STATE OF NEW HAMPSHIRE
SUPREME COURT

2013-0821

AMERICAN FEDERATION OF TEACHERS-NEW HAMPSHIRE, et al.

v.

STATE OF NEW HAMPSHIRE, et al

Appeal From A Final Judgment
Of The Merrimack County Superior Court

ANSWERING BRIEF FOR DEFENDANT NEW HAMPSHIRE RETIREMENT SYSTEM (RESPONDING TO PLAINTIFF'S CROSS APPEAL)

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Fifteen Minutes Oral Argument Requested
(Andrew R. Schulman to argue)

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QUESTIONS PRESENTED

I. HAVE THE PLAINTIFFS ESTABLISHED ANY OF THE ELEMENTS NECESSARY FOR AN ORDER OF EQUITABLE RESTITUTION ON THEIR "EARNABLE COMPENSATION CLAIM" WHEN:

A. THEY SEEK THE RETURN OF A PORTION OF THE MEMBER CONTRIBUTIONS THEY PAID TO NHRS OVER THEIR WORKING LIVES;

B. THEY DO NOT CONTEND THAT THOSE CONTRIBUITIONS WERE IMPROPER AT THE TIME THEY WERE PAID;

C. THEY HAVE BEEN CREDITED WITH EVERY DOLLAR OF THEIR CONTRIBUTIONS FOR THE PURPOSE OF DETERMINING PENSION BENEFITS;

D. THE AMOUNT IN DISPUTE IS IMPOSSIBLE TO CALCULATE; AND

E. TO THE EXTENT THAT PLAINTIFFS' EARNABLE COMPENSATION CLAIM HAS MERIT, THEY WOULD BE ENTITLED TO PROSPECTIVE INJUNCTIVE RELIEF.

II. IS THERE A CONSTITUTIONAL IMPERATIVE THAT REQUIRES THE RE-ESTABLISHMENT OF A SPECIAL ACCOUNT TO FUND AND PAY COLAS?

STATEMENT OF THE CASE[1]

A. Preface

This case challenges the constitutionality of several 2007 and 2008 statutory amendments to RSA Chapter 100-A relating to the New Hampshire Retirement System's (NHRS) funding and benefit scheme. The central issues in the case are:

A. Whether (i) the contracts between plaintiff NHRS members and their government employers include, as a material term, the statutory definition of "earnable compensation" that was in effect at the time each plaintiff commenced government employment, and, (ii) if so, whether subsequent statutory amendments to that definition violate the contracts clauses of the State and Federal Constitutions. N.H. Constitution, Part 1, Article 23 and U.S. Constitution, Article 1, Sec. 10. (As explained in detail below, "earnable compensation" is used to calculate member contributions, employer contributions and, indirectly, the size of NHRS annuities. A return to prior law, as the plaintiffs demand, would (i) *increase* some members' contributions, without necessarily providing them with larger retirement annuities, (ii) increase some members' annuities and (iii) have no effect whatsoever on most members.)

B. Whether the contracts between NHRS members and their employers also include, as a material term, the right to certain post-retirement COLA benefits and, if so, whether certain statutory changes to the COLA scheme violate our Constitutions' contracts clauses.

This case was filed five years ago. A preliminary injunction was never requested. The 2007 and 2008 statutory amendments are now buried underneath strata of more recent legislation. In the intervening half-decade, NHRS's working members made life decisions,

[1]The trial court record is cited in this Brief as follows: "SA" refers to the Appendix to the State's Brief. "NHRS-A" refers to the Appendix to this Brief.

NHRS employers made staffing and salary decisions and the NHRS Trustees twice certified employer contribution rates, as required by RSA 100-A:16, consistent with sound actuarial practice. Regardless of what may be required with respect to the definition of "earnable compensation" going forward, it would be *impossible* to place NHRS members, employers and their pension trust in the positions they would have been in had the law remained static. Put another way, any attempt to identify, quantify and roll back every decision, in the pursuit of a hypothetical *status quo ante* would require Herculean effort, to untangle something of Gordian complexity, for a Sisyphean result.

Therefore, if plaintiffs prevail on the substantive merits of their constitutional claim relating to "earnable compensation," the only plausible remedy is prospective injunctive relief. Were that the only remedy sought on appeal, NHRS would have filed a short, informational brief or no brief at all. That is because NHRS takes no position on whether prospective injunctive relief is constitutionally required.

More generally, NHRS does not take a position with respect to what compensation government workers are entitled to receive in return for their years of service. The NHRS Trustees are the holders of the pension trust *res* and their fiduciary obligation is to collect contributions and pay benefits in strict compliance with the trust instrument (i.e. RSA 100-A) as construed by this court. Therefore, if the only relief sought were prospective injunctive relief, NHRS would have no stake and no interest in the case beyond wanting to see a speedy, clear and final resolution capable of administration.

However, the plaintiffs and intervenors (collectively referred to below as plaintiffs) have also asked, presumably in the alternative, for the return of a portion of the member contributions they paid over their working lives. Plaintiffs' Brief at p. 48. Plaintiffs claim that because their

contributions were calculated, in part, based on compensation that if earned today would not be "earnable compensation," they have somehow overpaid and unjustly enriched the pension trust. Id. Because plaintiffs' claims for restitution from NHRS rests on a fundamental misunderstanding of the relationship between contributions and benefits, see pages 28-29 below, and because the NHRS Trustees have an obligation to preserve the pension trust, NHRS contests this claim.

NHRS takes a similarly nuanced stance with respect to the plaintiffs' COLA claims. NHRS takes no position, and remains a non-combatant on the questions of whether and to what extent its retirees are entitled to COLAs as contractual compensation for their years of service. If payment of COLAs were the only COLA-related relief requested, NHRS would not address the issue at all on appeal. However, plaintiffs demand that this court restore and order the replenishment of a special account within the pension trust. Plaintiffs' Brief, at pp. 44-47. The special account was previously used for medical insurance subsidies and COLAs. NHRS contests this claim because (a) regardless of whether NHRS members and retirees have a contractual right to COLAs, they have no right to determine logistical, internal and non-substantive accounting and bookkeeping procedures, (b) the special account was eliminated because its primary purpose—funding medical insurance subsidies—ran afoul of federal tax qualification rules and (c) the funds from the special account are presently being used for the purpose of paying retirement annuities and, therefore, were not diverted from the pension trust as the plaintiffs' claim. See, pages 20-22, 31-33, below..

B. The Travel Of The Case

The case was originally filed in August, 2009 as a putative class action. SA, 1-15. The Complaint was grounded solely on the contracts clauses of the State and Federal Constitutions.

The plaintiffs sought only declaratory and injunctive relief and attorneys' fees under 42 U.S.C. §1983. NHRS moved to dismiss the Complaint. NHRS-A, 1. NHRS argued that (a) it was an improper party as far as declaratory relief is concerned because it did not claim "adversely" to the plaintiffs, see RSA 491:22 and (b) the claim for attorney's fees was barred by sovereign immunity. NHRS-A, 1. The trial court deferred ruling on the motion to dismiss pending the briefing of cross-motions for summary judgment by the plaintiffs and the State. NHRS-A, 18.

Nine months after filing the Complaint, the plaintiffs simultaneously filed a motion for partial summary judgment, SA, 48, and a motion for leave to file an Amended Complaint. SA, 20 *et seq.* The proposed Amended Complaint added the two claims that NHRS contests on appeal, i.e., (a) the plaintiffs' claim for monetary restitution from the NHRS pension trust and (b) the plaintiffs' claim for the restoration and replenishment of the Special Account. SA, 37-38, 45. The Amended Complaint was grounded not only on the State and Federal contracts clauses, but also on the Federal Constitutions' takings and due process clauses (U.S. Constitution, Amendments V and XIV) and Part 1, Article 36-a of the New Hampshire Constitution. The latter State Constitutional provision was invoked solely with respect to plaintiffs' claims for replenishment of the special account.[2]

Although the defendants assented to the untimely Amended Complaint, the trial court nonetheless denied the plaintiffs' motion to amend. SA, 69. Two months later the trial court reversed itself and granted a motion for reconsideration, thereby substituting the Amended Complaint for the original Complaint. SA, 73.

[2]The Amended Complaint did not include a claim relating to the NHRS medical subsidy that was included in the original Complaint.

In November, 2010 (approximately a year and a half after the original Complaint was filed), all parties filed cross-motions for summary judgment. SA, 74, 140, 183. In their summary judgment motion, the plaintiffs formally and expressly withdrew their claims under the (a) federal due process clause and (b) Part 1, Article 36-a of the State Constitution. A, 184 at fn 1. Thus, they relied solely on the State and Federal contracts clauses and the Federal takings clause.

In December, 2010, the trial court ruled that the issue of class certification had to be resolved before the parties' summary judgment motions could be reached. SA, 292-294. At the plaintiffs' request, class certification had previously been deferred pending the resolution of dispositive motions. See, NHRS-A, 2, 3 and 5.

Because the issue of class certification had to be addressed, the parties agreed to a new case management order allowing the better part of a year for class discovery and the preparation of a motion to certify a class. NHRS-A, 4-6. That year came and went without plaintiffs' moving for class certification.

Eventually, in June, 2012 (approximately three years from the date the case was filed), the plaintiffs withdrew their class allegations and allowed the case to proceed based on the claims of the individual plaintiffs. SA, 300. The parties' long pending cross-motions for summary judgment were once again ready for decision.

However, because those motions included questions of first impression in New Hampshire, the Superior Court approved a joint motion for an interlocutory transfer without ruling, pursuant to Supreme Court Rule 9. SA, 301. This court declined the interlocutory transfer. SA, 302.

Thereafter, in November and December, 2012, all parties provided supplemental memoranda in support of the summary motions that had been filed two years earlier. SA, 300, 303, and 332. Then, in February, 2013, after the case had been twice fully briefed, the plaintiffs filed a Second Amended Complaint that added new parties and indicated whether each individual party had reached statutory vested status under RSA 100-A:10.[3] The parties later stipulated to these new facts concerning each individual plaintiff's years of service. SA, 442-443. Aside from this, the Second Amended Complaint was identical to the First Amended Complaint. Thus, by either accident or design the Second Amended Complaint purported to resurrect the federal due process clause and Part 1, Article 36-a claims that the plaintiffs earlier withdrew. Compare, SA, 184, at fn 1 (withdrawing the claims) with SA, 397 et seq. (Second Amended Complaint). The plaintiffs' supplemental memorandum did not address the previously withdrawn claims. SA, 332-345.

In March and April, 2013, the State and NHRS filed additional supplemental memoranda of law. SA, 427, 440. The court approved a stipulation to dismiss the plaintiffs' Section 1983 claims without prejudice, SA, 423-425, and the case was finally submitted and taken under advisement.

On July 10, 2013, the trial court issued a thirty-five page narrative order on the cross-motions for summary judgment. NHRS-A, 28 et seq. As a threshold matter, the trial court

[3]In a related case, presently pending in this court as Professional Fire Fighters Of New Hampshire et al. v. State of New Hampshire, 2013-0669, the trial court had ruled that NHRS members first obtain Constitutionally enforceable contractual rights under RSA Chapter 100-A once they work a sufficient number of years to attain statutory vested status under RSA 100-A:10. Although the plaintiffs disagreed with this ruling, they wished to amend their Complaint to ensure that the trial court would know which individual plaintiffs had attained statutory vested status. All parties agreed to the amendment for this limited purpose.

deemed the due process and Article 36-a claims as withdrawn. NHRS-A, 28-29 at fn. 1. The trial court then ruled that:

-With respect to the "earnable compensation claim," (a) NHRS members obtain a Constitutionally enforceable contractual right to their pension benefits after they attain statutory vested status under RSA 100-A:10 (which requires ten years of creditable service), NHRS-A, 42, (b) The statutory amendment to the definition of "earnable compensation" would infringe that contractual right if application of the amendment results in a reduced pension, NHRS-A, 51-52, (c) Only one "earnable compensation" plaintiff was both "vested" prior to the effective date of the statutory amendment and able to show a reduction in his pension as a result of the amendment, NHRS-A, 56-57, (d) summary judgment was granted to this plaintiff and against the other the "earnable compensation" plaintiffs. NHRS-A, 57. Although final order did not expressly indicate the applicable remedy, presumably the one prevailing plaintiff would be entitled to a recalculation of his pension and payment of the arrearage. This would moot the plaintiff's alternative request for "restitution" of a portion of his member contributions.

-With respect to the COLA claims, (a) the court did not determine whether NHRS retirees had Constitutionally enforceable rights to COLAs, NHRS-A, 58-59, but (b) ruled that even if such a right existed, the plaintiffs failed to demonstrate that the alleged infringement was both "not necessary" and "substantial," and (c) no plaintiff had demonstrated actual harm. NHRS-A, 59. Therefore, the court granted the State summary judgment on the COLA claims, including those related to the special account. NHRS-A, 59.

The plaintiffs unsuccessfully moved to reconsider. SA, 453 et seq., SA 512 et seq. This appeal follows.

STATEMENT OF THE FACTS

A. The New Hampshire Retirement System

The New Hampshire Retirement System is a tax qualified pension trust and governmental pension plan established by RSA 100-A:2.[4] NHRS provides defined benefit retirement annuities and other post-employment benefits for New Hampshire's full-time police officers, firefighters, teachers, and state employees as well as many political subdivision employees.[5] NHRS has over 48,000 working, contributing members and close to 30,000 retired members and beneficiaries. See, NHRS Comprehensive Annual Financial Report For The Fiscal Year Ended June 30, 2013, p. 59 (published on December 10, 2013), available at www.nhrs.org, ("2013 CAFR").

NHRS is a public institution and a component of the State of New Hampshire. State Employees' Association of New Hampshire, Inc. v. Belknap County, 122 N.H. 614 (1982). However, it is not an executive branch agency. New Hampshire Retirement System v. Sununu, 126 N.H. 104, 109 (1985). NHRS is governed by a Board of Trustees that "ha[s] the powers, privileges and immunities of a corporation," RSA 100-A:15. It is funded and administered exclusively through member and employer contributions and investment income. RSA 100-A:15 and 16. Thus, NHRS is self-supporting. It does not receive additional public funds for staff, consultants, facilities or operations. RSA 100-A:15. See also, N.H. Constitution, Part 1, Article 36-a.

NHRS' funding scheme is controlled by statute and by Part 1, Article 36-a of the New Hampshire Constitution (which specifically addresses employer contributions):

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[4]See, 26 U.S.C. 401(a) (defining the criteria for federal tax qualified pension trusts) and 26 U.S.C. 414(d) (defining the term "governmental plan").

[5]See, RSA 100-A:1 (definitions), 100-A: 3 (NHRS membership), 100-A:5 and 6 (annuities) and 100-A:8, 9, 10 and 52 et seq. (other post-employment benefits).

-NHRS working members pay contributions to NHRS as a percentage of their "earnable compensation." RSA 100-A:16, I. This percentage is set by statute, RSA 100-A:16, I, and NHRS has no discretion to alter it.

-NHRS employers pay contributions as a percentage of each of their member's "earnable compensation." The employer contribution rate is set, or "certified" every two years by NHRS based on its actuary's determination of what is necessary to fund the system's long term liabilities. RSA 100-A:16, II. See also, N.H. Constitution Part 1, Article 36-a.

-NHRS receives investment income through an investment policy adopted by the NHRS Trustees and implemented by the NHRS Independent Investment Committee in the exercise of their fiduciary responsibilities. RSA 100-A:15.

NHRS' benefit scheme is controlled entirely by RSA Chapter 100-A. Statutory formulae dictate whether, when and to what extent members and beneficiaries are eligible for benefits. See, RSA 100-A:5, 6, 8, 9, and 52 et seq. NHRS plays no role in determining the scope of member benefits. NHRS' obligations with respect to the payment of benefits are administrative and ministerial.

B. Facts Relating To "Earnable Compensation"

The concept of "earnable compensation," as defined by the twelve versions of RSA 100-A:1, XVII that have been in effect since NHRS was established in 1967 (see, p. 12 below), plays two fundamental but entirely distinct roles in the operation of the NHRS pension trust.

The Use Of "Earnable Compensation" To Determine Benefits: NHRS pension annuities and death benefits are paid in direct proportion to the average of a member's three highest years of "earnable compensation" (or five best years for members who did not attain statutory "vested"

status prior to January 1, 2012).[6] RSA 100-A:1, XVIII, 100-A:5 and 6. "Earnable compensation" for every year other than the highest three (or five) years is not considered at all in calculating member benefits.

The three (or five) years that are used to calculate a member's pension may not be indicative of either the amount or the make-up of the member's lifetime "earnable compensation." For example, a pension may reflect a substantial amount of overtime and paid details in a police officer's final year or two of employment, even if the officer rarely received such compensation in previous years. See generally, Milette v. New Hampshire Retirement System, 141 N.H. 342 (1996) (a case in which a members' highest year of "earnable compensation" included a severance payment that drove up the amount of the member's retirement annuity). Likewise, even before the statutory amendment at issue in this appeal, a member might have paid contributions based on "other compensation" (such as a uniform allowance) that was not available to the member during his or her highest earning years.

For the purpose of determining pension benefits, members are credited with the amount of "earnable compensation" that is reported by their employers for each year based on the definition of "earnable compensation" that is in effect at the time. SA, 115. The amount that is credited to a member for any given year is not recalculated to reflect subsequent Legislative changes in the definition of "earnable compensation." SA, 115. Thus, to use a hypothetical example, if (a) a member had "earnable compensation" of $50,000 in 2006 and $500 of this amount represented a clothing allowance and (b) the Legislature subsequently changed the definition of "earnable compensation" to exclude clothing allowances, then:

[6]The average of a member's three (or five) highest years of "earnable compensation" is called the member's "average final compensation." RSA 100-A:1, XVIII.

-The member's "earnable compensation" for the year 2006 would always be $50,000 for the purpose of determining pension benefits;

-If, at the end of the member's government service, the year 2006 was one of the member's three highest years for "earnable compensation," the full $50,000 would be included as one of the three figures to be averaged for the determination of the members' pension benefit.

-If, at the end of the member's government service, the year 2006 was not one of the member's three highest years for "earnable compensation," none of the $50,000 would be used to determine "average final compensation."

The Use Of Earnable Compensation To Determine Contributions: NHRS receives member and employer contributions based on the definition of "earnable compensation" that is in effect at the time the contribution is made. SA, 115. NHRS never refunds any member or employer contribution based on subsequent Legislative changes to the definition of "earnable compensation." SA, 115. Likewise, NHRS never requests members or employers to make additional contributions for prior years if the definition of "earnable compensation" has changed. SA, 115.

The Present Dispute: "Earnable compensation" was initially defined by 1967 Laws 134:1 (enacted as part of the statute establishing the New Hampshire Retirement System and codified as RSA 100-A:1, XVII (1967)). The original definition of "earnable compensation" has been amended on eleven separate occasions by the Legislature. See, 1967 Laws 405:1; 1969 Laws 354:2; 1975 Laws 461:2; 1991 Laws 313:1; 1995 Laws 270:1; 1996 Laws 187:1; 1997 Laws 274:1; 2001 Laws 275:6; **2008 Laws 300:1 (2008 HB 1645:1, the statute at issue in this case)**, 2011 Laws 224:161, and finally 2012 Laws 194:4.

At least one of these amendments significantly narrowed the meaning of "earnable compensation" by excluding direct cash compensation. The 1991 amendment (1991 Laws 313:1) capped "earnable compensation" in the final year of employment at 150% of a members' second highest earning year. This amendment limited the effect that early retirement stipends, paid leave time, and final year special duty details and overtime could have on retirement benefits. See generally, In Re Concord Teachers (New Hampshire Retirement System), 158 N.H. 529 (2009).

The present controversy concerns a less dramatic narrowing of the statute. 2008 Laws 300:1 (2008 HB 1645:1) excluded certain "other compensation" (such as, payments for uniforms or payments in lieu of participation in an employer's health or dental plan) from the definition of "earnable compensation."[7] Prior to the 2008 amendment, virtually all payments that were federally taxable qualified as "earnable compensation."

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[7]2008 Laws Ch. 300:1 is set forth below. The language it added is in ***bold italic***. The language it deleted is in [~~bracketed strikethough~~].

> "Earnable compensation" shall mean for all members the full base rate of compensation paid plus any overtime pay, holiday and vacation pay, sick pay, longevity or severance pay, cost of living bonus, additional pay for extracurricular and instructional activities or for other extra or special duty, and [~~other compensation paid to the member by the employer~~] ***any military differential pay***, plus the fair market value of non-cash compensation ***paid to, or on behalf of, the member*** [~~such as~~] ***for*** meals or living quarters if subject to federal income tax***, but excluding other compensation except cash incentives paid by an employer to encourage members to retire, supplemental pay paid by the employer while the member is receiving workers' compensation, and teacher development pay that is not part of the contracted annual salary***. However, earnable compensation in the final 12 months of creditable service prior to termination of employment shall be limited to 1-1/2 times the higher of the earnable compensation in the 12-month period preceding the final 12 months or the highest compensation year as determined for the purpose of calculating average final compensation, but excluding the final 12 months. Any compensation received in the final 12 months of employment in excess of such limit shall not be subject to member or employer contributions to the retirement system and shall not be considered in the computation of average final

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The definition of "earnable compensation" was further amended in 2011 and 2012. Because those more recent statutory amendments are not directly at issue in this appeal, they are detailed only in the following footnote.[8] None of these statutory changes were retroactive. Previously reported "earnable compensation" for prior years was not recalculated. SA, 115.

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compensation. Provided that, the annual compensation limit for members of governmental defined benefit pension plans under section 401(a)(17) of the United States Internal Revenue Code of 1986, as amended, shall apply to earnable compensation for all employees, teachers, permanent firemen, and permanent policemen who first become eligible for membership in the system on or after July 1, 1996. Earnable compensation shall not include compensation in any form paid later than 120 days after the member's termination of employment from a retirement eligible position, with the limited exceptions of disability related severance pay paid to a member or retiree no later than 120 days after a decision by the board of trustees granting the member or retiree disability retirement benefits pursuant to RSA 100-A:6 and of severance pay which a member was entitled to be paid within 120 days after termination but which, without the consent of the member and not through any fault of the member, was paid more than 120 days after the member's termination. The member shall have the burden of proving to the board of trustees that any severance payment paid later than 120 days after the member's termination of employment is earnable compensation and meets the requirements of an asserted exception to the 120-day post-termination payment requirement.

[8]2011 Laws 224:161 (2011 HB 2) amended RSA 100-A:1, XVII as follows:

(a) For [~~all~~]members ***who have attained vested status prior to January 1,*** **2012** the full base rate of compensation paid ***, as determined by the employer,*** plus any overtime pay, holiday and vacation pay, sick pay, longevity or severance pay, cost of living bonus, additional pay for extracurricular and instructional activities [~~or for other extra or special duty]~~, and any military differential pay, plus the fair market value of non-cash compensation paid to, or on behalf of, the member for meals or living quarters if subject to federal income tax, but excluding other compensation except cash incentives paid by an employer to encourage members to retire, supplemental pay paid by the employer while the member is receiving workers' compensation, and teacher development pay that is not part of the contracted annual salary. ***Compensation for extra and special duty, as reported by the employer, shall be included but limited during the highest 3 years of creditable service as provided in paragraph XVIII.*** However, earnable compensation in the final 12 months of creditable service prior to termination of employment shall be limited to 1-1/2 times the higher of the earnable compensation in the 12-month period preceding the final 12 months or the highest compensation year as determined for the purpose of calculating average final compensation, but excluding the final 12 months. Any compensation received in the final 12 months of

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employment in excess of such limit shall not be subject to member or employer contributions to the retirement system and shall not be considered in the computation of average final compensation. Provided that, the annual compensation limit for members of governmental defined benefit pension plans under section 401(a)(17) of the United States Internal Revenue Code of 1986, as amended, shall apply to earnable compensation for all employees, teachers, permanent firemen, and permanent policemen who first become eligible for membership in the system on or after July 1, 1996. Earnable compensation shall not include compensation in any form paid later than 120 days after the member's termination of employment from a retirement eligible position, with the limited exceptions of disability related severance pay paid to a member or retiree no later than 120 days after a decision by the board of trustees granting the member or retiree disability retirement benefits pursuant to RSA 100-A:6 and of severance pay which a member was entitled to be paid within 120 days after termination but which, without the consent of the member and not through any fault of the member, was paid more than 120 days after the member's termination. The member shall have the burden of proving to the board of trustees that any severance payment paid later than 120 days after the member's termination of employment is earnable compensation and meets the requirements of an asserted exception to the 120-day post-termination payment requirement.

(b)

(1) For members who have not attained vested status prior to January 1, 2012, the full base rate of compensation paid, as determined by the employer, plus compensation over base pay. Compensation over base pay shall include as applicable, subject to subparagraphs (2), (3), and (4), any overtime pay, holiday and vacation pay, sick pay, cost of living bonus, annual longevity pay, additional pay for extracurricular and instructional activities, compensation for extra and special duty, and any military differential pay, plus the fair market value of non-cash compensation paid to, or on behalf of, the member for meals or living quarters if subject to federal income tax, but excluding other compensation except supplemental pay paid by the employer while the member is receiving workers' compensation and teacher development pay that is not part of the contracted annual salary.

(2) Compensation over base pay shall be limited during the highest 5 years of creditable service as provided in paragraph XVIII.

(3) Earnable compensation shall not include compensation for extra and special duty for members who commence service on and after July 1, 2011.

(4) Earnable compensation shall not include incentives to encourage members to retire, severance pay or end-of-career additional longevity payments, and pay for unused sick or vacation time. Earnable compensation in the final 12 months of creditable service prior to termination of employment shall be limited to 1-1/2 times the higher of the earnable compensation in the 12-month period preceding the final 12 months or the highest compensation year as determined for the purpose of calculating

Continued on next page

No party presented any evidence concerning the number of NHRS members who were affected by the 2008 amendment that excluded "other compensation" from the definition of "earnable compensation." However, three plaintiffs received several thousand dollars per year from their employers in lieu of health insurance benefits. SA, 442-443. One of these plaintiffs retired in 2011 and the parties stipulated that his annual pension would be larger by $389 per month ($4,668 per year) if this "other compensation" were included as "earnable compensation" for his three highest earning years. SA, 443.

The two other plaintiffs who received substantial payments in lieu of health insurance are active members in the middle of their working lives. SA, 442-443. The record is silent with respect to whether they are likely to continue to receive cash payments in lieu of health insurance (which would depend both on their family insurance needs and on their future collective bargaining contracts). Therefore, one can only speculate as to whether their ultimate pensions will be affected by the exclusion of "other compensation" from the definition of "earnable compensation."

Continued from previous page

> ***average final compensation, but excluding the final 12 months. Any compensation received in the final 12 months of employment in excess of such limit shall not be subject to member or employer contributions to the retirement system and shall not be considered in the computation of average final compensation. Provided that, the annual compensation limit for members of governmental defined benefit pension plans under section 401(a)(17) of the United States Internal Revenue Code of 1986, as amended, shall apply to earnable compensation for all employees, teachers, permanent firemen, and permanent policemen who first become eligible for membership in the system on or after July 1, 1996. Earnable compensation shall not include compensation in any form paid later than 120 days after the member's termination of employment from a retirement eligible position.***

2012 Laws 194:4, amended RSA 100-A:1, XVII(b)(1) excluded "holiday, vacation pay and sick pay" from the definition of "earnable compensation" established by 2011 Laws 224:161 (2011 HB 2) for NHRS members who had not attained vested status prior to January 1, 2012.

For the past five years, however, these two plaintiffs have been better off financially because they have not been paying member contributions based on the payments they receive in lieu of health insurance. One plaintiff, a police officer who receives $642.87 per month in lieu of health insurance, SA, 443, would pay an extra $74.25 per month (i.e. $891 per year) in NHRS contributions if this payment were part of his "earnable compensation" (using on the statutory contribution rate of 11.55% for policer officers). The other plaintiff, a police officer who receives $333 per month in lieu of health insurance, SA, 443, saves $38.46 per month (i.e. $461.52 per year).

Two other plaintiffs received far more modest "other compensation" in the form of clothing allowances of $475 per year. Even if (a) these two plaintiffs continue to receive identical clothing allowances during their three highest earning years and (b) eventually retire with pensions equal to 75% of their average final compensation (which would require 30 years of service for these Group II members, see RSA 100-A:5), the effect of excluding their clothing allowances from "earnable compensation" will be minimal. Their pensions would be $29.69 per month lower. In contrast, they would save over twenty years of contributions on that compensation with the exclusion.

As the foregoing makes clear, the "earnable compensation" provision of 2008 Laws 300:1 (2008 HB 1645:1) does not affect the NHRS membership equally: The small minority of members who receive thousands of dollars each year in lieu of health insurance during their highest earning years will end up with lower pensions. Yet some members who presently receive payments in lieu of health insurance may choose to accept insurance (or may not have the option) during their highest earning years. Those members pay reduced contributions. Other members receive much lower amounts of "other compensation" which may or may not affect

their ultimate pensions because, until a member is nearing retirement, it is difficult to determine whether he is better or worse off as a result of the statutory amendment.

NHRS does not know—and has no way to determine—which members received or made contributions on "other compensation." SA, 116. Approximately 475 employers in the NHRS System provide NHRS with the total amount of "earnable compensation" for each of their members. SA, 116. None of these employers indicated how much, if any, of pre-2008 "earnable compensation" was "other compensation," let alone how much was for a clothing allowance or a payment in lieu of health insurance or some other specific benefit.

Thus, the alternative relief that the plaintiffs request—i.e. membership-wide equitable restitution from NHRS in the amount of contributions made over the course of each member's working life for "other compensation"—would require all of these employers to audit and reconstruct decades of payrolls.

C. Facts Relating To Colas And The Special Account

History: Prior to 1993, the Legislature granted COLAs on an *ad hoc* basis for one or more categories of beneficiaries. A general COLA statute was enacted in 1989, but it said only that NHRS beneficiaries would be entitled to COLAs "if and when enacted by the legislature." See, 1989 Laws 400:2; RSA 100-A:41-a, I (1989-1994).

In 1993, this statute was amended to require an annual COLA of between 1% and 5% if, and only if: (a) A COLA in a specific amount was approved that year by the Legislature's fiscal committee, see RSA 100-A:41-a, II (1994-2009); and (b) The NHRS actuary certified that funds were available in the NHRS special account to pay for terminal funding of the COLA. See, 1993 Laws 340:4; RSA 100-A:41-a (1994-2008).

In 2008, the Legislature amended the COLA statute. Pursuant to 2008 Laws 300:19 (2008 HB 1645:19) (the statute presently challenged by plaintiffs) COLAs were set at 1.5% of a member's retirement allowances in the previous year, subject to a $450 per year cap. See, RSA 100-A:41-a (2009).[9] COLAs were still only available to the extent there were sufficient funds in the NHRS special account. Id. Further, COLAs were only made available only for the single fiscal year beginning on July 1, 2008. Id.

The COLA statute has since been amended three times. See, 2009 Laws 144:242 (2009 HB 2:242, extending COLAs through the 2009 fiscal year); 2010 Sp. Sess. Laws 1:102 (same for 2010 fiscal year); and 2012 Laws 261:5 (eliminating reference to the special account). No COLAs have been provided since the end of the 2010 fiscal year.

In 2008, the Legislature also enacted a new statute, RSA 100-A:41-b, that provided temporary supplemental allowances.[10] 2008 Laws 300:20 (2008 HB 1645:20). Retirees who had at least 15 years of service and a retirement allowance of $20,000 or less, received a temporary supplemental allowance of $1,000 per year for fiscal 2008, 2009 and 2010. Retirees who retired prior to January 1, 1993, and their beneficiaries, received an annual $500 temporary allowance for the same years. Those temporary allowances ceased at the end of fiscal 2010.[11]

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[9]The statutory amendment provided that members who receive annuities greater than $30,000 woul receive COLAs based only on the first $30,000. 1.5% of $30,000 is $450.

[10]A temporary supplemental allowance differs from a COLA. The amount of a COLA becomes a permanent addition to a beneficiary's base retirement allowance. A temporary supplemental allowance is a a one-time payment. Compare, RSA 100-A:41-a (COLAs) and RSA 100-A:41-b (Temporary Supplemental Allowances).

[11]The same statute, RSA 100-A:41-b granted an additional temporary allowance to political subdivision retirees who were receiving NHRS medical insurance subsidies through fiscal 2012. The amount of this additional payment was $500 for retirees taking a one person medical benefit and $1,000 for retirees taking a two person medical benefit. However, this was offset by changes to the medical subsidy statutes. RSA 100-A:52-a and 52-b.

The Special Account: From 1993 through 2012, RSA 100-A:41-a made COLAs completely dependent on the presence of terminal funding in the NHRS special account established by RSA 100-A:16, II(h). The special account no longer exists. It was abolished by 2012 Laws 261:14. Its abolition was hastened by the fact that, as explained below, it was used in a manner that transgressed federal tax qualification requirements. SA, 111-112; 119-12. As explained below, the funds in the special account were always part of the NHRS pension trust and, by 2012, the pencil-built wall of bookkeeping entries that separated the special account from the State Annuity Accumulation Fund no longer served a purpose.

The special account was established in 1983.[12] See, 1983 Laws 469:146. It was designed as a depository for unexpectedly large investment gains. From 1983 until 2007, if actual investment income for a given year exceeded NHRS' assumed rate of return by more than 0.5%, the additional gain was placed in the special account. RSA 100-A:16, II(h)(2) (1984–2007). Income from funds in the special account remained in the special account. This account was designed to fund COLAs and other post-employment benefits. RSA 100-A:16, II(h)(7) (1984-2012). In practice, the special account was used only for COLAs and for the medical subsidies described below. SA, 112.

* * *

In 1988, the Legislature tapped the special account to pay for a newly established non-pension, post-employment benefit. 1988 Laws 191:5, codified as RSA 100-A:52, created a

[12]The special account was subdivided into accounts for each member classification (i.e. firefighters, police officers, teachers and employees), and later subdivided further to distinguish between State and political subdivision employees. See, RSA 100-A:16, II(h) (2003) and (2004-2012).

wholly new medical subsidy for certain Group II retirees and beneficiaries.[13] Retirees were allowed to continue to participate in their former employer's group medical insurance plan, RSA 100-A:50, and the medical subsidy defrayed some, but not all of the cost. RSA 100-A:52.

Consistent with federal tax qualification requirements, this non-pension benefit was financed via a medical subtrust established pursuant to 26 U.S.C. §401(h). See, RSA 100-A:53, I. The subtrust was funded in a roundabout fashion: Twenty-five percent of Group II employer contributions were placed in the medical subtrust. SA, 112. See also, RSA 100-A:53, I (1984-2012).[14] However, the employer contribution rate was calculated without regard to funding the medical subtrust. SA, 111. See also, RSA 100-A:16, II (h)(5) (1984-2012). Therefore, the pension trust's annuity accumulation fund was shorted by the diversion of twenty-five percent of employer contributions to the medical subtrust. This shortfall was offset by a dollar-for-dollar transfer of funds from the special account to the annuity accumulation fund. RSA 100-A:53, I (1984-2012).

The medical insurance subsidy was extended to certain Group I political subdivision retirees in 1999, RSA 100-A:52-a, and to Group I State retirees in 2001. RSA 100-A:52-b[15] The

[13]The NHRS membership consists of two groups. RSA 100-A:1, X. Group I members are teachers and "employees." Group II members are police officers and firefighters. (The term "employee" is defined by RSA 100-A:1-V. As a practical matter, any NHRS member who is not a teacher, police officer or firefighter, as those terms are defined by RSA 100-A:1, VI, VII and VIII is an "employee.")

[14]The statute provided that employer contributions to the medical subtrust would decrease to the amount necessary to maintain funded status. RSA 100-A:53, I (1984-2012). However, because the medical insurance subsidy continued to increase along with the cost of medical insurance, see RSA 100-A:52 (1989-2008), this decrease in contributions was never realized.

[15]Because State retirees already had a medical insurance benefit that was funded by the State under RSA 21-I:30, the NHRS subsidy really amounted to a transfer of funds to the State to defray some of the cost of providing the benefit.

funding process for Group I medical subsidies was identical to that used for Group II members, i.e. employer contributions were diverted to the medical subtrust and funds from the special account were transferred to the annuity accumulation fund to make up the shortfall. RSA 100-A:53-b, 53-c and 53-d.

Because the cost of the medical subsidy increased, in 2000 the Legislature directed that a full 33% of employer contributions members be diverted to the medical subtrust for the next seven years, again using the funds in the special account to make up the shortfall in contributions to the annuity accumulation fund. RSA 100-A:53-e.

* * *

In 2007, NHRS' tax counsel opined that because (a) the special account is an indivisible part of the pension trust and (b) it was in effect being used to fund the medical subtrust, NHRS was out-of-compliance with federal tax qualification statutes and regulations.[16] SA, 112, 119-120. Relying on tax counsel, and in order to maintain its tax qualified status, NHRS self-reported its non-compliance to the IRS and proposed corrective action under the IRS' voluntary compliance program. SA, 113-114.

To implement the corrective action that the IRS approved, NHRS sought and obtained legislation that stopped the practice of indirectly using the special account to pay for medical subsidies. See, 2007 Laws 268:7 (2007 HB 653:7). See also, 2008 Laws ch. 300 (2008 HB 1645), amending RSA 100-A:53, 53-b, 53-c and 53-d to eliminate references to the special

[16]With limited and inapplicable exceptions, funds from a pension trust cannot be transferred to a medical subtrust. This is detailed in the Appendix to the State's Brief, in a report from NHRS' outside tax counsel citing pertinent federal tax statutes and IRS regulations. SA, 117-139. No purpose would be served by delving into the minutia of these tax issues in the body of this brief.

account. Therefore, NHRS stopped moving funds in its bookkeeping system from the special account to the annuity accumulation fund.

Prior to the corrective legislation, the special account had been used only for COLAs and medical subsidies. SA, 113. After the legislation, the special account was used only for COLAs. SA, 113. Therefore, employer contributions to the NHRS system had to increase to meet the cost of the medical subsidy benefit.

To counterbalance this increase, and to reflect the fact that the special account no longer paid medical subsidies, the Legislature changed the manner in which it was funded. Under 2007 Laws 268:8 (2007 HB 653:8), funding from the annuity accumulation fund to the special account was prohibited unless the NHRS pension trust was 85% funded and, if that prerequisite were met, funding was limited to investment income over and above a 10.5% rate of return. Because the NHRS System was nowhere near 85% funded, the 2007 legislation effectively stopped the funding of the special account.

Additionally, in 2008 the Legislature directed a one-time transfer of $250 million from the special account to the annuity accumulation fund. See, 2008 Laws, 303:8 (HB 1645:8), codified as RSA 100-A:16,II (j) (2009-2012). Because this transfer increased funded status of the NHRS pension trust, it resulted in a decrease in the amount of employer contributions and this, in turn, offset the increase in employer contributions due for medical subsidies.

Finally, as noted above, in 2012 the Legislature abolished the special account. 2012 Laws 261:14, repealing RSA 100-A:16, I(h). The special account had always been part of the NRHS pension trust and, because COLAs could be paid directly from the pension trust, there was no longer a reason to maintain the fiction of a separate “account.”

SUMMARY OF ARGUMENT

I. Plaintiffs' primary request for relief on their "earnable compensation" claim is a prospective injunction that restores the pre-2008 definition of "earnable compensation." NHRS takes no position with respect to whether such injunctive relief is constitutionally required. However, NHRS objects to the alternative relief sought by plaintiffs, i.e. equitable restitution from the NHRS trust fund under the doctrine of unjust enrichment. Plaintiffs claim that NHRS was unjustly enriched by member contributions on "other compensation." Therefore, they seek the return of that portion of their lifetime contributions.

To prove unjust enrichment, plaintiffs must show that (a) NHRS received a benefit it was not legally entitled to receive and (b) it would be unconscionable to allow NHRS to retain that benefit. As the trial court held, neither of these elements is present in this case. NHRS-A, 57-58. NHRS was legally entitled to the full amount of the plaintiffs' contributions at the time they were made. Plaintiffs paid into the system based on the statutory formula for member contributions. Their contributions were equal to a percentage of their "earnable compensation" as defined by statute at the time the contributions were made. That same amount of "earnable compensation" was then credited to plaintiffs for the purpose of calculating their pensions. Those figures were never adjusted downward. Therefore, if any of a member's three highest earning years of "earnable compensation" occurred prior to the effective date of the 2008 amendment, that member's "other compensation" for such years would factor into his pension.

It must be remembered that NHRS members' pensions have never been calculated based on lifetime "earnable compensation." Only the three highest earning years are considered. Therefore, even before the 2008 amendment, contributions that a member paid based on "other

compensation," would never factor into the member's pension unless that "other compensation" was earned during one of the member's highest earning years.

It is not unconscionable to allow the NHRS pension trust to keep the contributions that its members made in prior years. NHRS relied on member contributions to fund the pension trust. The plaintiffs' pre-2008 contributions were considered by the NHRS actuary in determining the funded status of the pension trust and, by extension, the amount of necessary employer contributions. The Legislature relied on this information in making benefits decisions over the years. If anything, it would be unconscionable to undermine all of these decisions by depleting the trust in the manner requested by the plaintiffs.

The trial court's decision granting summary judgment to NHRS on plaintiffs' claim for restitution, NHRS-A, 57-58, should be affirmed.

II. Plaintiffs argue that they are constitutionally entitled to both COLAs and to the restoration and replenishment of the special account to fund COLAs. NHRS takes no position on whether, and to what extent, plaintiffs have a right to COLAs. However, NHRS objects to the request for a judicial order that re-establishes and re-fund the special account.

The plaintiffs wish to turn back the clock to the status quo ante, prior to 2008, when the special account was used to fund both COLAs and medical subsidies. But this is an impossible feat because the special account can never again be used for funding medical subsidies. To do so would jeopardize NHRS status as a tax qualified government pension trust. Therefore, if the special account were to be reestablished and used exclusively for COLAs, it would have to be funded differently than it was. If it were funded as prior law dictated, then it would be over-funded for COLAs and the annuity accumulation fund would be artificially underfunded for no

logical reason. Any alternative funding formula that the court might devise would be a policy decision best left to the Legislature.

More important, both the annuity accumulation fund and the former special account were part of a single, indivisible pension trust. Transferring funds from one account to the other is the institutional equivalent of an individual moving funds from his savings account to a separate account earmarked for his mortgage. From the individual's perspective, this might be a useful organizational tool. But it would not affect the mortgagee's rights.

Since no assets have left the pension trust as a result of the elimination of the special account, the plaintiffs cannot complain that the trust corpus has shrunk. Every dollar in the trust may only be used to fund retirement allowances. See, N.H. Constitution, Part 1, Article 36-a. Thus, plaintiffs can obtain no direct benefit by resurrecting and replenishing the special account. Their fortunes will not increase or decrease if dollars are moved from one column to another in NHRS' annual report.

This court should affirm the trial court's decision granting summary judgment to NHRS on the plaintiffs' claims for an order restoring and replenishing the special account.

ARGUMENT

I. THE PLAINTIFFS ARE NOT ENTITLED TO EQUITABLE RESTITUTION FROM THE NHRS PENSION TRUST ON THEIR EARNABLE COMPENSATION CLAIM

Plaintiffs seek equitable restitution from NHRS under the doctrine of unjust enrichment in connection with their earnable compensation claim. Plaintiffs' Brief at p. 48-49; SA, 208, 419-420. More particularly, they seek the return of all contributions they have made to NHRS over their working years based on "other compensation." Id. Although not argued as such in their brief, plaintiffs' request for restitution was expressly brought in the alternative to the primary relief that they seek, i.e. an injunction restoring the pre-2008 definition of earnable compensation. See, SA, 208 (Plaintiff's Motion For Summary Judgment):

> …[A]ctive members are contractually entitled to monthly pension benefits that include all of the "other compensation" that was part of the formula for determining pensions when they vested in their pensions However, should the Court conclude otherwise, then—alternatively—these members are entitled to "restitution" in the amount of their contributions that were attributable to this "other compensation."

As a threshold matter, NHRS takes no position with respect to whether the primary, injunctive relief that plaintiffs seek is required by our Constitutions. If injunctive relief is required, then given a reasonable lead time for implementation, the prior definition of earnable compensation can be used going forward. Further, if the judgment in favor of the one prevailing plaintiff in this case is affirmed, the same relief can be granted to other NHRS retirees who come forward and prove that they would have a greater pension under the pre-2008 statute.[17]

[17]As explained below, NHRS has no way to identify such potential claimants, let alone determine the amount of "other compensation" that should be considered in the calculation of their pensions.

However, NHRS contests plaintiffs' alternative request for restitution because none of the elements of unjust enrichment are present. In order to prevail, the plaintiffs must prove that: (a) NHRS received a benefit that it was not legally entitled to receive, and (b) it would be *unconscionable* to allow NHRS to retain this benefit. See e.g., Clapp v. Goffstown School District, 159 N.H. 206, 210 (2009) ("Unjust enrichment is an equitable remedy, found where an individual receives a benefit which would be unconscionable for him to retain."); Kowalski v. Cedars of Portsmouth Condominium Association., 146 N.H. 130, 133 (2001) (same); R. Zoppo Co., Inc. v. City of Manchester, 122 N.H. 1109 (1982) (same).

The first element of unjust enrichment is not present because NHRS was legally entitled to the full amount of the plaintiffs' contributions at the time they were made. Plaintiffs paid into the system based on the statutory formula for member contributions.[18] Even accepting, dubitante, plaintiffs' suggestion that it would be unconstitutional to use one definition of "earnable compensation" as a measuring stick for contributions and a different definition for the purpose of determining benefits, that was not the case when the contributions were made. Every year, NHRS members paid contributions based on the current definition of "earnable compensation." Every year they were credited with the same amount of "earnable compensation" for benefits purposes.

Those numbers were never adjusted downward to reflect subsequent changes in the definition of "earnable compensation." Thus, if at the time a member retires, it is determined that his highest earning three years of "earnable compensation" occurred prior to the effective

[18]Member contribution rates were increased while this case was pending in the trial court. See, 2011 Laws 224:172 (2011 HB 2:172), amending RSA 100-A:16, I(a). That constitutionality of that increase is presently before this court in Professional Fire Fighters Of New Hampshire et al. v. State of New Hampshire et al., 2013-0669. This brief does not express any opinion on whether the increase in member rates was constitutional.

date of the 2008 amendment, that member's pension will be calculated based, in part, on any "other compensation" the member earned in those years.

Because, as explained above, NHRS was legally entitled to the member contributions at the time they were paid and received, plaintiffs' argument must be that the contributions first became gratuitous *nunc pro tunc* in 2008. See, Plaintiffs' Brief at p. 49 ("NHRS has been receiving a gratuitous benefit since the effective date of the amendment."). Putting aside the grandfather paradox[19] presented by an illegality that supposedly travels back in time, plaintiffs' argument depends on the false premise that NHRS pensions are calculated based on the sum of contributions that have been made over a member's working years. In reality, members were never promised that each year's contributions would be factored into the calculation of their benefits—quite the contrary, RSA 100-A has always held that only their three (or five) highest earning years would be used in the benefit calculation. See, RSA 100-A:5, 100-A:6 and 100-A:1,XVIII. Thus, even under prior law, members might pay into the system based on "other compensation" that would not factor into their pensions. This would occur, for example, if a member received a payment in lieu of health insurance during his or her lower earning years but either opted for the insurance or was not eligible for the payment during his or her highest earning years. For all of these reasons, this court should reject plaintiff's strained argument that NHRS had no legal right to receive pre-2008 member contributions.

Turning to the second element of unjust enrichment, there is nothing *unconscionable* about allowing the NHRS pension trust to keep the contributions that its members made in prior years under these circumstances. NHRS has always relied on member contributions to fund the pension trust. The plaintiffs' pre-2008 contributions were considered by the NHRS actuary in

[19]See, Barjavel, Rene, Le Voyageur Imprudent (The Imprudent Traveller) (1943).

determining the funded status of the pension trust and, by extension, the amount of necessary employer contributions. See, RSA 100-A:16, II and N.H. Constitution, Part 1, Article 36-a. The Legislature relied on this information in making benefits decisions over the years. If anything, it would be *unconscionable* to undermine all of these decisions by depleting the trust in the manner requested by the plaintiffs.

Further, because restitution is an equitable remedy, the court must consider the balance of equities. Restitution along the lines the plaintiffs envision—as applied to the NHRS membership as whole and not just the individual plaintiffs in this case—is a completely impractical and unworkable remedy. NHRS has no way to determine what portion of its members' pre-2008 "earnable compensation" was based on "other compensation." Employers certified only each member's total "earnable compensation" to NHRS each year. SA, 116. NHRS never received a breakdown of how this figure was calculated. SA, 116. Thus, although NHRS accepts the individual plaintiffs' offers of proof in this case, it cannot verify those facts without auditing their employers' payroll records. SA, 116.

The plaintiffs withdrew their request for class certification after it became clear that they too had no way to determine (a) how many of the tens of thousands of NHRS members received "other compensation" over the years, (b) who those members were, (c) how much "other compensation" those members actually received and (d) whether their pensions were or are likely to be affected by the change in the definition of "earnable compensation. There are approximately 475 employers in the NHRS system and each one of them would need to go through decades of payroll records before NHRS could begin to comply with a restitution order.

Finally, in the event that this court disagrees with NHRS and finds that equitable restitution is a plausible remedy, there would still need to be a trial court hearing to determine the

ground rules and scope of any restitution order. Tax qualification ramifications were not addressed below—because no specific proposal for restitution was ever made—and NHRS should be provided the opportunity to be heard on these and other issues before any remedial order is issued.

III. REGARDLESS OF WHETHER PLAINTIFFS ARE ENTITLED TO COLAS, THEY ARE NOT ENTITLED TO RESTORATION AND REPLENISHMENT OF THE SPECIAL ACCOUNT

Plaintiffs claim a vested, constitutional right to both COLAs and "the manner in which the COLA is funded." Plaintiffs' Brief at p. 44. They argue that because "[t]he funding mechanism and the right to a COLA are intertwined[,]…both should be protected." Id., at 45. Thus, the relief that plaintiffs seek includes "a permanent injunction enjoining Defendants from changing the funding mechanism for the Special Account as it existed prior to Section 8 of HB 653 and Sections 1, 8 and 19 of HB 1645." SA, 420. See also, SA, 456.

NHRS takes no position on whether plaintiffs are entitled to COLAs. However, NHRS objects to plaintiffs' claim for the resurrection and replenishment of the special account that was abolished in 2012. The plaintiffs wish to turn back to the clock to the status quo ante, prior to 2008, when the special account was used to fund both COLAs and medical subsidies. But this is an impossible feat:

-The Special Account cannot be used to pay for medical subsidies ever again without jeopardizing NHRS' status as tax-qualified government pension trust under the U.S. Internal Revenue Code. SA, 112-113. Maintaining the trust's qualified status is a core statutory and fiduciary responsibility for NHRS' Board of Trustees. See, RSA 100-A:2 and SA, 110-111. Indeed, tax qualification is one of the primary and definitional purposes of the trust. RSA 100-A:2. If the trust loses its tax qualification its members will have to pay annual federal income

tax on theircontributions. SA, 111. Such a result would occur if NHRS were to willfully put itself out of compliance by once again using the special account to fund medical subsidies, contrary to the agreement it reached with the IRS through the voluntary compliance program.

-The special account was never before used exclusively for COLAs. If it is recreated and funded as it was under prior law, but not used to pay medical subsidies, then (a) the special account will be over funded for the limited purpose that it will now serve and (b) the annuity accumulation fund will be artificially underfunded for no logical reason.

-Any alternative funding formula that the court might devise, in an effort to mimic turning the clock back without actually doing so, would necessarily be grounded in a policy judgment rather than an articulable legal doctrine

More important, both the annuity accumulation fund and the former special account were part of a single, indivisible pension trust. Transferring funds from one account to the other is the institutional equivalent of an individual moving funds from his regular savings account to a separate account earmarked for a special expense, such as payment of a mortgage. From the individual's perspective, the creation and funding of a separate "mortgage account" might be very useful. The mortgagee, however, wouldn't care what account its checks came from, so long as they were for the right amount. It would have every right to payment, but no right to dictate how the homeowner funded his "mortgage account" from his other savings.

So it is with the *internal* division of the NHRS pension trust into a pool of money for annuities and a pool of money for COLAs. If the plaintiffs are entitled to COLAs (and NHRS takes no position on that question), then they should receive them regardless of whether some portion of the account that holds employer contributions and investment returns thereon is labeled a "special account" for bookkeeping purposes.

The principle behind the plaintiffs' argument—i.e. that every NHRS member and beneficiary is entitled to a particular set of bookkeeping, accounting and logistical practices—leads not so much down a slippery slope as off a cliff. Are any changes in administration that have the potential to adversely affect the size of the trust *res* forbidden? Are all of NHRS internal procedures forever frozen in amber? Or are plaintiffs instead entitled only to (a) their substantive benefits, regardless of how they are funded, and (b) a general, but enforceable, standard of fiduciary care on the part of the NHRS Trustees and Independent Investment Committee. See, RSA 100-A:15 and N.H. Constitution, Part 1, Article 36-a.

Although plaintiffs' claim for restoration of the special account is grounded on the State and Federal Constitutions' contracts clauses, see, Plaintiff's Brief at p. 44-48, it is not necessary to duplicate in this brief the substantial discussions of contract clause jurisprudence found in the plaintiffs' and the State's briefs. All that is necessary to say is that plaintiffs can obtain no direct benefit by resurrecting and replenishing the special account. Their fortunes will not increase or decrease if dollars are moved from one column to another in NHRS' annual report. Indeed, since no assets have left the pension trust as a result of the elimination of the special account, the plaintiffs cannot complain that the trust corpus has shrunk.

* * *

This does not end the discussion. The Legislature conditioned future COLAs on the availability of funds in the Special Account. RSA 100-A:41-a (1993-2008). Yet the Legislature retained the discretion to reduce or eliminate the special account. Therefore, the Legislature could in theory have exercised its discretion in such a way as to deprive the plaintiffs of COLAs (but NHRS does not opine on whether this actually occurred). In a private contractual setting, one party's use of contractual discretion that deprives a counterparty of a substantial benefit of

its bargain may be a violation of the implied covenant of good faith and fair dealing. See e.g., Centronics Corp. v. Genicom Corp., 132 N.H. 133, 143 (1989) (The implied covenant of good faith performance and fair dealing applies when a contract "by word or silence…invest[s] one party with a degree of discretion in performance sufficient to deprive another party of a substantial proportion of the agreement's value."); Ahrendt v. Granite Bank, 144 N.H. 308, 312-313 (1999) (same); Griswold v. Heat Corporation, 108 N.H. 119 (1967) (same); Atlas Truck Leasing, Inc. v. First NH Banks, Inc., 808 F.2d 902 (1st Cir.1987). Seaward Construction Co. v. City of Rochester, 118 N.H. 128 (1978).

Thus, the real questions in this case—on which NHRS takes no position—are

(A) Whether plaintiffs have a substantive, contractual and constitutionally enforceable entitlement to COLAs in the amount they claim and, if so;

(B) Whether the court should disregard the distinction between the former special account and the annuity accumulation fund in determining what COLAs must be paid?

If the plaintiffs prevail on those questions, then no purpose would be served by forcing NHRS to perpetually maintain and fund a special account. If the court rules against the plaintiffs with respect to their substantive right to receive COLAs, there would be no reason to even reach the question of how the special account is funded.

For all of the following reasons, this court should affirm the trial court's decision denying the plaintiffs' request for restoration and replenishment of the special account.

CONCLUSION

This court should affirm the Superior Court's decision granting summary judgment to NHRS with respect to the plaintiffs' claims for equitable restitution and restoration of the special account.

Respectfully submitted,

New Hampshire Retirement System
By Its attorneys

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REQUEST FOR ORAL ARGUMENT

NHRS requests this court to schedule an oral argument in this case. An oral argument may prove helpful to the court in light of the factual complexity of the case and the importance of the legal issues that are at stake.

CERTIFICATE OF SERVICE

I, Andrew R. Schulman, hereby certify that I have served this motion by e-mail attachment and by mailing same, first class mail, postage prepaid, to counsel for petitioners and Intervenors, Andru Volinsky and David Gottesman, and counsel for the State, Assistant Attorney General Richard Head on September 8, 2014.

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Andrew R. Schulman