law of this state").

In 2010, the Court of Appeals examined the discretion of investment fiduciaries under PERSIA. In *Detroit Police Officers Ass'n* (**Tab J**), the Retired Detroit Police and Fire Fighters Association sued several unions and the City of Detroit, seeking superintending control of its retirement system to reverse a resolution allowing the City a $2.5 million credit against its ARC during a period when the system was overfunded. The Court rejected the plaintiff's claim, largely based on the investment fiduciaries' discretion under MCL 38.1140m (**Tab J** at 9). The

board had that discretion because at the time the system was overfunded, which is the fatal flaw in the County's own MCL 38.1140m argument in this case.

**D. The 2010 Ordinance violates the exclusive benefit rule**

The Court of Appeals held that §141-32(b)(3) (Tab C) of the 2010 Ordinance, the provision directing the use of $32 million in the IEF reserve to reduce the Couinty's minimum funding obligation "directly conflicts with and violates the exclusive benefit rule" and that "a municipal ordinance that is in direct conflict with a state statute is preempted by state law" (Tab A, Opinion at 17). The County concedes that its ordinance cannot stand if it conflicts with PERSIA and debates only whether the exclusive benefit rule has been violated (Application at 21-27).

The County's mantra in claiming that there was no violation is that "the assets never left the Retirement System, and instead were used exclusively for the benefit of participants and their beneficiaries" (*id.* 21). But as the Court of Appeals pointed out, even though the transferred assets

> once part of the IEF and now [because of the 2010 Ordinance] 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, the County also enjoyed an enormous cost savings benefit. Accordingly, it cannot be said that the assets of the system were held or used "for the *exclusive* benefit of the participants and their beneficiaries." (**Tab A**, Opinion at 18, quoting from MCL 38.1133(8); emphasis by the Court of Appeals.)

The County takes issue with this statement, accusing the Court of Appeals of taking the words "exclusive" and "benefit" out of context, and claiming that what the language really means is only that the System's assets may not be "shared with others" (Application at 23-24). The County cites no on-point authority for this proposition, relying instead on unobjectionable general statements in off-point cases about reading statutory language in context (*id.*). According to the County, "exclusive benefit" must be read in the narrowest possible fashion, so that there

can be no violation if dollars do not physically leave the Retirement System.

To the contrary, "exclusive benefit" has a natural, plain meaning, and it is the meaning attached to it by the Court of Appeals. To be sure, not every conceivable benefit is encompassed, but none of the cases that define the exceptions—called "incidental benefits"—involve anything resembling the avoidance of millions in minimum funding obligation, to the direct benefit of the County and the direct detriment to the System.

The County has substantially overhauled for this Court the argument it previously made to the circuit court and the Court of Appeals. There it argued, in brief, that PERSIA protected only defined benefit assets, and that the funds in the Retirement System's IEF reserve were not defined benefit assets but some kind of unprotected "surplus" the County could use to satisfy its minimum funding obligation. The County no longer makes this argument, at last conceding that the exclusive benefit rule protects *all* "the assets of the system," not just *some* of its assets:

> The system shall be a separate and distinct trust fund and *the assets of the system shall be for the exclusive benefit of the participants and their beneficiaries* and of defraying reasonable expenses of investing the assets of the system. MCL 38.1133(8) (emphasis added), *quoted in* Opinion at 17 (Tab A).

"Assets," in turn is defined broadly in PERSIA to mean "the total of the cash and investments of a system valued at market." MCL 38.1132a. "System" means "a public employee retirement system created and established by...any political subdivision of this state." MCL 38.1132e. Accordingly, *all* assets of the Retirement System—defined benefit assets and IEF reserve assets alike—are fully protected by PERSIA.[18] The County is forbidden by the exclusive benefit rule from taking them directly and it is equally forbidden from using them indirectly by passing an

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[18] The Court of Appeals did not rely on the PERSIA definition, but reached the same conclusion as to the phrase's scope and meaning: "the phrase 'assets of the system' is clearly broad in scope and comprehensive, and it would necessarily encompass all assets held by the Retirement System, including the defined benefit plan assets and the assets in the IEF" (**Tab A**, Opinion at 17-18).

ordinance that says, in effect, "the Retirement System shall make an accounting entry reallocating certain of its assets from one of its reserves to another and, by the way, we will be underpaying our minimum funding obligation by the same amount."

As the Court of Appeals put it, the 2010 Ordinance, rather than reduce the ARC—which of course the County could not do—instead reduced

> the amount of money that the County had to take directly from its own coffers in order to satisfy the ARC obligation. The $32 million savings, which we decline to characterize as a minor or an incidental benefit, freed up County funds for other uses. To describe the impact of the 2010 ordinance as not being beneficial to the County is to wholly ignore the motive behind enacting the ordinance in the first place and the resulting fiscal reality. (Tab A, Opinion at 18)

The Court noted that §141-32(f) of the 2010 Ordinance, concerning attempts to "*reimburse* the Inflation Equity fund of $32 million dollars" (*id.* at 19, quoting Tab C; emphasis by the Court), was itself an admission of "an original benefit conferred upon and used by the reimbursing party" (Tab A at 19). The Court also noted that the County had admitted in 2010 that it faced "budget challenges" that could result in layoffs and curtailed services (*id.* 19 n.20).

The County's answer to all this is that its motive in adopting the 2010 Ordinance is irrelevant (Application at 28). But the Court of Appeals did not find a benefit to the County because of motive; that was merely corroborating background information. The benefit is obvious, and the Court was observing that the County was being disingenuous in denying it.

In the Court of Appeals, as here, the County writes inconsistently on the question of benefit. It both concedes and denies that it received a benefit. No concession is necessary, however, because the benefit speaks for itself. The County avoided paying $32 million that it owes to the Retirement System.

As noted earlier, the County's argument boils down to the simple claim that there can be no violation of the exclusive benefit rule unless assets are physically removed from the

Retirement System. The County's logic means that, instead of adopting the 2010 Ordinance, it hypothetically could have borrowed $32 million from a bank guaranteed by Retirement System assets without violating the exclusive benefit rule, because no assets would leave the System (unless the County defaulted on the loan). Even the County, however, would admit that it cannot borrow against Retirement System assets. But what it did was no better—the 2010 Ordinance was simply an IOU made out to the System, as is made clear by §141-32(f)'s directive to explore "reimburs[ing] the Inflation Equity fund of $32 million dollars" (Tab C, quoted in Tab A, Opinion at 19).

In subsection E of this response, the Retirement System examines case law relied upon by the County and discussed by the Court of Appeals, including cases deciding issues arising under federal ERISA law. These cases only make it clearer still that the 2010 Ordinance violates the exclusive benefit rule.

**E. MCL 38.1140m does not help the County**

The County briefly argues that MCL 38.1140m "expressly permits transfers and offsets similar to that under the 2010 ordinance" (Application at 29-30). In making this claim, the County relies on one sentence in a paragraph that, overall, authorizes *only* the "governing board" (*i.e.*, the Retirement Commission) to calculate and impose the annual required contribution: "In 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" MCL 38.1140m (emphasis added).

MCL 38.1140m does not support the County's argument for two reasons. First, the language the County relies upon refers only to discretionary action by the Retirement System, not the County. If there were a surplus, the Retirement Commission could (but need not) grant an offset against the County's ARC. *Detroit Police Officers Ass'n* (**Tab J**). Second, the exception applies only when plan assets exceed "actuarial accrued liability." It is undisputed that the

System's assets did not exceed its accrued liabilities in 2010 and had not done so for a number of years preceding 2010.

It is MCL 38.1133(8) that establishes the general rule, to which the sentence in MCL 38.1140m on which the County relies is but a commonsense exception. The exception cannot be read to apply at a time when the System is underfunded, Moreover, any judicial "interpretation" that adds additional exceptions to Section 13(8) would violate the well-established rule of statutory construction known as *expressio unius est exclusio alterius*, the expression of one thing is the exclusion of another. *Feld v Robert & Charles Beauty Salon*, 435 Mich 352, 362-364, 459 NW2d 279 (1990). The creation of statutory discretion afforded to the Retirement Commission to extend an offset during periods of overfunding, far from implying a right to do so during periods of underfunding, implies the opposite—the absence of any such right, even on the part of the Retirement Commission, much less the County itself. While a rule of construction is not a rule of law, "[it] is a product of 'logic and common sense.' It expresses the learning of common experience that when people say one thing they do not mean something else." 435 Mich at 363.

### F. Consideration of ERISA and cases in other jurisdictions shows that the Court of Appeals correctly decided the exclusive benefit issue

Throughout this litigation, the County has premised its argument against a violation of the exclusive benefit rule on a California case, *Claypool v Wilson*, 4 Cal App 4th 646, 6 Cal Rptr 2d 77 (1992), and the explanation of "incidental benefit" in *Hughes Aircraft v Jacobson*, 552 US 432, 119S Ct 755, 142 L Ed 2d 881 (1999), quoting from *Lockheed Corp v Spink*, 517 US 882, 116 S Ct 1783, 135 L Ed 2d 153 (1996). In this Court, the County devotes seven pages to these two cases (Application at 30-36). Although the Court of Appeals already has done a very thorough job of demonstrating why these cases do not help the County (**TAB A**, Opinion at 21-26), the Retirement System will respond as well. The County relies on *Hughes* in discussing the

concept of "incidental benefit," but *Hughes* itself is not an incidental benefit case and merely cites to and relies upon *Lockheed. Lockheed*'s list of incidental benefits, notably, does not include avoidance of an employer's mandatory funding obligation. *Hughes* also cites *Comm'r of Internal Revenue v Keystone Consol Indus, Inc*, 508 US 152, 113 S Ct 2006, 124 L Ed 2d 71 (1993), a case the County never cites, which highlights the strict limits on the manner in which mandatory funding obligations are met. *Keystone* is discussed below in the third section of argument concerning "prohibited transactions."

To repeat a point made already by the Court of Appeals (**Tab A**, Opinion at 22 and 25 n.26), ERISA cases and cases from other jurisdictions are not binding on a Michigan court analyzing Michigan law under PERSIA. The plain language of MCL 38.1133(8), alone, compels the result reached by the Court of Appeals (**Tab A** at 22). With that said, an examination of the County's cases reveals that they are, for the most part, consistent with the decision of the Court of Appeals here and, where they appear to vary, they are distinguishable.

**1. *Claypool*: Replacing one benefit with another**

*Claypool*, a case seldom cited outside California and never before in Michigan, dealt with amendment of a state pension statute by a state legislature, not the relationship of the state pension statute to a local ordinance. Unlike here, the only restrictions on the *Claypool* legislation were those established in California's constitution. Indeed, *Claypool* precipitated a change in California's constitution that further protected plan members from plan sponsors.[19] The County

[19] There are significant differences between Michigan and California law. Michigan plan fiduciaries, for example, are charged with discharging their duties solely in the interest of the participants and the beneficiaries, while defraying administrative expenses, MCL 38.1133(3), but in California there is yet another constitutionally-mandated duty— "minimizing employer contributions." Calif Const, art XVI, §17(b). (As an aside, the County's Application quotes only §17(a), and then only as the *Claypool* court reproduced it in a footnote, before its revision later in 1992.) As a result of *Claypool*, Californians voted to amend the constitution to change §17. As amended, the California Constitution clarifies that

says that *Claypool* involved "a credit and offset" provision that was "functionally the same" as the 2010 Ordinance (Application at 35), but that is inaccurate.

*Claypool* dealt with a COLA benefit (the "Boatwright benefit") initially established in 1980 when the California system had a huge $1 billion surplus, later to grow to $2 billion. The enacting statute *required* that recipients be told that the benefit "may be available for only a limited period of time." 4 Cal App 4th at 655. In 1982, new legislation expanded and extended the benefit (the "75% of purchasing power floor"), but again stated that it "may be available for only a limited period of time" and established an express sunset provision, effective January 1, 1989. *Id.* 656. Yet a third version of the benefit was established in 1988 (the "Extraordinary Performance Account benefit"). *Id.* 657. Because of vesting over the years as employees retired, all three versions were in use until 1991, when the challenged statute repealed them and replaced them with an alternative COLA program. *Id.* 657-658.

The *Claypool* court held that employees who retired before January 1, 1989, had no vested contract interest in the continuation of the benefit, because of the sunset provision. The court presumed, however, that those who retired after that sunset date *did* have a constitutionally protected contract benefit. *Id.* 665.[20] The *Claypool* court analyzed at length whether the

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discretion now resides in the retirement board and that the board's duty to members and beneficiaries ***"shall take precedence over any other duty."*** §17(b) (emphasis added). Although, under the California State Employees' Retirement System (PERS), "[t]he reduction of employer contributions," Gov Code §20203.3, remains a proper purpose for the expenditure of retirement funds, that purpose is now expressly subservient to the retirement board's constitutional duties to its members and beneficiaries. This significant change in post-*Claypool* California law—making it more closely resemble Michigan's—has been noted in recent California cases. *See, e.g. O'Neal v Stanislaus Cty Employees' Retirement Ass'n*, 2012 WL 1114677 (Cal App, 5th Dist 2012) (footnote 9 discussing *Claypool*).

[20] In the present case, the Court of Appeals found it "unnecessary, for the most part, to analyze this case under Const 1963, art 9, §24" (**Tab A**, Opinion at 2). The Court noted, however, that there was an "arguable" violation of this provision (*id.* at 20 n.23), which was unnecessary to resolve because the decision was based on PERSIA grounds (*id.*).

replacement program was a comparable alternative to the repealed programs, concluding that it was. No such analysis was undertaken by the circuit court or Court of Appeals here, for obvious reasons—"the 13th check program was eviscerated" (**Tab A**, Opinion at 26).

The County claims that the Court of Appeals misunderstood the significance of *Claypool* (Application at 34), but it is the County that overlooks key differences in the facts and law, not to mention the California reaction to *Claypool*, which was Proposition 162, the Pension Protection Act of 1992 (*see* footnote 19 at 34, *supra*). In the present case, the Court of Appeals chose its words carefully in referring to *Claypool* as an "aberration" (**Tab A**, Opinion at 26).

### 2. *Hughes* and *Lockheed*: Avoiding a mandatory payment is not an incidental benefit

*Claypool* is not a case explaining what "incidental benefit" means in pension law. For that, the County relies on *Hughes, supra* (Application at 31-34). *Hughes* is an ERISA case, not a public pension case, but the two statutes are similar with regard to the exclusive benefit rule, often called the anti-inurement rule in ERISA cases. (*See* ERISA §403(c)(1), 28 USC 1103(c)(1), which uses both phrases.) The County stresses "the factual parallels between *Hughes* and the present case" (Application at 32), but it is the differences that are striking. *Hughes* is strictly a case about a pension *surplus* built in part through participant contributions and a plan sponsor's rights to deal with it in plan amendments *adding* benefits. The 2010 Ordinance, in contrast, was adopted when the Retirement System had no surplus and added no benefit. Indeed, as the Court of Appeals explained, the effect of the 2010 Ordinance

> was as if the County Board reached into the pockets of the Retirement System, retrieved Retirement Systems funds previously allocated to the IEF for 13th checks under the County Board's very own ordinance, and then handed the funds back to the Retirement System for purposes of the ARC, pretending like it was County money and depriving the Retirement System of $32 million. (**Tab A**, Opinion at 24).

*Hughes* does, however, discuss what constitutes a permissible "incidental benefit" to employers:

> Among the 'incidental' and thus legitimate benefits that a plan sponsor may receive from the operation of a pension plan are attracting and retaining employees, paying deferred compensation, settling or avoiding strikes, providing increased compensation without increasing wages, increasing employee turnover, and reducing the likelihood of lawsuits by encouraging employees who would otherwise have been laid off to depart voluntarily.

*Hughes*, 525 US at 445, *quoting Lockheed*, 517 US at 893-894. The receipt of such benefits is not a breach of fiduciary duty or improper "inurement" of a benefit. *Hughes*, 525 US at 445. Fundamentally, an "incidental benefit" is "incidental" to some direct benefit received by plan participants.

The kind of indirect or collateral benefits described by the United States Supreme Court in *Lockheed* (*Hughes* itself is not an "incidental benefit" case) are *nothing* like the direct $32 million benefit the County obtained by adopting the 2010 Ordinance. Incidental benefits result from simply operating or sponsoring a tax-qualified retirement plan, not amending an underfunded plan to avoid paying the necessary ARC. The anti-inurement rule is intended precisely to prevent the employer's use of assets accumulating in trust and pension funds. An incidental benefit "involves a *quid pro quo* between the employer and the participant" (*Lockheed*, 517 US at 894), but here there is only a *quid* without any *pro* between the County and the plan participants. No pension case, ERISA or otherwise, has ever found avoidance of the mandatory annual funding obligation to be an incidental benefit.[21]

[21] The County's other (purportedly contrary) authorities are either easily distinguishable or not contrary. One example will suffice. In *Holliday v Xerox Corp*, 732 F2d 548 (CA 6 1984), the employer, Xerox, had two pension funds, an optional account and a retirement account, that were used to purchase annuities for retiring employees. Neither guaranteed a minimum pension floor. Xerox established a third pension plan to do that, called the Retirement Income Guarantee Plan (RIGP). As an *additional* benefit, the RIGP guaranteed the greater of the income from the retiring employee's own retirement account or a minimum annual pension. Annuity payments made under the retirement account were subtracted as an offset upon retirement to determine whether the additional RIGP payment was due and how much it would be. Plaintiffs were a class of employees formerly employed by companies acquired by and merged into Xerox who had deposited their former pension funds into the Xerox

Nothing is more fundamental to pension law than the plan sponsor's satisfaction of its mandatory funding obligation. The satisfaction must be full in amount and appropriate in manner. The Retirement System discusses this more fully in the next section of argument on "prohibited transactions," where we will discuss one of the cases cited in *Hughes*, namely *Keystone*.

## III. THE 2010 ORDINANCE VIOLATES PERSIA'S PROHIBITED TRANSACTION RULE BECAUSE IT REQUIRED THE TRUSTEES OF THE RETIREMENT SYSTEM TO USE TRUST ASSETS TO DIRECTLY AND INDIRECTLY BENEFIT THE COUNTY, A PARTY IN INTEREST, DURING A PERIOD OF UNDERFUNDING

### A. The standard of review is de novo

As noted in Section II(A) of this argument, *supra* at page 20, the parties and the lower courts all agree that the standard of review for issues of statutory construction is de novo.

### B. PERSIA's "prohibited transaction" rule

The Court of Appeals found that the 2010 Ordinance violated PERSIA's "prohibited transaction" rule, MCL 38.1133(8)(c), which makes it unlawful for the Retirement Commission to "cause the system to engage in a transaction" if it involves, "either directly or indirectly," a "use by or for the benefit of the political subdivision sponsoring the system of any assets of the system for less than adequate consideration" (**Tab A**, Opinion at 26, quoting the statute). The County tackles this holding at the end of its Application (Application at 41-46).

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optional account. Xerox transferred those funds to the employees' retirement accounts so they would be offset upon retirement to determine if an additional RIGP payment was due and how much it would be. Plaintiffs claimed this transfer benefited Xerox by reducing the amount it had to contribute to the RIGP. The district court rejected this claim, as did the Sixth Circuit. The offset calculation for the additional benefit in *Holliday* was nothing like the offset against the ARC payment mandated by the 2010 Ordinance, which directly reduced, dollar-for-dollar, the amount the County paid in ARC; a prohibited benefit to the County as employer. The Xerox transfer had no such effect. For both employees whose annuities exceeded the RIGP amount and those whose annuities did not, the transfer had the "obvious primary purpose and effect of benefitting the employees." *Id.* 551.

PERSIA requires that (a) the Retirement System "shall" be a separate and distinct trust fund, and that (b) the assets of the Retirement System "shall" be for the exclusive benefit of the participants and beneficiaries. MCL 38.1133(8). "The word 'shall' is unambiguous and is used to denote mandatory, rather than discretionary, action." *City of Detroit-2006,* 270 Mich App at 80. In order to protect the systems' trust assets from parties in interest (including the County), Section 13(8) absolutely precludes, either directly or indirectly, the Retirement System from engaging in any transaction involving (a) the lending of money or other extension of credit from the Retirement System to the County, without the receipt of adequate security and a reasonable rate of interest, or (b) the "use by or for the benefit of" the County of any of the trust assets of the Retirement System for less than adequate consideration. MCL 38.1133(8)(b) & (c).

In this case, the County has obtained the "use" or "benefit" of over $32 million of the Retirement System's trust assets by adopting an ordinance that instructs the Retirement System to debit that sum from its IEF reserve and credit the defined benefits assets and then to pretend—it is difficult to put it otherwise—that the $32 million had been paid by the County in satisfaction of its minimum funding obligation. Because the Retirement System received no consideration for this transaction, other than an empty promise to consider the feasibility of coming up with the money later, it is prohibited by PERSIA. MCL 38.1133(8)(c).

**C. The 2010 Ordinance violates the prohibited transaction rule**

The Court of Appeals held that the 2010 Ordinance violated this rule (Tab A, Opinion at 26-27). The Court also noted that the parallel ERISA provision discussed in *Hughes* would compel the same result (*id.* 26) The County's answer, in a nutshell, is that there was no "transaction" and that there cannot be a transaction without a third party. This is a new argument. The County's attempt to limit "transactions" to exclude what it calls "intra-system transfers" (Application at 45) is unsupported by authority and ignores the corresponding offset against the

County's mandatory funding obligation. This section of the Application (*id.* 44-45) does not cite a single case and merely cites the PERSIA provision. But PERSIA's mandate to the Retirement System is that it "shall not cause the system to engage in a transaction if [it] knows...that the transaction is any of the following, either directly or indirectly: (a) [certain sales, exchanges or leases], (b) [an] extension of credit from the system to a party in interest [*e.g.*, the County] without the receipt of adequate security and a reasonable rate of interest..., [or] (c) A transfer to, or use by or for the benefit of, the political subdivision sponsoring the system [*i.e.*, the County] of any assets of the stystem for less than adequate consideration." MCL 38.1133(8).

The plain language of the statute shows that "transaction" does not have the limited meaning contended for by the County. Looking first at subsection (c), the statute says in so many words that the transaction does not have to be a transfer of assets. The "ors" in "transfer to or a use by or for the benefit of" are disjunctive. Even if the transfer of $32 million from the IEF reserve into the defined benefit assets were not a "transfer"—something the Retirement System does not concede and the Court of Appeals did not hold—the corresponding offset was either directly or indirectly (both, in fact) a "use...for the benefit of" the County.

The effect of the 2010 Ordinance, with its promise to think about reimbursing the System for the $32 million, was likewise an extension of credit to the County (*i.e.*, a party in interest)[22] with no security and no interest, violating MCL 38.1133(8)(b). Although the County itself and the County Commission are not investment fiduciaries, the Court of Appeals correctly concluded that "they set into motion the prohibited transaction [which was] a sham transaction involving,

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[22] Contrary to what the County suggests (Application at 44-45), the County *is* a "party in interest" for *all* purposes of the prohibited transaction rule, not just subsection (c) of MCL 38.1133(8). The other subsections limit the County as well.

*effectively*, an unlawful transfer of assets to the County for use to satisfy obligations relative to the ARC" (**Tab A** at 27, emphasis by the Court of Appeals, citing *Hughes*, 525 US at 445).

When PERSIA and ERISA say that certain transactions are prohibited, they mean it. Transactions with even a *potential* for unfairness are prohibited. In the case of ERISA, parallel provisions in the Internal Revenue Code add economic teeth to these prohibitions. A good example, and a case cited in *Hughes*, is *Comm'r of Internal Revenue v Keystone Consol Indus, Inc*, 508 US 152, 113 S Ct 2006, 124 L Ed 2d 71 (1993). There the plan sponsor had attempted to satisfy its minimum funding obligation in part by transferring real property that it owned (truck terminals) to its retirement plans. The employer owned the terminals outright, with no liens, and transferred them at fair market value (purportedly, although the accuracy of the valuation did not figure in the Supreme Court's decision). ERISA and the IRC had a rule against using such property transfers to satisfy annual funding obligations if the property was encumbered, but the employer contended the result should be different if the property was free-and-clear.

The Supreme Court held otherwise. 508 US at 160-161. It was no answer to suggest that the retirement system could sell the properties, because of real estate commissions, problems finding buyers, and similar issues. It would be one thing for an employer to provide its pension plan with real property that was not linked to a diminution of the annual funding obligation, but otherwise the potential for abuse is too great and the transaction is prohibited. The goal is first and foremost to protect pension beneficiaries and their families from any transaction that might leave them less secure than if the annual required contribution were received in cash. Neither the employer nor the plan fiduciaries can take any action inconsistent with that goal. The bar is absolute, and no actual prejudice need exist. In the case at bar, of course, there was actual prejudice because plan participants' 13th checks were diminished.

As discussed in *Keystone*, the phrase "direct or indirect" is broad language intended "to expand, not limit, the scope of the prohibited-tansaction provision." If ERISA case law is useful in understanding PERSIA, *Keystone* is consistant with the Court of Appeals. The benefit to the County, of course, was that under the 2010 Ordinance the County was deemed to have satisfied its mandatory funding obligation to the extent of the corresponding offset, diminishing the amount it actually paid by the same amount. The "satisfaction of a monetary obligation" and the "diminution of the employer's funding obligation" are certainly transactions under ERISA. *Keystone*, 508 US at 158, 159.

*Keystone* is just one example. *See, e.g.*, *Baizer v Comm'r*, 204 F3d 1231 (CA 9 2000) (prohibiting the use of accounts receivable in diminution of employer's funding obligation); *Peek v Comm'r*, 140 TC 12, 2013 US Tax Ct LEXIS 13 (2013) **(Tab L)** (loan guaranties prohibited); *Rollins v Comm'r*, TC Memo 2004-260 (Memo Dec 2004) **(Tab M)** (prohibited transfers not saved even if plan benefits and there is no direct asset transfer). The 2010 Ordinance compelled a very plainly prohibited transaction. The Court of Appeals reached the right result for the right reasons. This Court should deny leave to appeal.

## CONCLUSION AND RELIEF REQUESTED

For all these reasons, and for the additional reasons in the Court of Appeals' opinion (**Tab A**), the Retirement System respectfully requests that this Court deny leave to appeal.

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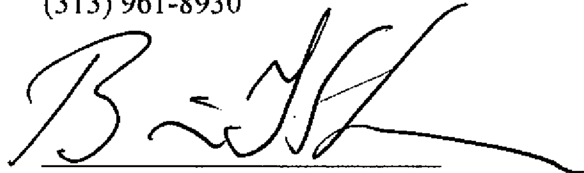

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