STATE OF MICHIGAN
IN THE SUPREME COURT

AFT MICHIGAN, et al,

Plaintiffs-Appellees,

vs.

STATE OF MICHIGAN,

Defendant-Appellant.

Supreme Court No. 154117
Court of Appeals No. 303702
Court of Claims Docket No. 10-91-MM

THIS APPEAL INVOLVES A RULING THAT A PROVISION OF THE CONSTITUTION, A STATUTE, RULE, OR REGULATION, OR OTHER STATE GOVERNMENTAL ACTION IS INVALID

TIMOTHY L. JOHNSON, JANET HESLET, RICKY A. MACK, and DENISE ZIEJA,

Plaintiffs-Appellees/Cross-Appellants,

vs.

PUBLIC SCHOOL EMPLOYEES RETIREMENT SYSTEM, PUBLIC SCHOOL EMPLOYEES RETIREMENT SYSTEM BOARD, TRUST FOR PUBLIC EMPLOYEE RETIREMENT HEALTH CARE, and DEPARTMENT OF TECHNOLOGY, MANAGEMENT, and BUDGET,

Defendants-Appellants/Cross-Appellees,

and

DIRECTOR OF DEPARTMENT OF TECHNOLOGY, MANAGEMENT, and BUDGET, DIRECTOR OF RETIREMENT SERVICES OFFICE, and STATE TREASURER,

Defendants.

Supreme Court No. 154118
Court of Appeals No. 303704
Court of Claims Docket No. 10-47-MM

PLAINTIFFS/APPELLEES/CROSS-APPELLANTS' DEBORAH McMILLAN, THOMAS BRENNER, THERESA DUDLEY, KATHERINE DANIELS, AND COREY CRAMB'S BRIEF ON APPEAL

**** * *ORAL ARGUMENT REQUESTED * * ****

DEBORAH MCMILLAN, THOMAS BRENNER, THERESA DUDLEY, KATHERINE DANIELS, and COREY CRAMB,

Plaintiffs-Appellees/Cross-Appellants,

vs.

PUBLIC SCHOOL EMPLOYEES RETIREMENT SYSTEM, PUBLIC SCHOOL EMPLOYEES RETIREMENT SYSTEM BOARD, TRUST FOR PUBLIC EMPLOYEE RETIREMENT HEALTH CARE, and DEPARTMENT OF TECHNOLOGY, MANAGEMENT, and BUDGET,

Defendants-Appellants/Cross-Appellees,

and

DIRECTOR OF DEPARTMENT OF TECHNOLOGY, MANAGEMENT, and BUDGET, DIRECTOR OF RETIREMENT SERVICES OFFICE, and STATE TREASURER,

Defendants.

Supreme Court No. 154119
Court of Appeals No. 303706
Court of Claims Docket No. 10-45-MM

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PLAINTIFFS/APPELLEES/CROSS-APPELLANTS'
DEBORAH McMILLAN, THOMAS BRENNER, THERESA DUDLEY,
KATHERINE DANIELS, AND COREY CRAMB'S
BRIEF ON APPEAL

*** * *ORAL ARGUMENT REQUESTED * * ***

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COUNTER-STATEMENT OF JURISDICTION

This Court granted Defendants' Application for Leave by Order dated May 31, 2017. The State's Application was filed following the Court of Appeals' June 7, 2016 decision on remand. (Appellants' Appendix, at 433a-462a.) As in its initial decision dated August 16, 2012 (Appellants' Appendix, at 132a-160a), the Court of Appeals determined that 2010 PA 75 ("PA 75") was unconstitutional under the Contracts Clauses and Takings Clauses of the State and Federal Constitutions, as well as under their guarantees of substantive due process.

Contrary to Defendants' assertion, this Court did not "reverse" the Court of Appeals' initial findings of unconstitutionality after 2012 PA 300 ("PA 300") amended PA 75. Rather, this Court vacated and remanded to the Court of Appeals for further consideration in light of its decision in *AFT v Michigan*, 497 Mich 197; 864 NW2d 555 (2015). For instance, in remanding the case to the Court of Appeals, this Court provided the following direction:

> On remand, the Court of Appeals shall consider what issues presented in these cases have been superseded by the enactment of 2012 PA 300 and this Court's decision upholding that Act, and it shall only address any outstanding issues the parties may raise regarding 2010 PA 75 that were not superseded or otherwise rendered moot by that enactment and decision.

AFT Michigan v State of Michigan, 498 Mich 851; 864 NW2d 555 (2015).

Having now granted leave, this Court will consider the issues involved. The Court of Appeals has twice reviewed the legal issues presented and rendered clear, well-reasoned decisions. Based upon the arguments contained herein, the Court of Appeals' decision must be affirmed.

COUNTER-STATEMENT OF QUESTIONS INVOLVED

I. WHETHER BOTH PUBLIC ACT 300 OF 2012 AND THE DECISION IN *AFT II* APPLY PROSPECTIVELY ONLY?

The Court of Appeals answer is "Yes"

Plaintiffs-Appellees answer "Yes"

Defendants-Appellants answer "No"

II. WHETHER THE MANDATORY 3% DEDUCTION FROM PLAINTIFFS' EARNED COMPENSATION, MADE PURSUANT TO PUBLIC ACT 75 OF 2010, RESULTED IN THE UNCONSTITUTIONAL IMPAIRMENT OF PUBLIC SCHOOL EMPLOYEES' EMPLOYMENT CONTRACTS?

The Court of Appeals answer is "Yes"

Plaintiffs-Appellees answer "Yes"

Defendants-Appellants answer "No"

III. WHETHER THE MANDATORY 3% DEDUCTION FROM PLAINTIFFS' EARNED COMPENSATION, MADE PURSUANT TO PUBLIC ACT 75 OF 2010, RESULTED IN AN UNCONSTITUTIONAL TAKING IN VIOLATION OF CONST 1963, ART 1, §2 OR AMENDMENTS V AND XIV OF THE UNITED STATES CONSTITUTION?

The Court of Appeals answer is "Yes"

Plaintiffs-Appellees answer "Yes"

Defendants-Appellants answer "No"

IV. WHETHER THE MANDATORY 3% DEDUCTION FROM PLAINTIFFS' EARNED COMPENSATION, MADE PURSUANT TO PUBLIC ACT 75 OF 2010, RESULTED IN A VIOLATION OF PLAINTIFFS' SUBSTANTIVE DUE PROCESS IN ACCORDANCE WITH THE FOURTEENTH AMENDMENT OF THE UNITED STATES CONSTITUTION OR CONST 1963, ART 1, §17?

The Court of Appeals answer is "Yes"

Plaintiffs-Appellees answer "Yes"

Defendants-Appellants answer "No"

COUNTER-STATEMENT OF FACTS

PA 75 took effect in May 2010, requiring all members of the Michigan Public School Employees Retirement System ("MPSERS") contribute 3% of their earned wages to help fund the cost of health benefits for members and their dependents when they retired and, at the same time, pay for health benefits for Retirement System members who had already retired and were receiving health benefits from MPSERS.

PA 75 required the 3% deducted from employees' wages by their local school district employers be sent to MPSERS, which would in turn place such contributions in an irrevocable trust fund created by the newly-enacted 2010 PA 77.

On June 11, 2010, Plaintiffs filed their Complaint in the Michigan Court of Claims seeking to declare various provisions of PA 75 unconstitutional. On a motion filed by Plaintiffs, the Court of Claims issued an injunction directing that the 3% deducted from the wages of all MPSERS' members be placed in an escrow account and not be used by Defendant Retirement System to pay for retirees' health benefits until the final disposition of Plaintiffs' lawsuit. (Appellees' Appendix, at 1b-2b.) Subsequently, Plaintiffs AFT and AFSCME filed similar lawsuits and the three cases were consolidated by the Court of Claims.

Until the passage of PA 300 in September 2012, the local school districts deducted the 3% pursuant to PA 75 and sent the money to MPSERS, who then placed the money in the escrow account established pursuant to the Court of Claims injunction. The amount currently in the escrow account pursuant to the 3% deduction, plus interest, is in excess of $550,000,000.

The Court of Claims ruled in Plaintiffs' favor and declared the operative provisions of PA 75 unconstitutional, as did the Michigan Court of Appeals. See, *AFT v Michigan*, 297 Mich 597; 825 NW2d 595 (2012) (***"AFT I"***). Defendants' Application for Leave to Appeal followed.

Shortly after the Court of Appeals ruled for Plaintiffs, the Legislature enacted PA 300, establishing *inter alia* an entirely new program from that which existed in PA 75 as to how all MPSERS members would be required to contribute 3% of their wages towards the expense of health care after their retirement.

PA 300 was in numerous respects materially different from the scheme established under PA 75. Among other things, all MPSERS members were then given a "choice" as to whether to participate in the health care program. If they chose not to participate, then they would not have the 3% taken from their wages. Unlike PA 75, participation in the health insurance program of MPSERS under PA 300 became voluntary. Additionally, PA 300 provided that if a person chose to participate in the 3% deduction program but did not end up receiving health benefits from the Retirement System, they would be repaid their 3% contributions over a period of several years upon reaching retirement after the age of 60.

Complaints were similarly filed in the Court of Claims challenging the constitutionality of PA 300. The Michigan Court of Claims, Court of Appeals, and this Court upheld the constitutionality of 2012 PA 300. *AFT v Michigan*, 497 Mich 197; 864 NW2d 555 (2015) (***"AFT II"***). PA 300 remains in effect and is operative at present. While the PA 300 case was pending in this Court, it held in abeyance any decision regarding Defendants' Application for Leave to Appeal regarding the Court of Appeals' decision on PA 75. (Appellants' Appendix, at 299a-302a.)

After its decision regarding the constitutionality of PA 300, this Court, without granting or denying Defendants' Application for Leave to Appeal, remanded the 2010 case regarding PA 75. On remand, the Court of Appeals found neither PA 300 nor this Court's decision in *AFT II* superseded its prior decision in *AFT I*. Specifically, the Court of Appeals stated:

> Per the Supreme Court's direction, we have considered whether the adoption of 2012 PA 300 or the Supreme Court's decision in *AFT II* renders moot any of the challenges to 2010 PA 75 or supersedes any of the constitutional analysis we employed in our earlier review of that act. We conclude that neither the legislative amendments nor the Supreme Court's decision supersedes or renders moot any of the issues raised in *AFT Mich. I* as to the mandatory wage reductions made during the period 2010 PA 75—but not 2012 PA 300—was in effect (hereinafter "the mandatory wage reduction period" or "the mandatory period"). We also conclude that neither the passage of 2012 PA 300 nor the Supreme Court's decision in *AFT Mich. II* requires that we alter the analysis we employed in our now-vacated decision in *AFT Mich. I* as to the constitutionality of 2010 PA 75 as it existed during the mandatory wage reduction period. The compulsory collection of 3% of employee wages during that period was unconstitutional. Accordingly, we remand this matter to the trial court with the direction to return the subject funds, with interest, to the relevant employees.

AFT v State of Michigan (On Remand), 315 Mich App 602, 611-612; 893 NW2d 90 (2016) (***"AFT III"***).

Defendants filed their Application for Leave to Appeal on July 19, 2016, and, on May 31, 2017, this Court granted leave. Defendants filed their main Brief herein on July 26, 2017.

Since PA 300 totally revised the statutory provisions for the employees paying a portion of their wages to the irrevocable trust fund established under 2010 PA 77, the only valid issue remaining for the Court is whether the $550,000,000 plus in escrow was unconstitutionally taken from the employees' wages and should be returned to the employees from whom it was illegally taken. For the reasons set forth herein, and for those given by the Court of Appeals on remand in *AFT III*, Plaintiffs ask this Court to order the money in the escrow account be returned by MPSERS to the employees from which it was unconstitutionally taken.

STANDARD OF REVIEW

Decisions involving questions of statutory construction and constitutionality of statutes are both reviewed *de novo*. *Ronnisch Constr Group, Inc v Lofts on the Nine, LLC*, 499 Mich 544, 570; 886 NW2d 113 (2016); *Hunter v Hunter*, 484 Mich 247, 257; 771 NW2d 694 (2009).

ARGUMENT

I. BOTH PUBLIC ACT 300 OF 2012 AND THE DECISION IN *AFT II* UPHOLDING ITS CONSTITUTIONALITY APPLY PROSPECTIVELY ONLY.

PA 300 was signed into law on September 4, 2012. At that time, it was given *immediate effect*. However, within the Act itself, the Legislature made no declarations as to its retroactive application. Further, this Court made no pronouncement in *AFT II* as to the application of PA 300 to actions which occurred prior to its adoption. Yet, Defendants seek to apply terms of that amendatory act to matters occurring prior to its effective date.

During the Application process, Defendants argued the following in their Reply Brief:

> Defendants have not, and do not, contend that PA 300 applies retroactively. Rather, the refund provisions of PA 300 apply prospectively, but to **all** contributions made under section 43e. While some of those contributions were made prior to the enactment of PA 300, this Court has long held that "[a] statute is not regarded as operating retrospectively because it related to an antecedent event."

Appellees' Appendix, at 35b-36b; Defendants' September 20, 2016 Reply Brief, at 4-5 – (emphasis in original; citation omitted).

Instead, Defendants claim PA 300 was "remedial" – *i.e*, "[T]he Union confuses the concepts of retroactivity and remedial legislation, and fail to understand that the Legislature designed PA 300 not to apply retroactively, but, instead, to correct judicially-identified flaws in PA 75." (Appellees' Appendix, at 32b; Defendants' September 20, 2106 Reply Brief, at 1.)

There is no confusion between the concepts of retroactivity and remedial legislation. As discussed below, legislation is presumed to be *prospective only*, and not retroactive. Although an exception to this presumption exists, that exception applies only if the statutory change is *remedial or procedural* in nature. Because of the impact the PA 300 amendments had on the substantive rights of members, it cannot be considered to fall within this exception.

The "flaws" in PA 75 which Defendants assert were corrected by PA 300 were not remedial or procedural in nature.

Despite their semantics, Defendants seek to apply PA 300 retroactively to assert dominion over those prior extractions. Defendants would have PA 300 reach back and capture from the escrow account the previous contributions involuntarily and unconstitutionally taken under PA 75 to have them placed in the irrevocable trust fund created by 2010 PA 77.

The Court of Appeals' analysis in *AFT III* was correct in concluding that PA 300 is not to be retroactively applied:

> The question before us now is whether the change from mandatory to voluntary contributions set forth in 2012 PA 300 retroactively rendered constitutional the reduction of wages during the mandatory period.
>
> As with any question of statutory interpretation and application, we begin with the language of the statute. *Lash v Traverse City*, 479 Mich 180, 187; 735 NW2d 628 (2007). **The language of 2012 PA 300, as the state concedes, contains no retroactivity provision and makes no reference to the funds collected during the mandatory period.** "Nothing will be read into a clear statute that is not within the manifest intention of the Legislature **as derived from the language of the statute itself**." *Thomason v WCAC Contour Fabricators, Inc*, 255 Mich App 121, 124-125; 662 NW2d 51 (2003). **Accordingly, we may not read the 2012 amendments as retroactive nor as governing funds collected before the application of 2012 PA 300.**

AFT III, 315 Mich App at 613 (emphasis added).

This reasoning is consistent with principles governing the retroactive application of legislation to prior occurrences.

A. <u>The presumption against retroactivity holds true in this case, and is supported by the language of PA 300 and its legislative history.</u>

Michigan courts agree with federal jurisdictions that statutes and statutory amendments are presumed to operate prospectively. See e.g., *Davis v State Employees' Retirement Bd*,

272 Mich App 151, 155; 725 NW2d 56 (2006); *Frank W Lynch & Co v Flex Technologies, Inc*, 463 Mich 578, 583; 624 NW2d 180 (2001).

The Legislature's expression of an intent to have a statute apply retroactively must be clear, direct, and unequivocal, as appears from the context of the statute itself. *Davis*, supra, at 155-156. See, for instance, *INS v St Cyr*, 533 US 289, 316; 121 S Ct 2271; 150 L Ed 2d 347 (2001), which stated, "A statute may not be applied retroactively, however, absent a clear indication from Congress that it intended such a result." As reiterated by this Court, "All other rules of construction and operation are subservient to this principle." *Frank W Lynch*, 463 Mich at 583 (citation omitted).

In *Frank W Lynch*, this Court embraced the principle that the Legislature must make clear its intentions with respect to retroactivity. Specifically, this Court agreed:

> [A]bsent some clear manifestation, we simply cannot attribute to the Legislature an intent to give the SRCA retroactive effect.
>
> In that regard, we agree with the *Landgraf* Court that **a requirement that the Legislature make its intention clear "helps ensure that [the Legislature] itself has determined that the benefits of retroactivity outweigh the potential for disruption or unfairness."** *Landgraf, supra* at 268, 114 S.Ct. 1483. **This is especially true when a new statutory provision affects contractual rights, an area "in which predictability and stability are of prime importance."** *Id.* at 271, 114 S.Ct. 1483.

Frank W Lynch, 463 Mich at 586-587 (citing *Landgraf v USI Film Products*, 511 US 244; 114 S Ct 1483; 128 L Ed 2d 229 (1994)) (footnotes omitted; emphasis added).

The *Frank W Lynch* Court relied on two particular signals which indicated there was *no* legislative intent to apply the new Sales Representatives' Commissions Act (SRCA) retroactively. First, this Court found to be "[m]ost instructive" the fact that the Legislature included no express language regarding retroactivity:

> **[T]he Legislature has shown on several occasions that it knows how to make clear its intention that a statute apply retroactively.** See, e.g.,

> M.C.L. §141.1157; MSA 5.3188(257) ("This act shall be applied retroactively . . ."); MCL 324.21301a; MSA 13A.21301a ("The changes in liability that are provided for in the amendatory act that added this subsection shall be given retroactive application").

Id. (emphasis added).[1]

A more recent example of this principle in action since PA 300 took effect involves 2014 PA 282. There, unlike the present case, the Legislature included a clear expression of its intention to apply the newly-enacted provisions retroactively (e.g., "This amendatory act is retroactive and is effective for tax years beginning on and after January 1, 2010.")

Absent from the language of PA 300, however, is any clear manifestation of an intention to apply any of its terms retroactively to the mandatory deductions already taken from the earned compensation of public school employees pursuant to PA 75. When the parties to this lawsuit entered into the Stipulation and Order dated September 8, 2010 in the Court of Claims, the State agreed it would return the 3% deducted pursuant to PA 75 if determined unconstitutional. (Appellees' Appendix, at 3b-5b.) There is no express language in PA 300 notifying the affected members that the amendment was now intended to apply to the deductions previously mandated by PA 75, which at the time of PA 300's amendments, had been declared unconstitutional by the Court of Appeals. No form of the word "retroactive" is found anywhere throughout PA 300. Additionally, use of the phrase "immediate effect" does not at all suggest that a public act applies retroactively. See *Johnson*, 491 Mich at 430.

The Legislature's reenactment of Section 43e of PA 75 into the new PA 300, instead, demonstrates that retroactivity was not intended. In adopting PA 300, Section 43e was not

[1]See also, *Johnson v Pastoriza*, 491 Mich 417, 430-431; 818 NW2d 279 (2012), which stated, "The Legislature was cognizant of the operative language necessary to apply any particular provision in the amendatory act retroactively but did not include such language in [the subsequent act]."

restated as it had been initially adopted in PA 75. Rather, changes were made to Section 43e as part of the new PA 300. From the initial Senate Bill (SB 1040) introduced March 22, 2012, and through each iteration until the final Senate Concurred Bill passed August 15, 2012, one consistent change with regards to Section 43e was the deletion of the qualifier, "beginning July 1, 2010." (Appellees' Appendix, at 17b through 28b.) This date (i.e., July 1, 2010) was the date upon which PA 75 first began deducting the 3% from the earned compensation of public school employees. By deleting the express reference to this date in SB 1040 and in the final PA 300, the Legislature made it abundantly clear that the newly-revised Section 43e no longer applied to the deductions "beginning July 1, 2010." As a result, PA 300 was not intended by the Legislature to be retroactive.

The second factor relied upon in *Frank W Lynch* in rejecting retroactivity was the fact that the new SRCA imposed liabilities if the principal "failed to comply with this section." Given this fact, the Court reasoned:

> Because the SRCA did not exist at the time that the instant dispute arose, it would have been impossible for defendants to "comply" with its provisions. Accordingly, this language supports a conclusion that the Legislature intended that the SRCA operate prospectively only.

Id.

Likewise, PA 300 includes statutory contingencies that could not have been accomplished prior to its adoption, and attaches consequences for members depending on which of those contingencies were subsequently activated. Yet, those provisions did not exist at the time the instant dispute arose regarding PA 75.

For example, while the PA 300 version of Section 43e now starts, "Except as otherwise provided in this section **or section 91a** . . .," the PA 75 version of Section 43e contained no such reference. *None* of Section 91a was included as part of PA 75, especially the original

Section 43e. It was only added by PA 300. Though the new Section 91a(8) begins, "A member or former member who does not make the election under subsection (5) . . . ," the election to be made under Section 91a(5) was expressly "effective on the transition date," and no time sooner. MCL 38.1391a(5) and (8). As PA 75 did not afford this election to members, there was no way for members to avoid the mandatory 3% deduction from their compensation.

As to the new Section 91a(8), Defendants conclude their Brief with an incomplete cite to the *AFT III* discussion on remand as to the retroactivity of the new refund mechanism under PA 300. (Defendants' Brief, at 48.) The *entire* discussion of the Court of Appeals reads as follows:

> The state correctly points out that **if** the escrowed funds are turned over to the state, the funds would be subject to the refund mechanism of 2012 PA 300 for those employees who ultimately do not qualify for retirement healthcare benefits. Specifically, MCL 38.1391a(8) provides that the refunded sum shall be "equal to the contributions made by the member under section 43e"; therefore, it must include the sums collected under Section 43e from its inception, not merely after the modifications of 2012 PA 300. Therefore, it can be argued that so long as MCL 38.1391a(8) remains unaltered and in effect, those employees who do not opt out of the new system but do not ultimately qualify for benefits will not suffer a constitutional deprivation because they will receive back what they put in, including the sums withheld during the mandatory period. **Putting aside the fact that the number of employees who will qualify for the refund is likely relatively few, this provision completely fails to address the fundamental constitutional defect imposed by 2010 PA 75 during the mandatory period.** The problem was not that mandatory contributions are in and of themselves unconstitutional. **The constitutional problem was, and is, that the mandated employee contributions were to a system in which the employee contributors have no vested rights.** Because retirement healthcare benefits are not "accrued financial benefits," the Legislature has the authority to reduce or eliminate those benefits—including the refund mechanism of MCL 38.1391a(8)—at any time. While there is no constitutional prohibition against inviting employees to voluntarily participate in an unvested system, the same is not true when participation is mandated by law. **The wages withheld during the mandatory period were taken without any legally enforceable guarantee that the contributors would receive the retirement health benefits provided to present retirees. That has not changed. The sums withheld during the mandatory period were taken involuntarily, and the state still retains the right to reduce**

> **or eliminate retiree health benefits for those who were compelled to surrender their wages.[3]**
>
> ———————
>
> FN 3 Indeed, 2012 PA 300 does not even contain a provision to refund the involuntarily withheld sums to those employees who chose not to participate in the retirement health system after the enactment of 2012 PA 300.

AFT III, 315 Mich App at 614-615 (emphasis added).

Taking the part quoted by Defendants out of isolation (i.e., the underlined portion), and placing it back into context with the Court of Appeals' entire discussion, illustrates that the *AFT III* court's ruling was *not* inconsistent with its ultimate conclusion that "we may not read the 2012 amendments as retroactive nor as governing funds collected prior to its application." *AFT III*, 315 Mich App at 614. This conclusion still rings true.

In *Brewer v AD Transport Exp, Inc*, 486 Mich 50, 56; 782 NW2d 475 (2010), this Court similarly determined an amendment expanding the jurisdiction of the Worker's Compensation Appellate Commission (WCAC) *did not* apply retroactively to claimants injured before the effective date of the amendment. Not only did this Court conclude the amendment failed to manifest a legislative intent to apply the amendment to antecedent events or injuries, it also determined the amendment provided a specific, future effective date and omitted any reference to retroactivity. *Brewer*, 486 Mich at 56.

The *Brewer* decision provided further rationale as to why the amendment was to only apply prospectively. As reiterated by this Court, "Even if the Legislature acts to invalidate a prior decision of this Court, the amendment is limited to prospective application if it enacts a substantive change in the law." *Id*. (citation omitted). In this regard, this Court concluded,

> Further undermining any notion of a legislative intent to apply the amendment of MCL 418.845 retroactively is the fact that, **although the Legislature adopted the amendment after our decision in *Karaczewski* it did not reinstate the pre-*Karaczewski* state of the law. On the contrary, the amendment enacted by**

> **2008 PA 499 created *an entirely new jurisdictional standard***, granting jurisdiction over out-of-state injuries of Michigan employees whose contracts of hire were not made in Michigan. **That is, this amendment did not restore the status quo before *Karaczewski*, which required a Michigan contract of hire for jurisdiction, but instead created a new rule** under which *either* a Michigan contract of hire *or* Michigan residency would suffice. **In light of these circumstances and the text of the amendment, we simply can discern no clearly manifested legislative intent to apply the amendment retroactively.**

Brewer, 486 Mich at 57 (boldface added; italics in original).

In the present case, PA 300 was signed into law *after* the Court of Appeals initially determined in *AFT I* the mandatory 3% deduction from members' earned compensation was unconstitutional. The amendments in PA 300 following *AFT I*, like those in *Brewer*, did not return the law to the status quo. Instead, PA 300 created a dramatically different set of substantive laws altogether.

Defendants suggest that the revisions made by PA 300 to Section 41 of the Retirement Act; MCL 38.1341, demonstrate the Legislature's intention to apply the amendments retroactively. (See, Defendants' Brief, at 40, n 5.) However, if anything, the terms of the revised Section 41(2) demonstrate that PA 300's terms applied prospectively only. According to the excerpt cited by Defendants:

> **Beginning in the 2012-2013 state fiscal year** and for each subsequent fiscal year, if the contributions described in section 43e are determined by a final order of a court of competent jurisdiction for which all rights of appeal have been exhausted to be unconstitutional and the contributions are not deposited into the appropriate funding account referenced in section 43e, the contribution rate for health benefits provided under section 91 shall be computed using a cash disbursement method. (Emphasis added.)

The above language was not included in PA 75, and was added by PA 300. Such language leaves no doubt that the changes in PA 300 were *not* intended to apply to occurrences prior to its adoption. It speaks from a prospective standpoint, applying only to future events.

As demonstrated by the highlighted terms, the contribution rate and funding method described in Section 41(2) could only be affected *after* PA 300 went into effect (i.e., September 4, 2012) since those terms would only apply beginning with the State's 2012-2013 fiscal year, and not before the 2012-2013 state fiscal year. The mandatory contributions at issue with PA 75 preceded the 2012-2013 fiscal year, as they were in effect during fiscal years 2010-2011 and 2011-2012. Any contributions for fiscal year 2012-2013 and forward would be under the PA 300 scheme, where the voluntariness of those contributions rendered it constitutional. That was not the case with PA 75 and its mandatory 3% deduction.

B. The possible exception to the presumption against retroactivity does not apply.

The fact PA 300 made *substantive* changes to the Retirement Act beyond those made by PA 75 is important. Although there is an exception to the general rule that statutes and amendments do not operate retroactively, that exception only applies if the statutory change is "remedial" or procedural in nature. However, this Court has "rejected the notion a statute significantly affecting a party's substantive rights should be applied retroactively merely because it can also be characterized in a sense as 'remedial.'" *Frank W Lynch*, 463 Mich at 585. "[T]he term 'remedial' in this context should *only be employed to describe legislation that does not affect substantive rights.*" *Johnson*, 491 Mich at 433 (emphasis in original).

Application of this principle is further illustrated in *Lenawee Co v Wagley*, 301 Mich App 134; 836 NW2d 193 (2013). There, the Legislature amended the Uniform Condemnation Procedures Act (UCPA) during the pendency of the action in the lower court. The amendment to the UCPA created a new right to an enhanced just compensation award that did not exist before, and imposed a converse duty on the condemning agency to remit an enhanced award. *Lenawee Co*, 301 Mich App at 175. In light of these circumstances, the Court determined the

amendment created "new obligations which counsels against retroactive application." *Lenawee Co*, 301 Mich App at 176. The Court further explained:

> Irrespective of whether a statute qualifies as procedural or otherwise remedial, a court may not retroactively apply the statute if this application would abrogate or impair vested rights, create new obligations, or "attach [] new disabilities regarding transactions or considerations that have already occurred."

Id. (citations omitted).

Similarly, in *Brewer*, supra, this Court also refused to apply the new act retroactively under the "remedial-procedural" exception, where the amendment "created an important new legal burden and potentially enlarged existing rights." *Brewer*, 486 Mich at 57-58.

The US Supreme Court has stated, "The inquiry into whether a statute operates retroactively demands a commonsense, functional judgment about 'whether the new provision attaches new legal consequences to events completed before its enactment.'" *Martin v Hadix*, 527 US 343, 357-358 (1999) (quoting *Landgraf*, 511 US at 270 (1994)). Whether a particular statute acts retroactively should be informed and guided by "familiar considerations of fair notice, reasonable reliance, and settled expectations." *INS*, supra, at 321; *Martin*, supra, at 358; *Landgraf*, supra, at 270. Indeed, in *Frank W Lynch*, this Court refused to apply the amendments to the SRCA retroactively where, *inter alia*, "retroactive application of the SRCA would change significantly the substance of the parties' agreement and unsettle their expectations." *Frank W Lynch*, 463 Mich at 585.

Importantly, "A statute may not be applied retroactively if it abrogates or impairs vested rights, creates new obligations, or attaches new disabilities concerning transactions or

considerations occurring in the past." *Davis*, supra, at 158 (citation omitted).[2] As *Davis* acknowledged in the accompanying footnote to that statement, the Due Process Clause protects the interests in fair notice and repose that may be compromised by retroactive legislation, and justification sufficient to validate a statute's prospective application under the clause may not suffice to warrant its retroactive application. *Davis*, supra, at 158, n 3, citing *Landgraf*, supra, at 266.

The situation arising with PA 300 and *AFT II* falls within the above cases and principles. Retroactive application of PA 300 would create new obligations and attach new disabilities concerning transactions or considerations occurring in the past under PA 75. As confirmed by Defendants, "PA 300 added real, tangible protections that did not previously exist under PA 75 . . . ." (Defendants' Brief, at 39.) As identified by the Court of Appeals, "The 2012 act [PA 300] did not repeal MCL 38.1343e, but it added provisions substantially altering that section's scope and effect." *AFT III*, 315 Mich App at 610.

PA 75, on the other hand, initially exposed all members of the Retirement System to a *mandatory* deduction of 3% from their earned compensation. At that time, no member had the ability to "opt out" of this deduction, as was ultimately the controlling factor in upholding the constitutionality of PA 300 in *AFT II*. While PA 300 added MCL 38.1391a(5) to give members a "choice" to either stay in the retiree health care plan and pay 3% of their earned compensation *or* opt out of the deduction and into the Tier 2 plan, PA 75 provided no such choice.

Furthermore, it is important to understand what this Court's decision in *AFT II* **did not** decide. *AFT II* did not rule on the retroactive application of the amendments made by PA 300,

[2]According to *Davis*, "[I]t must be observed that the presumption against statutory retroactivity is not restricted to actions involving vested rights." *Davis*, supra, at 158, citing *Landgraf*, 511 US at 275, n 29.

i.e., it did not determine that money taken from public school employees prior to PA 300 was part of the "voluntary" decision public school employees were forced to make as part of PA 300. *AFT II* expressly stated it was only ruling on the constitutionality of PA 300, and *not* PA 75. The basis for its ruling was the voluntary options afforded by PA 300 but not present in PA 75.

Referring back to the excerpt from Section 41(2), that provision was added by the Legislature through PA 300 *after* the Court of Appeals declared PA 75 to be unconstitutional on three separate grounds. The Legislature knew that the funding provisions under PA 75 were undoubtedly unconstitutional and enacted an entirely new scheme under which employees could be forced to pay some portion of their health care and retirement. The Legislature could have expressly stated that any money previously collected pursuant to PA 75 would remain with the State and be placed in the irrevocable trust fund established in 2010 PA 77 if PA 300 was ultimately declared to be constitutional. Yet, it never mentioned in any respect that the money taken from the employees pursuant to PA 75 would be retained by the State through PA 300.

> In an attempt to argue that PA 300 was curative, Defendants suggest the following:
>
> Indeed, the United States Supreme Court has, in the past, upheld a legislative body's enactment of a subsequent law to cure an identified defect in order to ratify and uphold actions undertaken pursuant to the deficient law.

Defendant's Brief, at 44.

A careful reading of the only two cases cited for this proposition – *United States v Heinszen & Co*, 206 US 370; 27 S Ct 742; 51 L Ed 1098 (1907), and *Mattingly v District of Columbia*, 97 US 687 (1878) – reveals that both cases support *Plaintiffs*' argument that the Legislature knows how to make enactments retroactive, but chose not to expressly do so.

In *Heinszen*, Congress initially passed an act prospectively permitting the United States government to keep tariffs levied and collected on goods coming into the Philippine Islands

when those Islands were under military control of the United States during the Spanish American War. When the peace treaty with Spain was signed in 1899, ending the war, it ended the President's ability to impose and collect the tariffs. However, the United States government continued to impose and collect the tariffs and Congress subsequently enacted a law in 1906 retroactively authorizing the government to impose and keep the tariff proceeds collected between 1899 and 1902.

The US Supreme Court first found that there was, after the treaty with Spain, no authority to implement the tariffs during those years, but then upheld the Congressional Act retroactively permitting the implementation and collection of said tariffs. The 1906 Act stated, in part:

> That the tariff duties, both import and export, imposed by the authorities of the United States or of the provisional military government thereof in the Philippine Islands **prior to March eight, nineteen hundred and two**, at all ports and places in said islands, upon all goods, wares and merchandise imported into said islands from the United States, or from foreign countries, . . . **is hereby legalized and ratified and confirmed as fully to all intents and purposes as if the same had, by prior act of Congress, been specifically authorized and directed**.

Heinszen, 206 US at 381; emphasis added.

In upholding the retroactive legislation, the US Supreme Court explained, "[T]he text of the act of Congress is unambiguous, and manifests, *as explicitly as can be done*, the purpose of Congress to ratify. . . ." *Heinszen*, 206 US at 382 (emphasis added). Unlike the present case, the legislative body in *Heinszen* (i.e., Congress) expressly stated that it intended to ratify a previous act of the military government of the United States.[3]

While Defendants claim the Legislature "clearly intended" PA 300 to apply to the money taken prior to the enactment of PA 300 (Defendant's Brief, at 42), they have not identified

[3]An almost identical factual situation existed in the 1878 *Mattingly* case cited by Defendants. As a result, both cases cited by Defendants actually reinforce the Michigan cases relied upon by Plaintiffs to support their retroactivity argument.

"clear, direct and unequivocal" language within the legislation to indicate that this was retroactively intended. *Davis*, 272 Mich App at 155-156. Instead, their analysis on this point is backwards – i.e., Defendants suggest the Legislature could have included language within PA 300 specifying that the amendments applied only to contributions made on or after the effective date of the act (i.e., *prospectively*), but that it somehow deliberately chose not to. This ignores the presumption against retroactivity, where statutes are already considered to be prospective unless there is clear, direct and unequivocal language to indicate otherwise.

C. The Court of Appeals correctly determined that the case is not moot.

The Court of Appeals addressed the issue of mootness in light of PA 300 and *AFT II*, and properly concluded that those subsequent occurrences did not render moot the ongoing situation with PA 75. According to the Court of Appeals:

> It is undisputed that during the mandatory period, three percent of public school employees' contracted-for wages were withheld by their employers. Those wages, totaling more than $550 million, are being held in escrow pending a final determination in this case. **The parties agree that if 2010 PA 75, as it applied during the mandatory period, is found to be constitutional, then the funds held in escrow will be provided to the state, but that if it is found to be unconstitutional, then the escrowed funds will be returned to the employees who earned them. Because determination of the constitutional questions before us will have a practical legal effect on the disposition of the escrowed funds, the issues raised in these cases are not moot.**

AFT III, 315 Mich App at 612 (emphasis added).

This reference to the agreement in the Stipulation and Order of September 8, 2010 (Appellees' Appendix, at 3b-5b) illustrates the ongoing issues that preclude a finding of mootness.

PA 300 has not and cannot render the deductions mandated by PA 75 voluntary, which was the premise upon which PA 300 was deemed constitutional by *AFT II*. Although PA 300 allowed employees to opt out via Section 91a(5), they could not get their previously-taken

money back at that time. As recognized by the Court of Appeals, there is no mechanism in PA 300 to give them back the money previously taken via PA 75 if they did opt out under PA 300. See, *AFT III*, 315 Mich App at 615, n 3.

For those who did not opt out, nothing in PA 300 expressly waived their rights to the money which had been already involuntarily taken via PA 75, and already deemed by the Court of Appeals to have been taken unconstitutionally from their earned compensation.

Finding the issues were not moot, the Court of Appeals did not err in considering the remaining arguments presented before it on remand.

D. Defendants' new arguments as to the Legislature's plenary powers do not affect the outcome of this case.

Defendants raise the argument that PA 75 is presumed to be a constitutional exercise of the Legislature's plenary powers. (Defendant's Brief, at 8-15.) Relying on Const 1963 art 4, §§1 and 51, Defendants suggest the courts should not second-guess the Legislature's wisdom on plenary powers issues. However, this is not dispositive in situations involving constitutional challenges.

Defendants had not raised the "plenary powers" argument before their Application from *AFT III*, and to the extent it is a new argument, they have not preserved error for the Court to consider at this time. Defendants have been litigating this matter since 2010 through a decision in the Court of Claims, two decisions of the Court of Appeals, and one prior Application for Leave to Appeal, and have thus far failed to raise the issue of plenary powers until now. There is a "time-honored rule that, absent unusual circumstances, issues not raised at trial may not be raised on appeal." *Peterman v State Dep't of Natural Resources*, 446 Mich 177, 183; 521 NW2d 499, 503 (1994) (citations omitted). As a result, courts consider a party to have waived a claim if they do not raise it at the trial level. *Napier v Jacobs*, 429 Mich 222, 227; 414 NW2d 862 (1987)

("A general rule of trial practice is that failure to timely raise an issue waives review of that issue on appeal.") (citations omitted). As a result, no credence should be given to Defendants' arguments in this respect.

Regardless, Defendants' position as to the Legislature's plenary powers is undermined by the constitutional matters at hand. While the Michigan Legislature possesses plenary powers to pass "suitable laws for the protection and promotion of public health," those plenary powers are limited by applicable federal law and the Michigan and federal Constitutions. Const 1963, art 4, §51; *People v Cooper*, 236 Mich App 643, 663-64; 601 NW2d 409 (1999) ("[A]n enacted statute in force regarding *any* subject or establishing *any* type of rule is valid as long as it does not contravene a provision of the Michigan Constitution or federal law." (Emphasis in original).) As further noted in *Cooper*,

> We, of course, are addressing the legal power of the state under Michigan law, not the proper exercise of that power. **We do not suggest that the Legislature should actually regard itself as free of any constraints on its actions other than the limits imposed by the Michigan Constitution and federal law.** These, however, are matters for the Legislature itself to determine, according to properly adopted procedures and the individual beliefs of its members. Under commonly accepted separation of powers principles, it is not our role to sit in judgment as a "Super Legislature" on such matters.

Id., at 664 n 6 (emphasis added).

The commentary in Note 6 of *Cooper* illustrates that any reference to the courts acting as a "super legislature" by overturning laws is limited to the wisdom of policies and not to their constitutionality. Therefore, it was and is entirely and properly within the courts' determination to rule on whether a statute is constitutional under the state or federal Constitutions. In doing so, this Court has the responsibility to strike down unconstitutional legislative acts.

The Court of Appeals considered the contested provisions in PA 75 both before (*AFT I*) and following (*AFT III*) the enactment of PA 300. In both instances, the Court of Appeals found

that these legislative enactments were unconstitutional for multiple reasons despite the underlying notion that the Legislature's actions are entitled to judicial deference as a co-equal branch of government. The Court of Appeals did not need to flesh out the requirements of judicial deference in order for them to afford sufficient deference in rendering their decision.

II. SECTION 43e OF 2010 PA 75 RESULTED IN THE UNCONSTITUTIONAL IMPAIRMENT OF PUBLIC SCHOOL EMPLOYEES' EMPLOYMENT CONTRACTS.

The Court of Appeals initially ruled that Section 43e, as added by PA 75, operates as a substantial impairment of the employment contracts between Plaintiffs and the employing educational entities. *AFT I*, 297 Mich App at 600. After that decision was issued, the Legislature made substantial changes to numerous sections of the Retirement Act via PA 300 (including Section 43e), enacting an entirely new and changed health benefit program for Michigan public school retirees. The changes were made by PA 300 to address the constitutional infirmities of that section of the Retirement Act. On remand, the Court of Appeals again found an unconstitutional contractual impairment under the terms of PA 75.

The provisions of PA 300 were the subject of a legal challenge that was ultimately decided by this Court in *AFT II*. Although *AFT II* determined PA 300 did not result in the unconstitutional impairment of contract, the Court based that ruling on certain provisions of PA 300 that afforded public school employees a "choice" between either agreeing to the 3% payroll deduction or opting into a retiree health care savings account. Because public school employees now had this choice, the *AFT II* Court determined the 3% deductions from earned compensation under PA 300 were now considered voluntary. *AFT II*, 497 Mich at 234. In so ruling, this Court stated "we do not decide whether the Court of Appeals correctly found

2010 PA 75 to be violative of the aforementioned constitutional provisions." *AFT II*, supra, at 233.

Because this Court's decision in *AFT II* regarding impairment of contract was grounded wholly on the *voluntariness of Plaintiffs' choice* between agreeing to either a 3% payroll deduction or a contribution into a health care savings account (with an employer match), and because no choice was afforded to those employees by the mandatory deduction imposed by PA 75, the *AFT II* decision has no relevance to this Court's determination regarding the constitutional validity of PA 75.

A. The mandatory payroll deductions imposed by PA 75 resulted in the impairment of the employment contracts between Plaintiffs and their school districts.

Plaintiffs are employees of public schools and colleges throughout the State of Michigan. They render services to their employers and receive compensation pursuant to employment contracts which set compensation, benefits, and other terms of employment. For instance, MCL 380.1231(1) of the Revised School Code provides there shall be written contracts between teachers and their public school employers. Thus, every public school teacher in Michigan works under a "written contract" signed by both the school district and the teacher. Those contracts must "specify the wages agreed upon." MCL 380.1231(1). Further, MCL 380.1229(2) of the Revised School Code requires other school employees who do not assume tenure in their positions shall also be employed by written contract.

Accordingly, all school employees work pursuant to individual written contracts which set forth their wages. The overwhelming bulk of MPSERS members are covered by collective bargaining agreements which set forth the wage schedules for employees in their particular bargaining unit. It is these contracts and the individual contracts referred to above that were

impaired by PA 75's requirement that Plaintiffs' employers deduct 3% from their earned compensation and forward the money, as employer contributions, to MPSERS.

The state and federal Constitutions prohibit laws that result in the impairment of contracts. Const 1963, art 1, §10 and US Const, art I, §10. These constitutional guarantees prohibit the State of Michigan from enacting laws that impair the obligation of a contract. As held in *Campbell v Michigan Judges Retirement Bd*, 378 Mich 169, 180; 143 NW2d 755 (1966):

> Michigan Constitution of 1908, art 2, §9, followed by Michigan Constitution of 1963, art 1, §10, and article 1, §10, of the United States Constitution, prohibit the impairment by State law of the obligation of a contract.

Both Constitutions protect not only contracts to which the State of Michigan is a party, *but to all contracts*. As the US Supreme Court explained in *United States Trust Co of New York v New Jersey*, 431 US 1, 17; 97 S Ct 1505; 52 L Ed 2d 92 (1977):

> It long has been established that the Contract Clause limits the power of the States to modify their own contracts as well as to regulate those between private parties. Fletcher v. Peck, 6 Cranch 87, 137-139, 3 L.Ed. 162 (1810); Dartmouth College v. Woodward, 4 Wheat. 518, 4 L.Ed. 629 (1819).

The case of *Washtenaw Community College Ed Ass'n v Bd of Trustees of Washtenaw Community College*, 50 Mich App 467; 213 NW2d 567 (1973), is also instructive regarding this issue. In that case, the Court of Appeals invoked the general non-impairment clause in the US Constitution, and held certain legislation impaired the contractual obligation of the college to its employees under its collective bargaining agreement with the union.[4] The Court held the subsequently passed legislation illegally impaired the college's contractual obligation to its employees in violation of US Const, art I, §10.

[4]The collective bargaining agreement provided the college would make a contribution to a private retirement fund. Subsequent legislation directed that all colleges contribute to only one retirement fund, the Michigan Public School Employees Retirement Fund.

Make no mistake, it is Plaintiffs' *employment contracts* with legislatively-created public school districts that have been impaired by the mandatory 3% reduction in earned compensation imposed by PA 75 – i.e., a reduction in employee compensation imposed as a means of reducing the financial obligations of public school employers and the State of Michigan. In its remand decision, the Court of Appeals ruled on those contracts:

> During the mandatory period, section 43e of 2010 PA 75 operated as a substantial impairment of the employment contracts between the plaintiffs and the employing educational entities. The employment contracts provided for a particular amount of wages, and 2010 PA 75 required that the employers not pay the contracted-for wages, but instead pay three percent less than the contracts provided.[5] We note that this is not a broad economic or social regulation that impinges on certain contractual obligations by happenstance or as a collateral matter. Rather, the statute directly and purposefully required that certain employers not pay contracted-for wages. Such an action is unquestionably an impairment of contract by the state.
>
> ———————
>
> FN 5 Defendants argue that there is no unconstitutional impairment of contract because (1) plaintiffs do not have a contract that is affected by 2010 PA 75 and (2) plaintiffs do not have a contractual right to be free from mandatory deductions for retiree healthcare or to continue in a particular retiree healthcare plan. These arguments are wholly without merit. Plaintiff-employees' employment contracts, which set forth specified wages, were unquestionably impaired by the mandatory and involuntary requirement in 2010 PA 75 that 3% of their wages be withheld and transformed into employer contributions to a retiree healthcare system without vested benefits. Moreover, plaintiffs have never claimed that they have a right to be free of mandatory deductions in general; they have only claimed a right to be free from unconstitutional mandatory deductions.

AFT III, 315 Mich App at 615-616.

As noted above, PA 75 changed the obligations of public school employers to pay the compensation specified in their employment contracts and collective bargaining agreements with Plaintiffs. Although Defendants argue Section 43e did not reduce Plaintiffs' pay rates, the mandate that employers pay Plaintiffs 3% less than their contracted-for compensation and send that money instead to MPSERS (as if it were the employers' own contributions) in order to

reduce the financial obligations of the school district employers themselves, unquestionably reduced Plaintiffs' pay.

In order to determine whether the statute in this case violates the constitutional protections regarding impairment of contract, this Court must consider not only whether there is an impairment, but also whether the impairment can be forgiven because it was both reasonable and necessary to serve an important public purpose. *US Trust Co*, supra, at 25. In the instant case, the substantial impairment to public school employees' employment contracts was *neither reasonable nor necessary*.

B. The impairment of Plaintiffs' contractually set wages was not reasonable.

PA 75 required Plaintiffs' employers to reduce the contractual compensation earned by Plaintiffs by 3%. The school district employers were then required to remit those amounts as "employer contributions" to MPSERS for deposit in the irrevocable trust established by 2010 PA 77. The statute, thus, expressly and purposefully requires that employers not pay contracted-for wages.

In *Baltimore Teachers Union, American Federation of Teachers Local 340, AFL-CIO v Baltimore Mayor and City Council*, 6 F3d 1012 (CA 4, 1993), the Fourth Circuit held that a *temporary* furlough plan under which employees lost 0.95% of their annual salary for one year resulted in a substantial impairment of the teachers' employment contracts. As explained:

> In the employment context, there likely is no right both more central to the contract's inducement and on the existence of which the parties more especially rely, than the right to compensation at the contractually specified level. Accordingly, we believe that the salary reductions at issue constituted a substantial impairment of the employees' contract with the City of Baltimore.[8]

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[8] To the extent that the magnitude of the ensuing economic loss from an impaired contract (as opposed to the nature of the right impaired) is relevant to the

> question of the substantiality of the impairment, we reject the City's contention that an annual salary reduction of .95% is insubstantial. . . .

Baltimore Teachers Union, supra, at 1018.

In the present case, the Legislature reduced employee compensation by more than three times the reduction experienced by the Baltimore teachers. Further, although the furlough plan in *Baltimore Teachers* was to last for only one year, the compensation reduction imposed by the statute at issue in the present case would continue indefinitely until such time as the law itself was changed. Defendants have acknowledged the purpose of PA 75 was to reduce the cost paid by public school employers for retiree health care and thus "ease the financial burden on public schools because they are assessed the cost of retiree health care under MCL 38.1341 and 38.1342." (Appellees' Appendix, at 11b, 12b; Defendants' May 23, 2011 Brief on Appeal, at 17, 27.) Thus, the reduction in Plaintiffs' compensation was imposed in order to leave more School Aid Fund money available to school districts for the payment of employer contributions to retiree health care. As a result, the statute's action in reducing Plaintiffs' earned compensation by 3% constitutes a substantial and unreasonable impairment of Plaintiffs' employment contracts.

C. The impairment to Plaintiffs' employment contracts is unconstitutional because the State has failed to show the impairment was necessary.

Defendants assert the impairment of contracts which results from PA 75 is not improper because the statute "serves a public purpose." (Defendants' Brief, at 20.) In support of this argument, Defendants quote the observation of the US Supreme Court in *United States Trust Co v New Jersey*, supra, at 22, that "[t]he States must possess broad power to adopt general regulatory measures without being concerned that private contracts will be impaired, or even destroyed, as a result." A thorough reading of the *United States Trust Co* decision, however,

reveals that case fully supports the Court of Appeals' determinations that PA 75 resulted in the unconstitutional impairment of Plaintiffs' employment contracts.

In *US Trust Co*, the States of New York and New Jersey passed statutory covenants in 1962 which limited the Joint Port Authority of New York and New Jersey from subsidizing rail passenger transportation from certain revenues and reserves pledged as security for consolidated bonds issued by the Port Authority. In 1974, in response to what both states perceived to be a crisis involving mass transportation, energy conservation, and environmental protection, the Legislatures of both states repealed those 1962 statutory protections. The United States Trust Company, as trustee for and holders of certain Port Authority bonds, brought a declaratory judgment action in the New Jersey Superior Court alleging New Jersey's repeal of the statutory covenant was a violation of the bondholders' rights under US Const, art I, §10.[5]

The Superior Court of New Jersey held New Jersey's repeal of the covenant represented an impairment of the contractual obligations of the State to the bondholders, but dismissed the complaint. The trial court held, among other things, the impairment was permissible under *Home Building & Loan Ass'n v Blaisdell*, 290 US 398; 54 S Ct 231; 78 L Ed 2d 413 (1934) and *City of El Paso v Simmons*, 379 US 497; 85 S Ct 577; 13 L Ed 2d 446 (1965), rehearing denied 380 US 296; 85 S Ct 879; 13 L Ed 2d 813 (1965). On similar grounds, the Supreme Court of New Jersey upheld the trial court's decision to dismiss.

On appeal, the US Supreme Court *reversed* the decisions of the trial court and the New Jersey Supreme Court, and held the repeal of the 1962 statutory covenant violated US Const, art I, §10. The Court's reasoning for its reversal of the New Jersey courts is relevant

[5]A similar action was brought in the New York state courts, but was held in abeyance pending the outcome of the New Jersey suit before the US Supreme Court.

to the issues in the present case, and a full examination of that decision is important to the determination of this case.

One of the chief arguments of the State of New Jersey was that under *Blaisdell*, supra, and *City of El Paso*, supra, the State has great latitude to impair contractual obligations under the "reserved powers clause" found in the Tenth Amendment to the US Constitution, which states:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

US Const, Am X.

This "great latitude" argument is precisely what Defendants are asserting in the present case.

The *US Trust Co* Court extensively analyzed a state's ability under the "reserved powers clause," and that clause's applicability to the facts. The Court recognized long-established law that a state cannot contract away or surrender the essential attributes of its sovereignty. The Court in *US Trust Co* then noted careful scrutiny is needed where the impairment of contract affects a state's own financial obligations:

> As with laws impairing the obligations of private contracts, an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose. **In applying this standard, however, complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake.** A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. **If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all.**

431 US at 25-26 (emphasis added; footnote omitted).

The contracts that are involved in the present case are statutorily-required individual employment contracts between local public school districts (all of which are also created by the Legislature) and their employees. See MCL 380.1231(1) and 1229(2). The State's own financial interests in these contracts is unquestionable because the 3% reduction of the payment

of Plaintiffs' earned compensation will lessen the financial obligations of the various school employers whose funds come directly from the School Aid Fund maintained by the State pursuant to the School Aid Act, MCL 388.1601, *et seq*. The use of 3% of Plaintiffs' earned compensation to reduce the financial obligations of the State of Michigan and its school districts therefore warrants the careful scrutiny mandated by the Court in *US Trust Co*.

The Court in *US Trust Co* applied the "reasonable and necessary test" to the facts of that case. The Court acknowledged "[m]ass transportation, energy conservation, and environmental protection are goals that are important and of legitimate public concern." 431 US at 28. It also recognized the State of New Jersey had contended these goals were so important that any harm to bondholders from repeal of the 1962 covenant was greatly outweighed by the public benefit. In response to those arguments, the *US Trust Co* Court stated:

> We do not accept the invitation to engage in a utilitarian comparison of public benefit and private loss. Contrary to Mr. Justice Black's fear expressed in sole dissent in *El Paso v Simmons*, 379 US, at 517, 85 S Ct, at 588, the Court has not "balanced away" the limitation on state action imposed by the Contract Clause. **Thus a State cannot refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote the public good rather than the private welfare of its creditors.** We can only sustain the repeal of the 1962 covenant if that impairment was both reasonable and necessary to serve the admittedly important purposes claimed by the State.
>
> The more specific justification offered for the repeal of the 1962 covenant was the States' plan for encouraging users of private automobiles to shift to public transportation. The States intended to discourage private automobile use by raising bridge and tunnel tolls and to use the extra revenue from those tolls to subsidize improved commuter railroad service. Appellees contend that repeal of the 1962 covenant was necessary to implement this plan because the new mass transit facilities could not possibly be self-supporting and the covenant's "permitted deficits" level had already been exceeded. **We reject this justification because the repeal was neither necessary to achievement of the plan nor reasonable in light of the circumstances.**

431 US at 29. (Emphasis added.)

The Court in *US Trust Co* further stated the concept of "necessity" can be considered on two levels. First, it could not be said the total repeal of the 1962 covenant was essential; a less drastic modification would have permitted the contemplated plan without entirely removing the covenant's limitations on the use of port authority revenues and reserves to subsidize commuter railroads. 431 US at 29-30. Second, the Court pointed out, ". . . without modifying the covenant at all, the States could have adopted alternative means of achieving their twin goals of discouraging automobile use and improving mass transit." *Id*. (footnote omitted.)

To the States' contention that choosing among various alternatives was a matter of legislative discretion, the US Supreme Court said:

> But a State is not completely free to consider impairing the obligations of its own contracts on a par with other policy alternatives. Similarly, a State is not free to impose a drastic impairment when an evident and more moderate course would serve its purposes equally well.

431 US at 30-31.

The Court in *US Trust Co* then concluded: "In the instant case the State has failed to demonstrate that repeal of the 1962 covenant was similarly necessary." 431 US at 31.

Similarly, the Legislature in the present case could have imposed a far less drastic method of financing retirees' health benefits. Importantly, at no time did MPSERS or the Legislature make any finding that imposing the 3% levy on the employees' wages for health benefits was necessary for the continuation of the retirement health benefits or the economic survival of the Retirement System.

US Trust next discussed the question of reasonableness. In that regard, the Court stated:

> We also cannot conclude that repeal of the covenant was reasonable in light of the surrounding circumstances. In this regard a comparison with *El Paso v Simmons, supra*, again is instructive.

431 US at 31.

The Court then distinguished the facts in *City of El Paso*, supra, and concluded its analysis of the reasonableness of the impairment in question with the following:

> By contrast, in the instant case the need for mass transportation in the New York metropolitan area was not a new development, and the likelihood that publicly owned commuter railroads would produce substantial deficits was well known….
>
> During the 12-year period between adoption of the covenant and its repeal, public perception of the importance of mass transit undoubtedly grew because of increased general concern with environmental protection and energy conservation. But these concerns were not unknown in 1962, and the subsequent changes were of degree and not of kind. We cannot say that these changes caused the covenant to have a substantially different impact in 1974 than when it was adopted in 1962. And we cannot conclude that the repeal was reasonable in the light of changed circumstances.

431 US at 31-32.

With that, the Court reversed the Supreme Court of New Jersey by holding that the Contract Clause of the US Constitution prohibited the retroactive repeal of the 1962 covenant.

The decision of the US Supreme Court in *US Trust Co*, supra, has been followed by numerous state and federal courts in holding various impairments of contractual rights (particularly those in the retirement area) are violative of the non-impairment clause of the US Constitution. Typical of these cases is that of the Ninth Circuit in *State of Nevada Employees Ass'n v Keating*, 903 F2d 1223 (CA 9, 1990), *cert den* 498 US 999; 111 S Ct 558 (1990). The facts in *Keating*, supra, are strikingly similar to what the Legislature did here by enacting PA 75.

In 1983, the Nevada Legislature decided to *increase pension benefits paid to employees who had retired.* To defray the costs of the post-retirement benefits increase, Nevada made employer-paid plans mandatory for all police officers and firefighters as of July 1, 1983, and for all other state employees effective July 1, 1985. In declaring Nevada's enactments violative of US Const, art I, §10, the Ninth Circuit stated:

> . . . the loss of the right to withdraw pension contributions cannot be offset by the increase in post-retirement benefits. **The State cannot justify impairing its contractual obligations to public employees by pointing to advantages accrued by former employees.**

Keating, 903 F2d at 1227 (emphasis added; citation omitted).

Applying the standards set forth in *US Trust Co*, supra, the Ninth Circuit found this substantial impairment of the state's contractual obligations was neither reasonable nor necessary. The Ninth Circuit concluded its opinion by stating:

> Nevada should not have interfered with the refund right of public employees when it was looking for ways to fund an increase in post-retirement benefits. States are not free to consider substantial contractual impairments on a par with other policy alternatives. In this case, the state has not met its burden of proving that the impairment of the public employees' pension rights was necessary to achieve an important public purpose. We hold that the Nevada legislation unconstitutionally impaired the State's contractual obligations.

Keating, 903 F2d at 1228, citing *US Trust Co*, supra, at 30-31.

The *US Trust Co* case addressed a situation where the bondholders involved did not lose any money. The case was decided in their favor simply because the state's actions lessened the bondholders' statutorily-provided security in having their bonds paid off. By contrast, Plaintiffs herein actually lost 3% of their already earned wages to the State, which in many cases amounted to several thousands of dollars. The fact that the amount of money in the escrow account established by the Court of Claims' injunction is in excess of $550 million is clear evidence that the 3% deduction was substantial.

Because PA 75 results in a substantial impairment to Plaintiffs' employment contracts, the burden rests upon Defendants to show impairment was both reasonable and necessary. As summarized by the Court of Appeals, the case law fails to support Defendants' claim that this impairment of contracts was reasonable or necessary. See *AFT III*, 315 Mich App at 619-620. Defendants have not shown they undertook other efforts to reduce retiree health care obligations

or to obtain additional funding for school districts in order to assist with payment for these benefits. Defendants cannot justify the impairment to Plaintiffs' employment contracts by pointing to financial advantages accrued to the State and its local school districts through the reduction of School Aid funds necessary to pay for retiree health care. Therefore, PA 75 resulted in a contractual impairment in violation of the Constitutions of this State and the United States.

III. THE MANDATORY 3% DEDUCTION FROM THE COMPENSATION EARNED BY PUBLIC SCHOOL EMPLOYEES IS AN UNCONSTITUTIONAL PHYSICAL TAKING IN VIOLATION OF CONST 1963, ART 10, §2, AND US CONST, AM V AND XIV.

The Fifth Amendment to the United States Constitution prohibits the taking of private property "for public use, without just compensation." US Const, Am V. This provision is made applicable to the states by Section 1 of the Fourteenth Amendment of the United States Constitution.[6] Likewise, Const 1963, art 10, §2 provides in relevant part:

> Private property shall not be taken for public use without just compensation therefore being first made or secured in a manner prescribed by law.

The mandatory 3% deduction from the compensation earned by public school employees imposed through Section 43e of PA 75 violated these constitutional provisions.

A. "Physical" and "regulatory" takings.

The law recognizes two types of unconstitutional takings: *physical* or *per se takings*, and *regulatory takings*. Physical takings (e.g., physical invasion or appropriation cases), occur when the government physically takes possession of an interest in property for some public purpose.

[6]"No State shall make or enforce any laws which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law nor deny to any person within its jurisdiction the equal protection of laws." US Const, Am XIV.

Tahoe-Sierra Pres Council v Tahoe Reg'l Planning Agency, 535 US 303, 321-322, n 17; 122 S Ct 1465; 152 L Ed 2d 517 (2002).[7]

On the other hand, when the government acts in a regulatory capacity, such as when it bans certain uses of private property, the question of whether a taking has occurred is more complex. *Tahoe-Sierra Pres Council*, 535 US at 323. Such cases are considered *regulatory takings* because they do not involve a categorical assumption of the property in question. *Id*. The rationale of a regulatory taking claim is that the State regulation goes so far it "effects a taking" of the property involved. See, e.g., *Meriden Trust & Safe Deposit Co v FDIC*, 62 F3d 449, 454 (CA 2, 1995).

Because of the distinction between physical takings and regulatory takings, the US Supreme Court has stated:

> This longstanding distinction between acquisitions of property for public use, on the one hand, and regulations prohibiting private uses, on the other, makes it **inappropriate to treat cases involving physical takings as controlling precedents for the evaluation of a claim that there has been a "regulatory taking," and vice versa**. For the same reason that we do not ask whether a physical appropriation advances a substantial government interest or whether it deprives the owner of all economically valuable use, we do not apply our precedent from physical takings context to regulatory takings claims.

Tahoe-Sierra Pres Council, 535 US at 323-324 (footnote omitted; emphasis added).

The 3% deduction from the compensation earned by public school employees constitutes a *physical taking*. Section 43e of PA 75 references the term "compensation," which is defined under Section 3a of the Retirement Act to mean "the remuneration *earned by a member for*

[7]The fact of a physical taking is fairly obvious in such cases -- for example, the government might occupy or take over a leasehold interest for its own purposes, or the government might take over a part of the rooftop of an apartment building so that cable access may be brought to residences within. See *United States v General Motors Corp*, 323 US 373, 375, 380; 65 S Ct 357; 89 L Ed 2d 311 (1946); and *Loretto v Teleprompter Manhattan CATV Corp*, 458 US 419, 421; 102 S Ct 3164; 73 L Ed 2d 868 (1982).

service performed as a public school employee." MCL 38.1303a(1) (emphasis added). This includes not only salary and wages, but other enumerated forms of remuneration. MCL 38.1303a(2).

Public school employers were mandated by PA 75 to deduct 3% from all earned compensation of public school employees, and transmit those deductions to MPSERS. Those funds were to be "remitted as employer contributions." In turn, MPSERS was required to deposit the deductions in the irrevocable trust established by 2010 PA 77; MCL 38.2731, *et seq.* The trust fund can only be used to fund the retirement health care benefits of retirees and their dependents, and it cannot be refunded or returned, either to the employer or the employee. See MCL 38.2733 and MCL 38.2734. The injunction as to PA 75 deductions has prevented that to date.

Were it not for the mandatory 3% deduction taken from members' compensation via PA 75, the health care coverage of public school retirees would solely be the obligation of the State and its public school employers, to be paid out of tax dollars and other sources of public revenue. The seizure of the earned compensation of public school employees through PA 75 was intended to substantially reduce the amount school districts are required to pay for the health care benefits of current retirees. (Appellees' Appendix, at 9b-10b, 14b-16b; Defendants' May 23, 2011 Brief on Appeal, at 5-6, citing the Affidavit of Phillip Stoddard.)

Thus, PA 75 sought to *physically take* the earned compensation of public school employees and utilize that money for a public purpose, i.e., to reduce the financial obligations of the State and its public school districts. There can be no question that contributing to the trust fund constitutes a public purpose, because the assets of the trust are to be used solely to perform an essential function of the State. Nor is there any doubt the money taken from members' earned

wages was to be used for a public purpose, i.e., balancing Michigan's budget by paying towards the State's unfunded accrued liabilities and reducing the cost paid by public school employers with State School Aid Act funds. Defendants' prior briefing in this case is replete with admissions to this effect. (Appellees' Appendix, at 8b, 11b, 12b; Defendants' May 23, 2011 Brief on Appeal, at 1, 17, and 27.)

B. Accrued salary, or earned compensation, is a protected property interest.

Contrary to Defendants' claim, the amounts at issue do not involve "future compensation." (Defendants' Brief, at 26-28.) Rather, the 3% mandatory deduction was taken from the compensation *already earned* by the public school employees. Defendants further contend the requirement to pay money cannot support a violation of the Fifth Amendment, and that the public school employees at issue do not have a property interest at stake because the money they earned is somehow "public property" that never belonged to them. (Defendants' Brief, at 26-27.) Again, the deductions at issue occurred after the compensation was already earned by the employees.

Section 43e of PA 75 stated, "[E]ach member *shall contribute 3% of the member's compensation* to the appropriate funding account established under the public employee retirement health care funding act." (Emphasis added.) The sentence within Section 43e of PA 75 upon which Defendants rely thereafter states, "The member contributions shall be deducted by the employer and remitted as employer contributions in a manner that the retirement system shall determine." Thus, the "member contributions" are clearly comprised of each member's "compensation," which is defined above by Section 3a of the Retirement Act to mean "the remuneration *earned by a member for service performed* as a public school employee."

MCL 38.1303a(1) (emphasis added). Given the use of past tense in the statute, a member's compensation is something already earned for service performed, and, thus, accrued.

In this sense, the public school employees do have a property interest in the funds deducted under PA 75, because those funds were derived directly from their earned salaries. Without public school employees accruing salaries or earning compensation, there would be nothing from which the public school districts could deduct 3%. Additionally, if the amounts to be contributed were "public" funds or "public" property, as Defendants suggest, then there would be no need to deduct those amounts from the earned compensation of each employee. Within their arguments, Defendants even refer to the money as being the *employees'*. (Defendants' Brief, at 24 – i.e., "PA 75 merely asked public school employees to pay a small portion of *their compensation* in order to help fund and prefund a fraction of the current and future retiree healthcare benefits that they are eligible to receive." (Emphasis added).)[8]

Contrary to Defendants' claims, accrued salaries are property. *Sims v United States*, 359 US 108, 110; 79 S Ct 641; 3 L Ed 2d 667 (1959). The Sixth Circuit relied upon this principle in *US v Safeco Ins Co*, 870 F2d 338, 340-341 (1989), to find, *inter alia*, that a taxpayer had a property right in fees he had earned for purposes of attaching a tax lien.

In addition, Defendants' argument would disregard the decision of the US Supreme Court in *Webb's Fabulous Pharmacies, Inc v Beckwith*, 449 US 155; 101 S Ct 446; 66 L Ed 2d 358 (1980). In *Webb's*, the Court unanimously struck down a state's attempt to keep, as public

[8]Defendants further claim, "That is precisely what PA 75 does here – require public school employees to contribute a small fraction of their salary to fund their <u>own</u> retirement healthcare fund." (Defendants' Brief, at 30; emphasis in original.) Plaintiffs reiterate that the lower courts have resolved that the 3% mandatory deduction was not for the purpose of having active public school employees contribute to "their" retire healthcare entitlement, especially where Defendants maintain that those same public school employees do not have any right to receive retiree healthcare benefits. (Defendants' Brief, at 17, 26.)

property, the money earned as interest on a private fund deposited in the state's county courts during the course of litigation. The state statute in that case required any interest earned on the money deposited was to become the income of the office of county court clerk. *Webb's*, 449 US at 157-158. More onerously, the State in the present case is taking not only the compensation earned by members, but also the interest accruing to that money over the years which members contribute.

In overturning the state's action, the *Webb's* Court found an unconstitutional taking had occurred. In particular, the US Supreme Court held that the principal sum of money deposited with the Court was plainly private property, and the interest derived therefrom should follow the principal and be allocated to the owner of the principal sum. *Webb's*, 449 US at 160, 162. The US Supreme Court concluded:

> To put it another way: a State, by *ipse dixit*, may not transform private property into public property without compensation, even for the limited duration of the deposit in court. This is the very kind of thing that the Takings Clause of the Fifth Amendment was meant to prevent. That Clause stands as a shield against the arbitrary use of governmental power.

Webb's, 449 US at 164.

The Court of Appeals properly relied on *Webb's* to support its "takings" analysis, and additionally distinguished the plurality opinion in *Eastern Enterprises v Apfel*, 524 US 498; 118 S Ct 2131; 141 L Ed 2d 451 (1998). See, *AFT III*, 315 Mich App at 623-624. As explained by the Court of Appeals, "Subsection 43e of 2010 PA 75 confiscated a specific fund, i.e., plaintiff employees' paychecks, and removed three percent of the property before allowing them to take possession of their property." *Id*., n 10.

This Court has also addressed the protection of earned compensation. In *Ramey v Michigan Public Service Comm'n*, 296 Mich 449, 462; 296 NW 323 (1941), this Court agreed,

"[I]t is settled that, after a salary has been earned, the public employee's right thereto becomes vested and cannot be taken away by any legislation thereafter enacted." (Citation omitted.) The decisions in *Sims*, *Webb's*, and *Ramey* are directly on point, where the property at issue in the present case is similarly compensation already earned by public school employees.

The Court of Appeals agreed in *Butler v Michigan State Disbursement Unit*, 275 Mich App 309, 313-14; 738 NW2d 269 (2007), that a confiscation or seizure of money can constitute a taking requiring just compensation. In *Butler*, the state agency that collects and disburses child support payments retained the interest on the amounts awaiting disbursement, and the court determined the money was part of a "definable and distinct parcel of money in which the eventual recipient had a property interest" and could not be taken without payment of just compensation.

The primary analysis of *Butler* relied heavily on the US Supreme Court decision in *Brown v Legal Foundation of Washington*, 538 US 216; 123 S Ct 1406; 155 L Ed 2d 376 (2003). In *Brown*, the government similarly asserted a right to control interest accrued on lawyer trust accounts (IOLTAs), and the Court confirmed this was a *per se* taking of property for which just compensation was required. *Brown*, 538 US at 235. See also, *Phillips v Washington Legal Foundation*, 524 US 156; 118 S Ct 1925; 141 L Ed 2d 174 (1998), to the same effect.

In *AFT II*, this Court noted the term "property" encompasses everything over which a person "may have exclusive control or dominion." *AFT II*, 497 Mich at 216 (citation omitted). *AFT II* further noted the term "taking" can encompass governmental interference with rights to both tangible and intangible property. *AFT II*, 497 Mich at 218 (citation omitted). Citing to *Webb's*, supra, *AFT II* acknowledged:

> It is possible nonetheless, for the government to undertake a constitutional taking that requires compensation **when it asserts control over a discrete and**

> **identifiable fund of money**, such as a deposit account. *Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155, 164-165; 101 S. Ct. 446; 66 L.Ed.2d 358 (1980).

AFT II, 497 Mich at 218 (emphasis added).

AFT II did not deny the mandatory 3% deduction from members' earned compensation was "property" for taking purposes. Rather, this Court held only "that 2012 PA 300 does not violate the uncompensated taking prohibitions," and emphasized "that we address in this case only 2012 PA 300 and *do not decide whether the Court of Appeals correctly held that 2010 PA 75 violated those same provisions*." *AFT II*, 497 Mich at 216 (emphasis added). Despite having the opportunity to side with Defendants' position that the 3% was not "property" within the context of the Takings Clause, *AFT II* instead based its decision entirely on the voluntariness underlying PA 300. With this, Defendants' assertion PA 300 has now entirely superseded Plaintiffs' takings claim falls short.

There is no requirement that the funds which courts have protected in cases such as *Webb's Pharmacies*, supra, be in a specific bank account. The paychecks public school employees earned were specific and quantifiable funds, earned through their employment under the contracts and collective bargaining agreements applicable to each public school employee's employment. Each payroll period there is an identifiable fund of money for each employee, representing compensation earned in return for services already performed. Those earnings were taken from these employees by their employers pursuant to PA 75, and forwarded to the State of Michigan as if they were "employer contributions," for what the State and the statutes here in question acknowledge to be a public purpose.

All employees have exclusive control over their earned compensation for services already performed. For example, Section 6 of the Wage and Fringe Benefits Act (WFBA),

MCL 408.471, *et seq*., controls the method of payment of wages made by employers to employees. MCL 408.476. "Wages" means all earnings of an employee. MCL 408.471(f). The WFBA imposes a duty on employers to pay their employees the "wages earned" within a specified time period. MCL 408.472. While employers may require employees to receive wages only through direct deposit or a payroll debit card, each employee determines which choice he or she prefers. Employees then have the right to direct to which account or accounts each paycheck is deposited, and those funds are immediately at the disposal of the employee upon receipt. Employees further have the ability to dictate whether other deductions can be made from their earned wages, e.g., for purposes of making pre-tax contributions to flex-spending or 401(k) accounts. MCL 408.477. By being able to direct how and where payment of earned wages is made, employees have exclusive dominion and control over their earned wages.[9]

To further support their assertion the public school employees do not have a property interest for purposes of the Fifth Amendment, Defendants cite a string of cases, many of which address *regulatory takings rather than a physical taking.* The major flaw in Defendants' argument is the reliance on cases such as *Concrete Pipe & Prods, Inc v Construction Laborers Pension Trust,* 508 US 602; 113 S Ct 2264; 124 L Ed 2d 539 (1993).

In *Concrete Pipe,* the property at issue was the payment of a *monetary penalty* stemming from Plaintiff's withdrawal from a multi-employer pension plan. In applying the *regulatory taking* analysis already established by prior court decisions, the US Supreme Court did not question whether the money was a property right protected from taking. Nor was such a consideration made in *Connolly v Pension Benefit Guaranty Corp,* 475 US 211; 106 S Ct 1018;

[9]The fact the 3% deduction mandated by PA 75 could only be taken from a public school employee's *earned* compensation for services *already performed* additionally defeats Defendants' artificial claim that this case is about a property interest in future compensation. (Defendants' Application, at 26-28.)

89 L Ed 2d 166 (1986), the case upon which the analysis of *Concrete Pipe* was primarily based. Were money so obviously not a property right protected from taking, as suggested by Defendants, then how is it the US Supreme Court overlooked that issue? It did not.

Defendants' reliance on cases such as *Adams v United States*, 391 F3d 1212 (Fed Cir, 2004), *cert den* 546 US 811; 126 S Ct 330; 163 L Ed 2d 43 (2005), is also misplaced. The question in *Adams* was whether the plaintiffs were entitled to the statutory rate of overtime pay provided by the Fair Labor Standards Act, 29 USC 201, *et seq*. As such, it is clearly distinguishable from the present case, which addresses whether the government can deduct amounts of money from the wages *already earned* by public school employees. That is, because the action to enforce payment of a statutory overtime obligation for the payment was unlike a contract for payment, the *Adams* court found a vested property right was not at issue, and a taking claim could not arise. *Adams*, 391 F3d at 1223.

Defendants' citation to *Kitt v United States*, 277 F3d 1330 (Fed Cir, 2002), is likewise misplaced. In *Kitt*, the government did not assert ownership over any particular property; instead, the purported taking was nothing other than the liability a statute imposed on the plaintiffs to pay an additional tax. *Kitt*, 277 F3d at 1336-1337 ("the government did not seize or take any property of the Kitts. All it did was to subject them to a particular tax to which they previously had not been subject."). The *Kitt* court did point out, however, that "[i]n some situations money itself may be the subject of a taking, for example, the government's seizure of currency or its levy upon a bank account." *Kitt*, 277 F3d at 1337 (citations omitted).

On page 17 of the Court of Claims Opinion, the Court criticized Defendants' prior citation of *United States v Sperry Corp*, 493 US 53; 110 S Ct 387; 107 L Ed 2d 290 (1989), calling its use by Defendants a serious distortion of the *Sperry* holding.

(Appellants' Appendix, at 99a-122a.) Defendants have reiterated the same argument on pages 29-31 of their current Brief. Defendants' citation to *Sperry* also disregards the US Supreme Court's determination that the fee in question was "a reasonable user fee" for the use of the government tribunal by the *Sperry* plaintiffs. Here, however, the mandatory 3% deduction from the employees' earned compensation does not fit the definition of a "user fee."

There are three criteria to be considered in defining a "user fee": (1) a user fee must serve a regulatory purpose rather than a revenue-raising purpose; (2) user fees must be proportionate to the necessary costs of the service; and (3) a user fee must be voluntary. *Bolt v City of Lansing*, 459 Mich 152, 161-162; 587 NW2d 264 (1998). Without needing to address the first two requirements, the mandate within PA 75 precludes a finding that the 3% was in any way voluntary under the third. Indeed, *AFT II* acknowledged the 3% taken under PA 75 was *mandatory*.[10]

Throughout their argument, Defendants are unable to discern how the mandatory 3% deduction from employees' earned compensation should be characterized. Defendants use the terms "tax," "user fee," "assessment," and "garnishments" interchangeably to describe what took place, depending on which case they are attempting to rely upon. (See, e.g., Defendants' Brief, at 19, 26, 29.) However, each of those terms has its own legal significance, and the fact that Defendants cannot pin-down which one should be used to classify the money taken from Plaintiffs is telling. None of those terms apply.[11]

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[10]See *AFT II*, 497 Mich at 220 ("Unlike the 3% retiree health care contribution in 2010 PA 75, which the Court of Appeals held to be a taking in *AFT I*, the same contribution arising from 2012 PA 300 is not mandatory.")

[11]See *AFT III*, 315 Mich App at 626 – "The mechanism defined in subsection 43e of 2010 PA 75 was *neither* one involving general taxation for a general fund with specific uses of the monies later determined by the Legislature *nor* one imposing a fee for service to the payee." (Emphasis in original.)

For instance, Defendants cite *McCarthy v City of Cleveland*, 626 F3d 280 (CA 6, 2010), which is distinguishable from the present situation. There, the Sixth Circuit addressed whether a *traffic violation fee* was an unconstitutional taking. The Court held the fee, which plaintiffs had voluntarily paid upon receipt of traffic citations, did not constitute a taking. The Court, however, distinguished that payment of fines from the taking of funds such as interest, and noted the City of Cleveland did not seize funds from the plaintiffs' bank account. *McCarthy*, 626 F3d at 285. In the present case, however, 3% has been seized from the earnings of all public school employees before those funds even make it to their bank accounts.

Again, Defendants' citations to cases such as *Concrete Pipe*, supra, and others that address the *regulatory taking* of property are factually irrelevant to the present case. For example, in *Concrete Pipe*, supra, the US Supreme Court upheld Congress' imposition of withdrawal liability on employers in multi-employer pension plans. In *Maine Nat'l Bank v US*, 69 F3d 1571 (CA Federal, 1995), the United States Court of Appeals for the Federal Circuit upheld a congressional act permitting the Federal Deposit Insurance Corporation to seize the assets of a bank to offset losses resulting from the failure of another bank owned by the same holding company.

In declaring none of those actions were impermissible under the "Takings Clause" in the Fifth Amendment to the United States Constitution, the courts in each of these cases pointed out the government *had taken nothing to pay its own debt or obligations*, but had simply imposed liability on the complainants in furtherance of regulating the relationship between competing economic groups within our society. By contrast, PA 75 was passed by the Legislature for the purpose of paying the State's statutory financial obligations for health care benefits to persons who are no longer members of the retirement system. There is more than a mere obligation to

pay money in the present case. There is an identifiable property interest in the compensation received by each public school employee as it is earned once service is performed.

Likewise, relying upon cases such as *Buffalo Teachers Federation v Tobe*, 464 F3d 362 (CA 2, 2006), in a takings discussion would be misplaced. In that case, the state imposed a temporary wage freeze which prevented the plaintiff unions from receiving a scheduled wage increase negotiated as part of their labor contracts. As in *Adams*, supra, the issue in *Buffalo Teachers* was whether the plaintiffs were entitled to a certain rate of pay. Analyzing the case as a *regulatory taking*,[12] the Court determined the wage freeze was temporary and operated only during a specific control period, and that the freeze was a negative restriction rather than an affirmative exploitation of a property interest, such that *nothing was actually taken by the state*. *Buffalo Teachers*, supra, at 375.

PA 75, on the other hand, took from public school employees money already earned, in an amount exceeding $500 million between July 2010 and August 2012, and sought to turn it into an "employer contribution." Were it not for the injunction put into place by the Court of Claims, and the diversion of the deductions into the resulting escrow account, that money would have long ago been spent by the State to fund its own liabilities.

As a result, the public school employees had a sufficient property interest in their earned compensation for purposes of a takings challenge.

[12] *Id.*, at 374 ("The wage freeze does not present the 'classic taking' in which the government directly appropriates private property for its own use. Rather, the interference with appellants' contractual right to a wage increase arises from [a] public program adjusting the benefits and burdens of economic life to promote the common good. The freeze falls into the category of a regulatory, not physical taking, and should have been analyzed as such.") (Citations and internal quotation marks omitted.)

C. No "just compensation" was given in return for the 3% taken under PA 75.

From the above, it is evident a taking of private property has occurred. The State, through its public school employers, is taking 3% from each public school employee's earned compensation. Constitutionally, any taking must be accompanied by "just compensation." No compensation was given in return for the mandatory 3% deduction imposed by PA 75.

In fact, the statutory enactment was clear that retiree health care benefits are not guaranteed by the Retirement Act, and the terms of PA 75 did not affect any change in retirement for public school employees. Any suggestion that those MPSERS members who suffered the 3% deduction from their earned compensation under PA 75 would receive lifetime health care provided by the Retirement Act in exchange for those deductions is simply false. (See, e.g., Defendants' Brief, at 30 – "PA 75 required public school employees to pay a small percentage of their compensation toward the cost of *their statutory retiree healthcare entitlement.*" (Emphasis added).) At the time of its enactment, and during the course of the deductions made from employees' earned compensation until PA 300 became effective, there was no contract for lifetime health care benefits upon which the taking in PA 75 could be premised. In return for PA 75's mandatory deduction of 3% from their earned compensation, public school employees received *nothing*.

The prior discussion regarding the prospective treatment of PA 300 demonstrates the subsequent amendatory act does not provide public school employees with just compensation for the *prior* deductions PA 75 required from their earned compensation. Additionally, the decision in *AFT II* upholding PA 300 as constitutional was premised entirely on the Court's view that the substantive changes implemented by that amendment resulted in *voluntary* choices being made by the public school employees as to whether they wished to have the deductions made from

their earned compensation. *AFT II*, supra. However, no choices were presented by PA 75, thereby rendering its mandatory deductions unconstitutional. Further, *AFT II* made no suggestions that the amendments adopted through PA 300 clearly, directly, and unequivocally applied to the prior deductions mandated by PA 75.

There has been a physical taking of the earned wages of all public school employees for which they were not given any compensation. This taking violates both the Michigan and US Constitutions, and the property taken must be returned to each public school employee from which it was taken, with interest earned upon it.[13]

IV. THE MANDATORY 3% DEDUCTION FROM EMPLOYEES' EARNED COMPENSATION UNDER PA 75 AMOUNTS TO A VIOLATION OF PLAINTIFFS' SUBSTANTIVE DUE PROCESS IN ACCORDANCE WITH US CONST, AM XIV, OR CONST 1963, ART 1, §17.

In addition to finding an unconstitutional taking, the Court of Appeals found Section 43e of PA 75 to be unconstitutional under substantive due process principles derived from the Fourteenth Amendment of the US Constitution; US Const, Am XIV, as well as Const 1963, art 1, §17. Contrary to the argument of Defendants, the analysis of this case is not limited to the Takings Clause under the Fifth Amendment of the US Constitution; US Const, Am V. (Defendants' Brief, at 34-35.)

The US Supreme Court has previously applied substantive due process analysis to legislation imposing economic burdens on parties. For instance, in *Usery v Turner Elkhorn Mining Co*, 428 US 1; 96 S Ct 2882; 49 L Ed2d 752 (1976), due process principles were applied to a statutory provision which required coal mine operators to compensate former employees

[13]If Defendants were correct that PA 300 applied retroactively to the deductions taken under PA 75, and the new Section 91a(8) provides "just compensation" through the separate retirement allowance, those amounts deducted and the separate retirement allowance would be "accrued financial benefits" protected by Const 1963, art 9, §24.

disabled by pneumoconiosis. In addition, *Pension Benefit Guaranty Corporation v R.A. Gray & Co*, 467 US 717; 104 S Ct 2709; 81 L Ed 2d 601 (1984), similarly applied principles of substantive due process to consider the legislative imposition of withdrawal liability on employers who withdrew from pension plans before the effective date of such amendatory enactments. These cases were later cited in *Connolly*, supra, where the US Supreme Court mentioned both in a "takings" context, thereby acknowledging the correlation between claims under the Takings Clause and claims based on substantive due process violations. *Connolly*, supra, at 223.

This Court has similarly acknowledged the possibility of bringing both takings claims and substantive due process claims. In *Electro-Tech, Inc. v H.F. Campbell Co*, 433 Mich 57, 76-77; 445 NW2d 61 (1989), both claims were raised, and this Court stated:

> We are not suggesting, however, that Electro-Tech was foreclosed from asserting a substantive due process claim in the instant case. In fact, we agree with Justice Brickley that both the United States Supreme Court and this Court have acknowledged the possibility of substantive due process claims in response to governmental regulation of property. [Multiple citations omitted.]

This language from *Electro-Tech*, supra, is contrary to Defendants' assertion that the statute may not be analyzed under a substantive due process standard.

Defendants cite to *Cummins v Robinson Twp*, 283 Mich App 677; 770 NW2d 421 (2009), for the proposition that "one could not raise a substantive due process claim when the claim is really a Takings Clause claim." To assert this, however, Defendants would have to concede that the present case is, indeed, one involving a taking. Their prior arguments dispute whether the Takings Clause applies, thereby rendering the substantive due process claim a viable alternative theory.

Given the viability of a substantive due process claim, it is not precluded as suggested by Defendants. Therefore, the Court of Appeals properly considered this allegation in invalidating PA 75, and so too must this Court. As cited by the Court of Appeals, "The essence of a claim of violation of substantive due process is the government may not deprive a person of liberty or property by an *arbitrary* exercise of power." *AFT III*, 315 Mich App at 626 (emphasis in original; quotations and citation omitted). As explained previously by the Court of Claims:

> The action taken here by the Michigan legislature is quintessentially arbitrary and unreasonable. As noted, the Michigan Supreme Court in *Studier, supra*, found in 2005 that the statute granted no vested or accrued rights. The Michigan Legislature is charged with knowledge of that decision. **Yet, the Legislature enacts a law which imposes a financial burden on future retirees to help alleviate the State's current financial troubles in relation to those already retired and still leaves in place a system that provides absolutely no assurance that future retirees will receive any of the benefits – let alone continue at the same level. By any standard, that is "arbitrary and capricious."**

Appellants' Appendix, at 99a-122a; Court of Claims Opinion, at 21 (emphasis added).

In addition, the Court of Claims stated, "The imposition of a significant financial burden on the active public school employees, in the absence any (sic) legislative grant of any accrued, vested or contract rights, constitutes a deprivation of their substantive due process." (Appellants' Appendix, at 99a-122a; Court of Claims Opinion, at 22.) These conclusions were proper. Indeed, in concluding that PA 75 was unreasonable, arbitrary, and capricious in violation of the Due Process Clause, the Court of Appeals agreed that PA 75 was "not a mechanism that required individuals to fund benefits that they themselves had a vested right to receive." *AFT III*, 315 Mich App at 628.

With the imposition of the mandatory 3% deduction from the earned compensation of public school employees under PA 75, no new benefits or assurances were given to members of MPSERS, either in the form of an enhanced retirement allowance or in terms of vested health

care. Defendants' prior claim that the 3% deduction was imposed to require members of MPSERS to contribute toward the cost of the health care they will receive when they retire is illusory. (Appellees' Appendix, at 11b, 12b; Defendants' May 23, 2011 Brief on Appeal, at 17, 27.) To borrow the above words of the Court of Claims, this is arbitrary and capricious by any standard.

PA 75 mandates that costs which are otherwise to be borne by the individual school districts (which, in essence, are funded by the State) are to now be paid by the employees of those districts who are members of MPSERS. The 3% was not otherwise spread across taxpayers. Instead, PA 75 required a portion of every dollar of salary earned only by MPSERS members for services performed to be surrendered to the State to help balance its budget in the area of school funding.

In return for the extraction from their accrued salaries, PA 75 provided to public school employees no vested, or even improved, benefits under the Retirement Act. Yet, the State and those school districts which it funds extracted over $500 million to lessen their own burdens – i.e., to balance Michigan's budget and ease the financial burden on public schools. (Appellees' Appendix, at 8b, 11b, 12b; Defendants' May 23, 2011 Brief on Appeal, at 1, 17, and 27.) As a result, the objective of PA 75 was not to benefit the then-existing members of MPSERS. Rather, the objective was to benefit the State and its local school districts.

Defendants claim PA 75 was a proper application of police power. (Defendants' Brief, at 39.) However, the cases cited fail to support Defendants' reliance on the police power in the present case. See *Wyant v Director of Agriculture*, 340 Mich 602; 66 NW2d 240 (1954) (police power used to preclude the importation of bees); *Grayson v Michigan State Bd of Accountancy*, 27 Mich App 26; 183 NW2d 424 (1970) (police power used to protect CPA

applicants against the embarrassment of their failures being made public). Neither case compares to the financially-motivated legislation enacted by the State for the benefit of itself and its public school districts.

Further, Defendants' reliance on *Michigan Manufacturers Ass'n v Dir of Workers' Disability Compensation Bureau*, 134 Mich App 723; 352 NW2d 712 (1984), is also misplaced. The Court of Appeals properly distinguished *MMA*. *AFT III*, 315 Mich App at 627-628. This Court is encouraged to do the same.

As a result, the Court of Appeals acted properly in considering and applying the principles of substantive due process.

CONCLUSION AND RELIEF REQUESTED

For the reasons stated herein, the Court of Appeals decision must be affirmed.

Respectfully submitted,

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By /s/ Timothy J. Dlugos

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