COMMONWEALTH OF KENTUCKY
SUPREME COURT
CASE NOS. 2018-SC-000419, 2018-SC-000421

MATTHEW G. BEVIN, in his official capacity as Governor of the Commonwealth of Kentucky, *et al.*, **APPELLANTS,**

v. **On Appeal From Franklin Circuit Court, Div. I**
Nos. 18-CI-379, 18-CI-414

COMMONWEALTH OF KENTUCKY, *ex rel.* ANDY BESHEAR, ATTORNEY GENERAL, *et al.*, **APPELLEES.**

BRIEF OF APPELLANT GOVERNOR BEVIN

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that a copy of this brief was served on August 27, 2018 by first-class mail to Hon. Samuel P. Givens, Jr., Clerk, Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601; Hon. Phillip J. Shepherd, Judge, 222 St. Clair Street, Frankfort, KY 40601; Hon. Andy Beshear, J. Michael Brown, La Tasha Buckner, S. Travis Mayo, Marc G. Farris, & Samuel Flynn, Office of the Attorney General, 700 Capital Avenue, Suite 118, Frankfort, KY 40601 (also served via email); Jeffrey Walther & Victoria Dickson, Walther, Gay & Mack, 163 E. Main St., Suite 200, Lexington, KY 40588 (also served via email); David Leightty & Alison Messex, Priddy, Cutler, Naake, Meade, 2303 River Road, Suite 300, Louisville, KY 40206 (also served via email); David Fleenor & Vaughn Murphy, Office of the Senate President, Capitol Annex, Room 236, Frankfort, KY 40601 (also served via email); Eric Lycan, Office of the Speaker, Capitol Annex, Room 332, Frankfort, KY 40601 (also served via email); Mark Blackwell, Katherine Rupinen, & Joseph Bowman, Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, KY 40601 (also served via email); & Robert B. Barnes, Teachers' Retirement System, 479 Versailles Road, Frankfort, KY 40601 (also served via email). The certified record has been returned.

Matthew F. Kuhn

INTRODUCTION

This is the Attorney General's challenge to Senate Bill 151, the 2018 pension reform bill that the General Assembly passed in an attempt to save Kentucky's public pensions from near-certain financial collapse. There are two issues: (1) whether the substance of the bill violates the so-called inviolable contract or the Contracts Clause of the Constitution; and (2) whether the procedure used to pass the bill was constitutional.

STATEMENT CONCERNING ORAL ARGUMENT

The Court has already scheduled oral argument in this matter for September 20, 2018, and counsel for the Appellant look forward to addressing the Court at that time.

STATEMENT OF POINTS AND AUTHORITIES

STATEMENT OF THE CASE

I. Introduction

"I'll gladly pay you Tuesday for a hamburger today." – J. Wellington Wimpy

Sadly, this has been Kentucky's approach to public pensions for the last two decades. We have eaten all the hamburgers, and now Tuesday is here, and it is time to pay the bill.

Public pension debt is a lead weight pulling the Commonwealth down into the depths of insolvency. After decades of irresponsible decision making—including the repeated sweetening of pension benefits, the failure to adequately fund the pension systems, the reliance on unsound and unrealistic actuarial assumptions, and the poor management of pension investments—the Commonwealth of Kentucky now has an unfunded pension liability that could be as much as *$84 billion*. In fact, one of the Commonwealth's largest pension funds—the KERS Non-Hazardous fund—is projected to run out of money as early as 2022. No state can long survive such a crushing debt, at least not with any hope of remaining solvent and sparing its citizens from unthinkable tax burdens. If nothing is done to address this problem, one of four things will happen:

(1) The pension funds will eventually run out of money and retirees will stop receiving their checks, as has happened in places like Prichard, Alabama;[1]

(2) Kentucky's already over-burdened taxpayers will be subjected to astronomical tax increases in order to maintain the solvency of the pension funds;

(3) Spending on essential government services—like education and public protection—will have to be slashed in order to devote more funding to pensions; or

[1] *See* Michael Cooper & Mary Williams Walsh, *N.Y. Times*, "Alabama Town's Failed Pension is a Warning," (Dec. 22, 2010), *available at* https://www.nytimes.com/2010/12/23/business/23prichard.html (last visited Aug. 25, 2018).

(4) There will be a combination of heavy tax increases *and* devastating cuts to essential services.

These are the only alternatives in the absence of meaningful pension reform.

Recognizing the magnitude of the problem, the General Assembly took aim at such reform in the 2018 Regular Session. The result was Senate Bill 151—a bill that makes only modest changes for current employees, but, primarily through two important innovations, provides a pathway to solvency for the pension funds. First, SB 151 establishes a new method for paying off the unfunded liability in 30 years. This mechanism, known as "level-dollar funding," establishes a recommended system of payments that are analogous to mortgage payments. If the General Assembly follows through and adopts these recommended payments over time by appropriating the money to pay them, the level-dollar funding mechanism will allow the unfunded liability to be paid off over time in a responsible manner without having to drastically raise taxes or cut essential government services. Second, SB 151 creates a new hybrid cash balance retirement plan for new teachers. This plan, which is essentially the same plan that other public employees have had since 2014, decreases the likelihood that the unfunded liability in the teachers' retirement plan will continue growing. And it has the added benefit of potentially providing teachers with a more generous retirement benefit—a fact that even the Jefferson County Teachers' Association acknowledges. [Vol. VIII, R. 1100-01]. With level-dollar funding and the new hybrid cash balance plan for teachers, the Commonwealth has a chance to finally stop digging its pension hole and actually start filling it in.

The Commonwealth now finds itself at a crossroads. Based on the outcome of this case, its future will either be a bleak one defined by insolvency, extreme taxation, and maybe even a time when pension checks stop coming in the mail—as they have in places like Prichard, Alabama—or it will move toward a bright one defined by solvent pension systems, low taxes that encourage economic development, and adequate financial resources to pay for both pensions *and* important government services. Hopefully this case will not be the Commonwealth's Prichard, Alabama, moment.

To understand how the Commonwealth found itself in such a disastrous pension situation, it is helpful to understand the history of public pensions in Kentucky. Part II below will discuss the history of the Kentucky Retirement Systems, and then Part III will discuss the history of the Kentucky Teachers' Retirement System. With that background, Part IV will then explain how the Commonwealth arrived at its current predicament. Parts V and VI will provide the procedural histories of SB 151 and this lawsuit, respectively.

II. Creation and history of the Kentucky Retirement Systems

Public employees in Kentucky have long been provided pension benefits. But, for much of the twentieth century, those benefits were viewed by the courts as a mere gratuity that could be taken away from an employee at any moment prior to retirement. *See, e.g.*, *City of Louisville v. Bd. of Educ. of Louisville*, 163 S.W.2d 23, 25 (Ky. 1942).

In 1972—two years before Congress enacted the Employee Retirement Security Act, which governs private pensions—the Kentucky General Assembly set out to change this. In order to provide greater security for public employees' pensions, it enacted KRS 61.692(1), which, at the time, provided that:

> [I]n consideration of the contributions by the members and in further consideration of the benefits received by the state from the member's employment, KRS 61.510 to KRS 61.700 shall constitute an inviolable contract of the Commonwealth, and the benefits provided therein shall not be subject to reduction or impairment by alteration, amendment, or repeal.

1972 Ky. Acts ch. 116, § 60.[2]

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[2] KRS 61.692 applies to most state employees. Identical inviolable contract provisions were also enacted for county employees and the State Police in 1972. *See* KRS 16.652(1) (state

Many details of the pension benefits available under this statute have changed over time, but the overall approach to the basic benefit has generally stayed the same: when employees retire at full retirement age, they are eligible to receive an annual retirement allowance equal to their years of service, multiplied by the average of their five highest years of salary—three highest for hazardous-duty employees—and then multiplied by a specific benefit factor, commonly known as a multiplier. *See* KRS 61.510(14); KRS 61.595.

From the beginning, it was clear that the so-called inviolable contract was not set in stone. Instead, its provisions have ebbed and flowed many times over the years. For instance, in 1976, the General Assembly modified the covered provisions within the inviolable contract, reducing the range of statutes included within it from the range of KRS 61.510 to KRS 61.700 to the range of KRS 61.510 to KRS 61.692. 1976 Ky. Acts ch. 321, § 40. In 1988, the covered provisions were extended to include the present range of KRS 61.510 to KRS 61.705. 1988 Ky. Acts ch. 349, § 29.

Over time, many specific provisions have also been added to *and* taken away from the inviolable contract. *See, e.g.*, KRS 61.585 (repealed by 1976 Ky. Acts ch. 321, § 41); KRS 61.620 (repealed by 1976 Ky. Acts ch. 321, § 41). One significant benefit added to the inviolable contract after its creation was hospital and medical insurance for retirees. *See* KRS 61.702. This benefit was added in 1978. 1978 Ky. Acts ch. 311, § 9.

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police); KRS 78.852(1) (county employees). The statutory provisions governing the County Employees Retirement System (CERS), State Police Retirement System (SPRS), and Kentucky Employees Retirement System (KERS) are essentially identical, so those three retirement systems and the provisions governing them will generally be treated in this brief as if they are one system, even though they are technically three systems united under the same Board of Trustees. Teachers are members of a separate system, the Kentucky Teachers' Retirement System (KTRS), which is discussed separately below. Legislators and judges also are in different pension systems.

But the General Assembly's tinkering with the inviolable contract has not been limited solely to measures that increase benefits. In 1986, the General Assembly raised the percentage of income that employees were required to contribute to the pension system. When the inviolable contract was created in 1972, employees were required to contribute 4 percent of their income to the pension system. 1966 Ky. Acts ch. 35, § 5. In 1986, however, the General Assembly raised the required contribution to 5 percent. 1986 Ky. Acts ch. 293, § 4.

Two years later, the General Assembly amended the inviolable contract to create a 10 percent service credit bonus for employees. *See* KRS 61.596 (repealed by 2000 Ky. Acts ch. 385, § 42). That amendment, however, also contained a sunset clause that prohibited members from taking advantage of the bonus if they did not retire by a certain date. *See* 1988 Ky. Acts ch. 336, § 1. Thus, KRS 61.596 created a benefit within the inviolable contract that terminated before all members of the retirement system could take advantage of it.

In 1993—in response to the Boptrot prosecutions—the General Assembly amended the inviolable contract to provide that legislators convicted of a felony relating to their duties would forfeit their pension rights and benefits, "except for the return of [the legislator's] accumulated contributions and interest credited on those contributions." *See* KRS 6.696; 1993 (1st Extra. Sess.) Ky. Acts ch. 4, § 78 (amending the inviolable contract to apply "except as provided in KRS 6.696").

In 2000, the General Assembly repealed KRS 61.554, which had allowed LRC employees to purchase service credit after working six legislative bienniums. 1990 Ky. Acts ch. 480, § 6 (repealed by 2000 Ky. Acts ch. 385, § 42).

Similarly, in 2003, the General Assembly removed hospital and medical insurance benefits from the inviolable contract for employees hired on or after July 1, 2003. KRS 61.702(8)(e) (added by 2003 Ky. Acts ch. 155, § 1).

In 2008, the General Assembly made perhaps the most significant changes yet to the Kentucky Retirement Systems, creating what are now referred to as Tier II benefits for employees hired on or after September 1, 2008. *See generally* 2008 (1st Extra. Sess.) Ky. Acts ch. 1. Employees who were already in the system prior to those reforms are said to have Tier I benefits.

The major distinctions between Tier I and Tier II benefits are:

(1) Tier II employees are required to contribute 1 percent of their income for future medical and hospital insurance benefits, while Tier I employees are not required to contribute anything, KRS 61.702(2)(b);

(2) Tier II employees generally have lower multipliers, KRS 61.595(1);

(3) The "high five" and "high three" calculations for Tier II employees must be based on full years of employment, whereas the "high five" calculation for Tier I employees can be based on as little as 48 months of employment and the "high three" calculation can be based on as little as 24 months of employment, KRS 61.510(14);

(4) Tier I non-hazardous employees can retire with unreduced benefits at any age after 27 years of service, but Tier II non-hazardous employees can only retire with unreduced benefits if they are at least 57 years old and their age plus years of service equals at least 87, KRS 61.595(2); and

(5) Tier I employees generally receive full medical and hospital insurance benefits at 20 years of service, whereas Tier II employees simply receive a cash stipend—based on their months of service—to defray the cost of insurance, KRS 61.702.

In 2013, the General Assembly made still more changes to the Kentucky Retirement Systems, this time creating what are known as Tier III benefits. *See generally* 2013 Ky. Acts ch.

120. Tier III benefits are different in nature from the Tier I and Tier II benefits. Whereas the earlier tiers are pure defined benefit plans, Tier III is a hybrid cash balance plan. KRS 61.595(3); KRS 61.597. It is known as a "hybrid" plan because it has characteristics of both a defined benefit plan and a defined contribution plan. Under Tier III, a member has a cash balance in an account designated for the member, and that balance increases based on required contributions from the member and the member's employer, as well as a certain level of guaranteed investment returns. KRS 61.597(2). Upon retirement, a Tier III employee can either receive a distribution made up of their contributions plus their employer's contributions plus the investment returns, or they can opt for an annuity calculated according to actuarial assumptions and based on their accumulated account balance. KRS 61.597(7). Like Tier II employees, Tier III employees also receive a stipend for medical and hospital insurance based on their months of service. Tier III employees are not expressly covered by the inviolable contract, but their contributions—and only their contributions—are protected. KRS 61.692(2).

III. Creation and history of the Kentucky Teacher Retirement System

In 1978, six years after the creation of the inviolable contract for members of the Kentucky Retirement Systems, the General Assembly extended the inviolable contract to the Commonwealth's teachers. *See* 1978 Ky. Acts ch. 152, § 20 (codified at KRS 161.714). The teachers' inviolable contract, which is essentially identical to the inviolable contract provisions that apply to state employees, county employees, and the State Police, initially provided that:

> [I]n consideration of the contributions by members and in further consideration of benefits received by the state from the member's employment, KRS 161.220 to KRS 161.710 shall constitute an inviolable contract of the Commonwealth, and

> the benefits provided therein shall not be subject to reduction or impairment by alteration, amendment, or [repeal].[3]

Like the pension benefit available to state and county employees, the benefit available to members of KTRS under the inviolable contract provisions is calculated by multiplying a member's years of service by their final average salary—calculated according to their highest five or highest three years of salary—and then multiplied by a benefit factor, commonly referred to as a multiplier. KRS 161.220(9); KRS 161.620. KTRS members are generally able to retire with unreduced benefits after 27 years of service, or the age of 60, whichever comes first. KRS 161.600.

Like the inviolable contract for state and county employees, the details within the KTRS inviolable contract have changed significantly over the years. First, the rate at which teachers are required to contribute to their pension system has increased several times since 1978. When the inviolable contract was created, members of KTRS were required to contribute 7.7 percent of their salaries. 1978 Ky. Acts ch. 152, § 8. This increased to 7.84 percent in 1979; to 9.32 percent on January 1, 1984; to 9.6 percent on July 1, 1984; and to 9.855 percent in 1988. 1978 Ky. Acts ch. 152, § 8; 1982 Ky. Acts ch. 326, § 7; 1984 Ky. Acts ch. 253, § 15; 1988 Ky. Acts ch. 240, § 3.

In addition, benefits covered by the inviolable contract have been reduced, and even eliminated, since 1978. In 1992, for instance, the General Assembly repealed KRS 161.705. 1992 Ky. Acts ch. 192, § 18. That statute had allowed a KTRS member, or the member's employer, or both, to make voluntary contributions of up to 4 percent of the member's salary,

[3] The original language actually stated that the benefits "shall not be subject to reduction or impairment by alteration, amendment, or *appeal*." This appears to have been a scrivener's error that was officially corrected in 1992. 1992 Ky. Acts ch. 192, § 17.

which would be invested by KTRS for the member's benefit. 1990 Ky. Acts ch. 476, Pt. V, § 542.

Changes in 1995 further reduced KTRS members' benefits. Prior to 1995, KRS 161.700 provided that pension payments were exempt from state and municipal taxes. 1990 Ky. Acts ch. 476, Pt. V, § 541. In 1995, however, the statute was amended to provide that retirement benefits would be subject to the state income tax after January 1, 1998. 1995 (2d Extra. Sess.) Ky. Acts ch. 1, § 6; KRS 161.700.

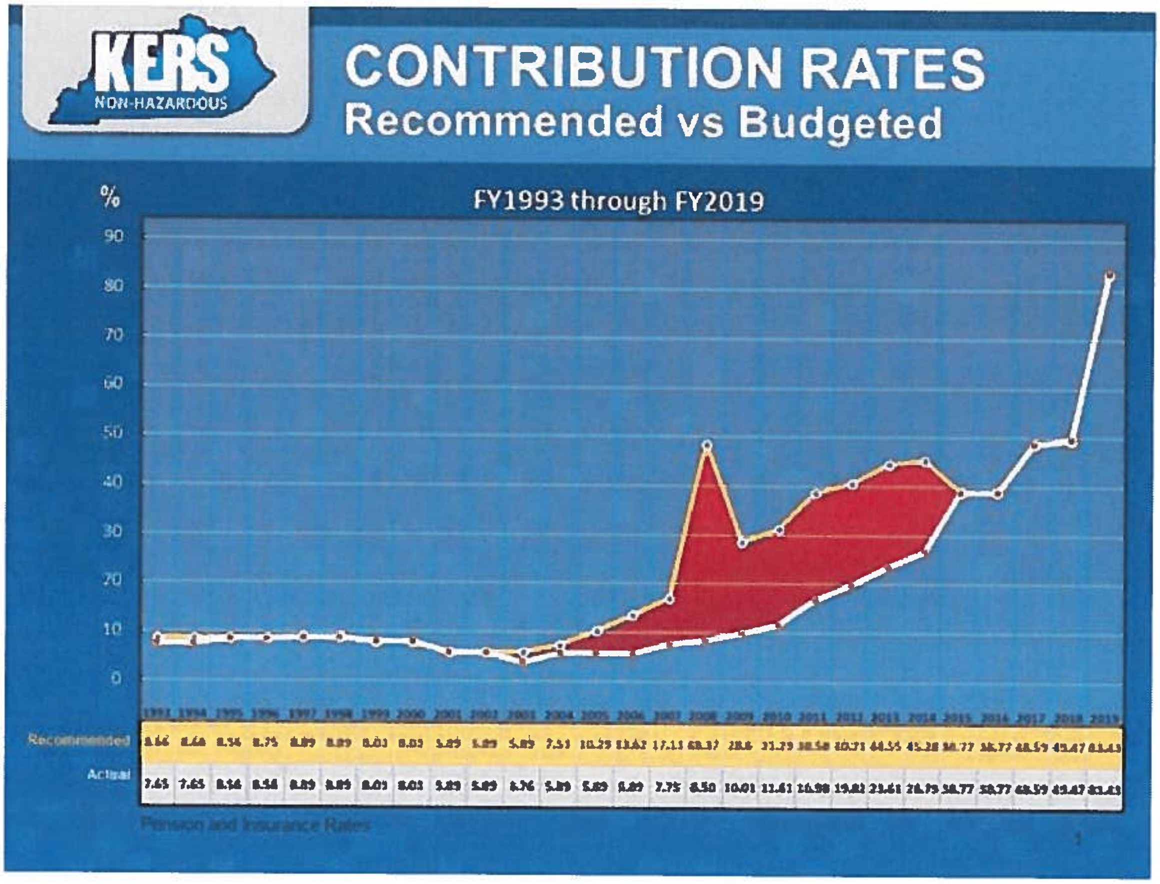
IV. Unfunded liabilities and the arrival of the pension crisis

Any pension system that allows employees to work for 27 years and then collect a defined benefit retirement allowance for the rest of their lives—which could be 40 or 50 years—is bound to run into funding problems. And so it is with all of Kentucky's public pension systems.

Standard & Poor's recently ranked Kentucky's pension systems as the worst funded in the nation. [*See* Vol. V, R. 635]. And a recent study conducted for the benefit of the Commonwealth revealed that the total unfunded liability for Kentucky's public pension systems lies somewhere between *$33 billion*—in the best case scenario—and *$84 billion*, depending on the assumptions used to calculate it. [Vol. V, R. 718; *see also* Vol. V, R. 646-47]. The average public pension fund in the United States is funded at 73.2 percent, but the KERS Non-Hazardous plan is funded at a mere *16 percent*. [Vol. V, R. 741-42]. The KERS Hazardous, CERS Non-Hazardous and Hazardous, SPRS, and KTRS plans are better funded—with the best being the KERS Hazardous plan at 59.7 percent—but they are still far below the national average. [Vol. V, R. 742].

This ever-present sword of Damocles threatens every aspect of the Commonwealth's fiscal well-being. Pension spending in Kentucky obviously has not kept pace with the level of spending necessary to keep the pension systems adequately funded, and yet, pension spending has increased nearly five times as fast as General Fund revenue over the last decade. [Vol. V, R. 743-44]. This means that pension spending is crowding out the Commonwealth's spending on other priorities, like education and public protection. If the unfunded liability continues to grow, the Commonwealth will be forced to devote more and more of its financial resources to the pension plans all the while falling further and further behind.

How—one might ask—did the Commonwealth acquire such a large unfunded liability? The answer is complex. One part of the answer is that the state has underfunded pensions for many years, and it accelerated that trend starting around 2008. But this raises another question: How, exactly, was the legislature able to underfund the pensions? After all, there are statutes that specify the exact method for determining how much money the Commonwealth should contribute to the pension systems each year. *See, e.g.*, KRS 61.565. The answer to this question is simple: Those statutes do not actually appropriate any money. Instead, they do nothing more than set forth the method by which the pension boards and their actuaries are required to calculate the amount of money that *should* be paid into the pension systems. Those calculations are communicated to the General Assembly, but obviously cannot be binding on it. In other words, the contribution rates established by statutes like KRS 61.565 are nothing more than *recommended* contribution rates, and it is up to the General Assembly to accept or reject those recommendations through the budgeting process. Thus, while statues like KRS 61.565 establish the framework for determining how much money *should* be paid into the pensions, it is the biennial budget bill that *appropriates* the money and determines how much *actually will be paid* into the pension funds. The following graph[4] demonstrates this point:



This graph shows, for example, that KRS 61.565 called for a KERS Non-Hazardous employer contribution rate of 44.55 percent in 2013, but the budget bill passed by the General Assembly only required a contribution rate of 23.61 percent. Thus, in the budget for that biennium, the General Assembly provided that "Notwithstanding KRS 61.565 and 61.702 the employer contribution rates for Kentucky Employees Retirement Systems from July 1, 2012, through June 30, 2013, shall be 23.61 percent . . . ." 2012 Ky. Acts, ch. 144, Part IV, § 8. In other words, the General Assembly rejected the contribution rate that had been recommended

4 This graph can be downloaded at https://kyret.ky.gov/About/Documents /KRS_Overview_KPR_June%202018.pdf (last visited Aug. 24, 2018).

by KRS 61.565 and required state government employers to pay a different contribution rate. Thus, it is the budget bill, not KRS 61.565 or other employer-contribution provisions, that actually determines how much money the Commonwealth spends on pensions. And this explains how the General Assembly has been able to underfund pensions even though there are statutes establishing the amount of money that is supposed to be contributed to them.

But it is important to understand that the unfunded liability is not just a problem of underfunding. In reality, only 15 percent of the unfunded liability is attributable to underfunding. [Vol. V, R. 722]. This is demonstrated most clearly by the experience of CERS. While the Commonwealth has often failed to pay the full amount of its full actuarially required contribution to KERS, local governments have typically paid the full requirement because they cannot override the recommended contribution rates of KRS 61.565 like the General Assembly can. [Vol. V, R. 730]. Thus, local governments, over the years, have wound up paying the full recommended amount while the General Assembly has often allowed state government to pay a lower amount. If paying the full amount were enough, one would expect CERS to be nearly 100 percent funded. But it is not. Instead, it is only 59 percent funded. [Vol. V, R. 742]. This proves that the unfunded liability is not simply a matter of underfunding.

Instead, the bigger issue is that the pension systems are structurally unsound. That is to say, their structure simply is not conducive to long-term solvency. This is due to a number of factors—*e.g.*, the pension systems allow individuals to collect pensions for far longer than they paid into the systems, and defined benefit pension plans work best when there are many more active workers than retirees, but the number of active state employees has been steadily decreasing over the years to the point where there are now more KERS Non-Hazardous retirees than employees. Moreover, the pension systems have provided unaffordable cost-of-living adjustments and have made demonstrably inappropriate actuarial assumptions. Such structural issues account for more than half of the unfunded liability. [Vol. V, R. 722].

Given the structural problems, it is not surprising that the pension systems have had abysmal cash flows over the last decade. Until recently, the KERS Non-Hazardous fund, for example, has had negative cash flows to the tune of hundreds of millions of dollars per year going back to FY 2002. [Vol. V, R. 722-23]. As a result, it is now in such poor shape that estimates show it could be insolvent as early as 2022 if it stays on the same path. [Vol. VI, R. at 764]. The other funds have had similar experiences over the past decade. This is not sustainable.

V. Governor Bevin and the General Assembly try to save the pension systems

In light of the obvious problems with Kentucky's pension systems, Governor Bevin and the General Assembly did what any good leaders would do: they confronted the problems head-on and resolved, finally, to stop kicking the can down the road. To that end, they held discussions about pension reform among themselves and with citizen groups—including the Kentucky Education Association (KEA) and the Kentucky State Lodge Fraternal Order of Police (FOP)—throughout 2017. [*See* Vol. VIII, R. 1096-97]. These conscientious and diligent efforts to save the pension systems from insolvency initially resulted in the introduction of Senate Bill 1 on February 20, 2018. *See* http://www.lrc.ky.gov/record/18RS/SB1.htm (last visited Aug. 25, 2018).

The bill was assigned to the Senate Committee on State & Local Government the next day, *id.*, and from there it went through several weeks of review and public comment. One part of that review came from the Attorney General, who drafted a legal memorandum regarding the provisions of SB 1 eight days after the bill was filed. [Vol. I, R. 150-Vol. 2, R.

155]. In his legal memorandum, the Attorney General laid out what he believed were 21 different reasons the bill violated Kentucky law. [*Id.*]

Critically, the Attorney General drafted this memorandum in his statutory role as the "chief law officer" of the Commonwealth, and he addressed it to every single member of the General Assembly. [*Id.*] It was not an op-ed or a letter to the editor. Rather, it was a memorandum containing legal advice addressed to legislators—those to whom he is obligated to provide legal advice under Kentucky law. KRS 15.020 provides that the Attorney General is the Commonwealth's chief legal officer and "legal advisor of all state officers, departments, commissions, and agencies," and it requires him to provide legal advice to state agencies as needed. Indeed, the Attorney General's legal memorandum makes clear that he is providing legal advice pursuant to his statutory duty, establishing an attorney-client relationship with the recipients. [Vol. II, R. 155]. He even urged every member of the General Assembly to continue to consult with him regarding the legality of the bill. [*Id.*]. And he followed up with a second legal memo on March 6 after the legislature made changes to the bill. [Vol. II, R. 156-61].

After receiving the Attorney General's first letter, the General Assembly moved the provisions of SB 1 into SB 151, and in doing so adopted several of the revisions recommended by the Attorney General's legal-advice memorandum. The Attorney General, for example, advised the General Assembly that he believed reducing the cost of living adjustments (COLAs) for retired teachers violated the Commonwealth's inviolable contract [Vol. II, R. 151], and this provision was eliminated in SB 151. While the General Assembly did not adopt every suggestion by the Attorney General, it is rare to find a client who agrees with every opinion of his attorney.

After lengthy debates on the floors of the House and Senate, both chambers passed SB 151, and the Governor signed it into law on April 10, 2018. *See* http://www.lrc.ky.gov/record/18RS/SB151.htm (last visited Aug. 25, 2018). SB 151 makes a number of much-needed reforms to Kentucky's public pension systems. Among its more important provisions are the following, divided according to the affected pension systems:

Reforms to all KRS pensions (KERS, CERS, and SPRS)

- There are no changes for current retirees.

- For Tier I members who retire after July 1, 2023, service credit obtained for unused sick leave cannot be added to the member's service credit to determine whether the member is eligible to receive a retirement allowance or to reduce applicable actuarial penalties for early retirement. *Id.* §§ 16-17.

- Tier I members hired on or after July 1, 2003 must contribute 1 percent of their creditable compensation to a fund for retiree health insurance. *Id.* § 30.

- Level-dollar funding (analogous to a mortgage payment) over a 30-year amortization period is established to help pay down the unfunded liabilities. Level-dollar funding is a more direct and fiscally-responsible method of paying down the unfunded liabilities than the current level-percent-of-payroll, which backloads the payments on the questionable assumption that state and county payrolls will increase over time. *Id.* § 18.

Reforms to KERS and CERS only

- For Tier I non-hazardous members who retire after July 1, 2023, lump-sum payments for compensatory time upon termination of employment cannot be used to increase their average final compensation for the purpose of computing their retirement allowance. Thus, members will not be able to spike their pensions with payments for compensatory time. *Id.* §§ 14-15.

- Tier I members cannot use uniform, equipment, or any other expense allowances paid on or after January 1, 2019 to increase their average final compensation for the purpose of computing their retirement allowance. In other words, members will not be able to spike their pensions with the amounts paid to them for payments for uniform, equipment, or any other expense allowances. *Id.* §§ 14-15.

- For Tier I non-hazardous members retiring on or after January 1, 2019, the determination of their highest five years of compensation must be based on five *complete* fiscal years. Likewise for Tier I hazardous members retiring after January 1, 2019, the determination of their highest three years of compensation must be based on three *complete* fiscal years. *Id.* §§ 14-15.

Reforms to KTRS

- There are no changes for current retirees.

- All members hired on or after January 1, 2019 will have a hybrid cash balance plan, like Tier III members of KERS, CERS, and SPRS. *Id.* § 43.

- For existing members, payment for unused sick days accrued as of December 31, 2018 can be used to increase their average final compensation for the purpose of computing their retirement allowance, but unused sick days accrued after that date cannot be so used. *Id.* § 44.

- For existing members, only sick leave accrued as of December 31, 2018 can be converted into service credit. *Id.* § 74.

- Level-dollar funding (analogous to a mortgage payment) over a 30-year amortization period starting in 2021 is established to pay down the unfunded liability. As explained above, level-dollar funding is a more direct and fiscally-responsible method of paying down the unfunded liabilities than the current level-percent-of-payroll. *Id.* § 63.

- An actuarially defined employer contribution is established for KTRS for the first time, with the goal that adequate amounts will be appropriated for employer contributions to KTRS in future budgets. *Id.* § 63.

Reforms to Legislators' Retirement Plan

- SB 151 removes salary reciprocity for non-legislative compensation earned on or after January 1, 2019. Thus, it ends the practice of legislators spiking their pensions by taking a higher paying job in another branch of government. *Id.* § 4.

- The multiplier to be used in the retirement allowance formula is reduced from 2.75 percent to 1.97 percent for service accrued on or after January 1, 2019. *Id.* § 3.

Reforms to the Judicial Retirement Plan

- SB 151 prohibits members of the Judicial Retirement Plan who retire after January 1, 2019 from earning additional benefits in the Legislators' Retirement Plan or the Judicial Retirement Plan. *Id.* § 8.

- SB 151 gives members of the Judicial Retirement Plan the option to participate in a 401(a) money purchase plan. *Id.* § 7. In providing this option, SB 151 removes members' ability to participate in a hybrid cash balance plan. *Id.*

- SB 151 amends the judicial inviolable contract to remove changes to the Judicial Retirement Plan that took effect on or after July 1, 2018. *Id.* § 11; *see also id.* § 5.

These reforms are significant accomplishments. By adopting level-dollar funding and moving all new KTRS members into a hybrid cash balance system, the reforms will help Kentucky stop digging its pension hole deeper, and will help to ensure that it actually starts filling it in. Moreover, the new hybrid cash balance plan for KTRS members promises to provide them with potentially better benefits than they would have received under the old pension plan. In fact, the Jefferson County Teachers' Association (JCTA) has publicly stated that the new hybrid cash balance plan has the potential to provide greater benefits than the old defined benefit plan. [Vol. VIII, R. 1100-01]. In addition, the JCTA has noted that creating an actuarially defined employer contribution to KTRS is a positive development, and that level-dollar funding will eliminate the unfunded liability faster than other funding methods. [Vol. VIII, R. 1102; *see also* Vol. VIII, R. 1103]. KTRS's leadership has even attested under oath in this litigation to the many benefits SB 151 brings for teachers. [*See* Vol. VIII, R. 1131-34].

While JCTA and KTRS appear to be largely pleased with SB 151, at least one observer fears that the bill did not go far enough. Standard & Poor's recently downgraded the Commonwealth's bond rating from A+ to A due in large part to the Commonwealth's significant unfunded pension liability. [Vol. VIII, R. 1108-09]. While observing that the Commonwealth's 2018 pension reform gives it a stable outlook for the time being, the ratings agency expressed concern that these reforms did not go far enough to put the Commonwealth on solid financial ground. [Vol. VIII, R. 1118]. Regardless, it is clear that Standard & Poor's views SB 151 as a positive development for the Commonwealth. [Vol. VIII, R. 1104-06]. Its most recent ratings report refers to the reforms in SB 151 as "welcome" changes, and it notes that the Commonwealth's "stable outlook reflects Kentucky's enacted pension reform." [Vol. VIII, R. 1112, 1118]. Similarly, Moody's, another credit rating agency, recently reported that SB 151 is "credit-positive for the [C]ommonwealth." [Vol. VIII, R. 1124]. Moody's also observed that SB 151 is a "positive step" but noted that "large accrued liabilities remain." [Vol. VIII, R. 1125].

VI. The Attorney General tries to undo pension reform through this lawsuit

Despite the positive strides made by SB 151, the Attorney General filed this suit against the Governor and numerous other parties, including *the very legislators who were recipients of—and who heeded*—his legal advice regarding the bill.

The Verified Complaint asserted a plethora of claims: (1) that the law impairs the inviolable contract that exists between the Commonwealth and public employees under the various pension statutes; (2) that it violates Section 46 of the Constitution because it did not receive three readings in each house of the General Assembly; (3) that it violates Section 56 of the Constitution because it was signed by the Speaker Pro Tempore of the House, not the Speaker; (4) that it violates Section 13 of the Constitution by taking property from public employees without compensation; (5) that it violates KRS 6.350 because it was enacted without an actuarial analysis; (6) that it violates KRS 6.955 because it was enacted without a fiscal note; and (7) that it is arbitrary and therefore in violation of Section 2 of the Constitution. [Vol. I, R. 8-40]. The Kentucky Education Association and the Kentucky State Lodge Fraternal Order of Police joined the Attorney General's Complaint as Co-Plaintiffs. [*Id.*]

Along with their Verified Complaint, the Plaintiffs filed a Motion for Temporary Injunction. [Vol. I, R. 57-76]. The circuit court initially held a hearing on that motion on April 19, 2018, but ordered further briefing and argument rather than ruling on the motion. Significantly, at that hearing, the circuit court *sua sponte* raised a claim not pled by the Plaintiffs, and it ordered them to brief that claim in their dispositive motion. [VR 4/19/18; 10:36:45-10:40:45]. The claim raised by the circuit court is that SB 151 is unconstitutional on the basis that it is an appropriation of money, which would mean that it required at least 51 votes to pass in the House of Representatives under Section 46 of the Constitution—and it only received 49 votes. [*Id.*] The circuit court ostensibly raised this unpled claim that "occurred to the Court" because it is "very important to have a full record for our Supreme Court to review when it gets . . . up there." [VR 4/19/18; 10:37:38-10:37:45, 10:40:40-10:40:45].

When the Plaintiffs filed their subsequent brief on May 2, 2018,[5] they addressed the claim that the circuit court told them to brief, arguing for the first time that SB 151 is an appropriation of money and therefore could not be enacted with fewer than 51 votes in the House. [Vol. III, 350-53]. The Plaintiffs did not argue that SB 151 creates a debt, thus also requiring it to receive 51 votes in the House under Section 46 of the Constitution. [*See id.*] In addition, there was much that the Plaintiffs did not address in their merits brief, or in their subsequent reply brief, for that matter. Most significantly, even though the Plaintiffs filed briefs totaling nearly 100 pages, the Plaintiffs never even attempted to explain what the "inviolable contract" means and how SB 151 violates it. Instead, they simply relied on their own *ipse dixit* on that point.

The Plaintiffs' briefing also failed to contest many key facts pointed out by the Governor. In particular the Plaintiffs, as the parties seeking summary judgment and opposing a cross-motion for summary judgment, did not dispute the following points:

1. Every single change to the various inviolable contracts is *prospective only* and does not affect any accrued benefits;

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[5] In the meantime, the Governor had moved to disqualify the Attorney General from the case because he was suing the very legislators to whom he had previously given legal advice regarding pension legislation. The circuit court denied that motion on May 1, 2018. [Tab 3 at 8-12].

2. SB 151 does not affect the inviolable contract rights of a *single public school teacher* in Kentucky;

3. SB 151 makes no changes for current retirees;

4. The change in the guaranteed return from 4 percent to 0 percent for those who opted into the hybrid cash balance plan *does not affect a single individual* because no one has ever actually been given the option to opt in;

5. Health insurance is not a benefit covered by the inviolable contract;

6. The General Assembly has increased employees' pension contribution rates multiple times over the years;

7. The General Assembly has changed the benefits contained in the various inviolable contracts many times over the years, and, in some instances, certain benefits have been eliminated outright;

8. Kentucky has the worst funded public pension systems in the country, with an unfunded liability of between $33 *billion* and $84 *billion*;

9. Only 15 percent of the unfunded liability is attributable to inadequate funding from the General Assembly, meaning that additional revenue and funding alone cannot save the pension systems, and, therefore, that the modest structural changes in SB 151 are necessary;

10. Without reforms, KERS will likely be insolvent by 2022, and KTRS will likely be insolvent by 2036;

11. The new hybrid cash balance plan for teachers will likely provide them with a better retirement benefit than the old plan; and

12. Credit rating agencies view SB 151 as a credit-positive development that helps to stabilize the Commonwealth's fiscal situation.

After receiving briefing on the claims raised by the Plaintiffs—as well as briefing on the Section 46 appropriation claim raised by the court—the court heard oral argument on June 7, 2018. [Vol. XII, R. 1772-XIII, R. 1864]. Less than two weeks later, on June 20, the circuit court issued a decision finding SB 151 unconstitutional. [Tab 1].

Reasoning—appropriately—that it should avoid addressing constitutional issues if possible, the circuit court began its analysis by addressing the Plaintiffs' claims that SB 151 violates KRS 6.350 and KRS 6.955 because it allegedly was enacted without an actuarial analysis or fiscal note. [*Id.* at 11]. Ultimately, the trial court begrudgingly acknowledged that *Board of Trustees of Judicial Form Retirement Systems v. Attorney General*, 132 S.W.3d 770 (Ky. 2003), compels the conclusion that SB 151 does not violate those statutes, but the court signaled its displeasure with this Court's precedent by adding that "the circumstances of this case may present compelling reasons for the Supreme Court to revisit its ruling" from that case. [Tab 1 at 12-13].

Curiously, even though the court had already acknowledged that it should resolve all statutory matters before addressing constitutional issues, it then skipped over the biggest statutory issue—*i.e.*, whether SB 151 violates the "inviolable contract" provisions in the various pension statutes—and proceeded straight to the constitutional issues regarding the requirement that a bill be read three times in each chamber, as well as the unpled claim that SB 151 needed 51 votes in the House of Representatives. [*Id.* at 14-27, 31-32].

The court began with the three-readings issue. After rejecting the argument that the issue is not justiciable, the court found that the three-readings requirement "is a fundamental safeguard for the right of all legislators to know what they are voting on and the right of the public to voice support or opposition to legislation before it is called for a vote, rights which are essential to democratic government." [*Id.* at 14-19]. The court then proceeded to conclude that SB 151 did not receive the requisite number of readings because the initial readings of the bill occurred when the bill was in an earlier form—which addressed wastewater services rather than pensions—and it was not re-read three times after being amended to address pensions. [*Id.* at 19-23]. However, the court refused to define what exactly a "reading" is, or how the three-readings requirement must be accomplished. Rather, the court concluded that:

> Because the enactment of SB 151 plainly violated the provisions of Section 46, the Court reserves for another day

> and declines to consider whether pre-amendment or pre-substitution readings count towards the three-readings requirement, nor will the Court consider under what circumstances amendments may be so minor that the previous readings may be deemed to sufficiently inform the legislature of the substance of the bill.

[*Id.* at 23 n.11]. The court further found that "[t]he purpose of Section 46 is clear: to ensure that legislators and the public are fully informed about the content of bills before they are brought to a vote. In this case, there is no doubt that three post-substitution readings were required to satisfy this purpose." [*Id.*]. This finding, however, was not supported by any evidence. The reality is that all legislators knew what they were voting on because they had been discussing pension reform and the provisions of SB 1—most of which made up SB 151—for the entire session. Moreover, the court ignored the fact that the Capitol was full of protesters when SB 151 was passed precisely because they knew what was in the bill.

After determining that SB 151 did not receive the requisite number of readings prior to its passage, the circuit court then added two other alternative grounds for striking down SB 151: that it was required to receive 51 votes in the House because it is an appropriation of money, and that it was required to receive 51 votes in the House for the additional reason that it is a bill that creates a debt. [*Id.* at 23-27]. Again, both claims were raised *sua sponte* by the court, and the latter was not even addressed by the Plaintiffs. Relying on *Fletcher v. Commonwealth*, 163 S.W.3d 852 (Ky. 2005), the circuit court first found that SB 151 is an appropriation of money because it "'specifically mandate[s] that payments or contributions be made,' and not only authorizes, but commands that these funds be used for a specific purpose." [Tab 1 at 26]. The court then found that SB 151 also creates a debt because the pension systems have an unfunded liability and "SB 151 continues to impose that financial obligation, though under altered terms." [*Id.* at 27].

The court then expressly decided not to address the remaining issues in the case—*i.e.*, whether SB 151 impairs the statutory inviolable contract rights of the members of the pensions systems, and, if so, whether such impairment is permissible under the Contracts Clause of the Constitution. [*Id.* at 31-32]. This is odd in light of the fact that the court, at the April 19 hearing, had noted that it is "very important to have a full record for our Supreme Court to review when it gets . . . up there." [VR 4/19/18; 10:37:38-10:37:45].

Given that those issues are arguably the most important in the case, the Governor filed a motion under CR 59.05 asking the court to address them as well as to address the question of severability. [Vol. XIII, R. 1888-91]. The court entertained oral argument on this motion on the afternoon of July 11, and then issued an 11-page opinion denying the motion in roughly the time it took the Governor's counsel to return to their offices in the Capitol. [Tab 2].

The Governor timely appealed the circuit court's judgment, as well as its ruling on the CR 59.05 motion [Vol. XIII, R. 1925-27], and he moved to transfer the case to this Court [8/10/18 Motion to Transfer]. Recognizing the overwhelming significance of this case, this Court immediately granted transfer. [8/10/18 Order].

And there can be no doubt that this case does indeed carry tremendous significance. This lawsuit threatens to halt the Commonwealth's forward economic momentum. Indeed, Moody's has expressed concern about this lawsuit, noting that the Attorney General has stated that the positive changes brought about by SB 151 are "legally impermissible." [Vol. XIII, R. 1126]. Standard & Poor's has expressed similar concerns. [Vol. XIII, R. 1118]. It is puzzling that the Commonwealth's own Attorney General would find this lawsuit to be a good and worthwhile endeavor when it plainly jeopardizes the Commonwealth's fiscal well-being and the long-term security of the Commonwealth's public retirees.

SB 151 is a helpful and important step toward helping to keep the pension systems solvent, and it also provides teachers with benefits that are potentially more generous than they would have obtained under the old plan. These are positive developments. And yet, the Attorney General, the KEA, and the FOP want to stop them for some reason. Their crusade against fiscal responsibility and improved retirement benefits is as mind-boggling as it is perilous. The Governor and General Assembly are trying to *save* the pension systems, and the Plaintiffs—if they succeed here—will inexplicably be hastening the pension systems to their graves.

ARGUMENT

SB 151 is constitutional, and this Court should declare it to be so. It does not violate the contractual rights of employees or retirees, and it was not passed in a procedurally defective manner. The circuit court erred in finding otherwise, and it should be reversed.

The single biggest issue in this case is the one issue that the circuit court inexplicably refused to address: whether SB 151 violates the inviolable contract. That is the ultimate issue here, and while it is simple to phrase, it is exceedingly complex to understand. To some extent, the complexity comes from the very term itself. After all, an "inviolable" contract appears at first glance to be an oxymoron, much like an unsinkable ship or an uncrashable airplane. And even greater complexity arises from the fact that there is very little legal authority addressing what exactly it means to be an inviolable contract. It cannot literally be inviolable, or else the Plaintiffs would not see a need to bring this case. In other words, despite its name, the inviolable contract is obviously capable of being violated.[6] Thus, the real question is whether

[6] While the inviolable contract cannot literally be inviolable, this brief will nevertheless refer to the contract throughout as the "inviolable contract" for the purposes of convenience and consistency with the statutory language.

SB 151 violates the so-called inviolable contract. As explained below in Part I, it simply does not.

But even if SB 151 could somehow be viewed as violating the inviolable contract—which it cannot—it would still be constitutional because any such impairment would not amount to a violation of the Contracts Clause of the Constitution. As explained below in Part I.D., any contract violations caused by SB 151 are reasonable, necessary, and insubstantial. Therefore, they are not prohibited by the Contracts Clause.

In addition to the foregoing substantive claims regarding the inviolable contract and the Contracts Clause, this appeal also involves procedural claims—one pled by the Plaintiffs, and one raised *sua sponte* by the circuit court. These claims address the manner in which the bill was passed, and they are just as unavailing as the substantive claims. The claim pled by the Plaintiffs is that SB 151 did not receive the requisite three readings before being passed. As explained below in Part II, this claim is not justiciable, and, in any event, it is wrong. The procedural claim raised *sua sponte* by the circuit court, which is that SB 151 is an appropriation of money and a bill creating a debt and therefore was required to receive 51 votes in the House, is similarly unavailing, as explained in Part III below.

Finally, the circuit court also erred in refusing to disqualify the Attorney General from this case. As explained below in Part IV, the Rules of Professional Conduct plainly prohibit a lawyer from giving legal advice to individuals and then suing them on the very same issue on which the lawyer provided advice. That is precisely what the Attorney General did here—he provided legal advice to the members of the General Assembly regarding pension reform, and then he turned around and sued them over SB 151.

I. SB 151 does not violate any contractual rights.[7]

Does SB 151 violate the inviolable contract? That is the single most salient question in this case. There are two potential ways to analyze this issue, but only one of them is correct.

One way—which is the analysis urged by the Plaintiffs—is to say that a public employee's ability to accrue pension benefits is locked in at the moment the employee is hired, and the employee must be allowed—at the very least—to continue earning those exact same benefits at the exact same rates as long as the employee remains employed. In other words, any change to an employee's ability to accrue benefits in the future is a violation of the contract. This is commonly known as the "California Rule." It has proven to be an unmitigated disaster in its namesake state, as well as other states that have experimented with it. Thus, the California Rule has been overwhelmingly rejected across the country. In fact, even the *California* courts are walking away from it. And yet, the Plaintiffs argue that this is the rule Kentucky should follow. Tellingly, their briefing before the trial court simply assumed that this is the correct rule without undertaking any analysis or explanation as to *why* it is the correct rule. Were the Plaintiffs to attempt such an explanation, they would have to confront the realities of the California Rule—*i.e.*, that it is nonsensical, fiscally irresponsible, and legally unjustifiable.

The alternative analysis—which the Plaintiffs did not even acknowledge before the circuit court—says that a public employee's right to already-accrued pension benefits must be protected, but the employee does not have to be permitted to continue accruing pension benefits in the future. In other words, a public employee has an inviolable right to pension benefits that he or she has already accrued, but has no right to future accruals. This is

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[7] The Governor preserved this argument. [*E.g.*, Vol. VIII, R. 1178-Vol. IX, R. 1212; Vol. X, R. 1401-14].

analogous to salaries and wages—*i.e.*, an employee has a contractual right to be paid for work that he or she has already performed, but generally does not have a right to continue earning money in the future. This is the prevailing view (hereinafter, the "Prevailing Rule") across the country with regard to public pensions, and it is *the only* analysis applied with respect to private pensions. In contrast to the California Rule, the Prevailing Rule is sensible, fiscally responsible, and legally justified. To say it is obvious that the Court should follow the Prevailing Rule instead of the California Rule is an understatement. And, assuming that the Court does so, it can only conclude that SB 151 does not violate the inviolable contract since SB 151 only alters prospective, unaccrued benefits.

It is undisputed that SB 151 only affects public employees' ability to accrue certain pension benefits *in the future*. It *does not* take away or reduce any benefits they have already accrued, and it has no effect whatsoever on those who are already retired. If the Court goes against the great weight of authority and follows the California Rule—which even California Governor Jerry Brown says should be abandoned[8]—then it likely will find that SB 151 violates contractual rights. Conversely, if the Court follows the Prevailing Rule, then it must find that SB 151 *does not* violate any contractual rights. Only one of these options is sensible, fiscally responsible, and legally justified. And it is not the California Rule.

A. The Court should not follow the California Rule.

California is not known for its sound public policy. The California Rule regarding pension rights is especially problematic—so much so that even California courts are starting to walk away from it. This Rule, which was created out of whole cloth by California courts

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[8] Adam Ashton, "Jerry Brown to Supreme Court: Hurry up and hear my pension law case," *The Sacramento Bee*, (July 27, 2018), *available at* https://www.sacbee.com/news/politics-government/the-state-worker/article215029230.html (last visited Aug. 26, 2018).

primarily during the second half of the twentieth century, provides that public employees have "a right to earn future [pension] benefits through continued service." *Legislature v. Eu*, 816 P.2d 1309, 1332 (Cal. 1991) (in bank). And not only do they have the *right* to continue accruing benefits in the future, but they also have the *right* to continue accruing benefits at no less than the rate at which they were permitted to accrue benefits when they were first hired. *See id.* at 1333. In other words, under the California Rule, when a public employee is hired, that employee has a locked-in right to continue accruing future pension benefits forever at no less than the accrual rate that was available to the employee on his or her first day of employment. Simply put, the California Rule denies public employers any flexibility when it comes to current employees' future pension accruals—they must be afforded the opportunity to accrue any and all benefits that were capable of being accrued when they were hired.

The California Rule has only been cited with approval by courts in a handful of states, and several of them subsequently repudiated the rule. *See* Amy B. Monahan, "Statutes as Contracts? The 'California Rule' and its Impact on Public Pension Reform," 97 Iowa L. Rev. 1029, 1071-73 (2012). Why? Because it is nonsensical, fiscally irresponsible, and legally unjustifiable.

It makes no sense to say that public employees have a right to future pension accruals. Taken to its logical extent, such a rule would mean that public employers could never terminate their employees or reduce their compensation. No reasonable person can dispute that terminating an employee completely ends the employee's ability to continue accruing pension benefits, nor can anyone reasonably dispute that reducing an employee's compensation reduces the rate at which the employee accrues pension benefits. Therefore, anyone who is being intellectually honest would have to admit that the California Rule—carried to its logical conclusion—would affect the ability to terminate employees or reduce their compensation.

But, of course, no one takes issue with the ability to terminate public employees or reduce their compensation. This destroys any rationale for holding that there is a right to future accruals. "After all, if your employment can be terminated and your salary lowered prospectively, what is the basis for finding a right to future accruals?" *Id.* at 1077. There is none. And, tellingly, the California courts have never even attempted to provide one. Instead, "[t]hey simply treat it as a given." *Id.* Logic, however, says that it is anything but.

Moreover, a pension is a form of deferred compensation. *See, e.g., Brosick v. Brosick*, 974 S.W.2d 498, 504 (Ky. App. 1998). Thus, it is analogous to salary or wages, and should be treated the same way.[9] Indeed, as the Oregon Supreme Court has held, pension benefits are simply "another form of compensation." *Moro v. State of Oregon*, 351 P.3d 1, 20 (Or. 2015). "Whereas, for example, salary is compensation paid to the employee every two weeks or at the end of each month, a pension is compensation paid to the employee at retirement." *Id.* Therefore, since salary and wages can be reduced prospectively—meaning that there is no right to continue accruing them at the same rate in the future—it makes no sense to say that pension benefits cannot similarly be reduced on a prospective basis. In other words, since there is no right to continue accruing future salary or wages at the same rate, there is no logical—or legal—basis upon which to conclude that employees should have a right to continue accruing pension benefits at the same rate.

Guaranteeing a right to future accruals is also inefficient and irresponsible. It is absurd to suggest that a state legislature would provide employees with a specific set of unalterable pension benefits from the day they are hired. Doing so would encumber the state with obligations running as long as 70 or 80 years without any flexibility to take measures to protect

[9] If pensions were not a form of compensation, they likely would constitute an emolument, and therefore be unconstitutional. *See* Ky. Const. § 3.

the state from run-away costs. No state that cares about its fiscal future would put itself on the hook for such obligations; it would expose the state to far too much vulnerability and uncertainty.

In addition, it is not in the best interest of employees to guarantee a right to future accruals. This might seem counterintuitive at first glance, but it is true. If public employers cannot alter pensions on a prospective basis in order to preserve solvency, then they may have to accomplish that by terminating employees, reducing salaries and wages, or reducing fringe benefits like health insurance—or all three. *See* Monahan, 97 Iowa L. Rev. at 1079. These obviously are not desirable outcomes, and many employees may prefer to accept reduced future pension accruals in exchange for preserving their jobs, preserving their wage rate, or preserving affordable health insurance. The California Rule, however, would not allow such flexibility. *See id.*

The California Rule was initially influential and was adopted by several states, but it appears that only a handful of states still follow it. Why? Because nearly everyone recognizes that it is a disastrous rule. This is nowhere more evident than in California itself. California is experiencing crushing financial pressures stemming from its out-of-control public pensions. From 2002-03 to 2017-18, public employers' pension contributions in California increased by 400 percent on average. *See* Joe Nation, *Pension Math: Public Pension Spending and Service Crowd Out in California, 2003-2030*, Stanford Institute for Economic Policy Research, at x (Oct. 2, 2017), *available at* https://siepr.stanford.edu/research/publications/pension-math-public-pension-spending-and-service-crowd-out-california-2003 (last visited Aug. 25, 2018). For California public employers, "pension contributions now consume on average 11.4 percent of all operating expenditures, more than three times their 3.9 percent share in 2002-03." *Id.* And pension contributions are projected to increase by an additional 73 percent to 113 percent by

2029-30. *Id.* As a result, state and local governmental entities in California "have reduced social, welfare and educational services, as well as 'softer' services, including libraries, recreation, and community services. In some cases, governments have reduced total salaries paid . . . ." *Id.* at xi. The bottom line is that "rising pension costs are making it harder to provide services traditionally considered part of government's core mission." *Id.* at 1.

These results are so disastrous that even the California courts are walking away from the California Rule. This is most clearly demonstrated in *Marin Association of Public Employees v. Marin County Employees' Retirement Association*, 206 Cal. Rptr. 3d 365 (Cal. App. 2016) (review granted), where the court retreated from the traditional California Rule in an apparent attempt to unwind some of the damage caused by the rule. *Marin Association* involved a challenge to a provision of the California Public Employees' Pension Reform Act of 2013 that attempted to eliminate pension spiking by prohibiting things like payments for unused sick leave from being counted as part of an employee's compensation when calculating the employee's pension benefit. The plaintiffs alleged that they had a contractual right to spike their pensions with such payments. *See id.* at 381. Thus, in the plaintiffs' view—and consistent with the holding in *Eu*—the state could not change pension spiking with regard to existing employees. *See id.*

In evaluating this claim, the court began by noting that "a pension is treated as a form of deferred salary that the employee earns prior to it being paid following retirement." *Id.* The court then noted that "pension rights are not immutable." *Id.* at 382. It further noted that "the government entity providing the pension may make reasonable modifications and changes in the pension system. This flexibility is necessary 'to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system and carry out its beneficent policy.'" *Id.* (quoting *Miller v. State of California*, 557 P.2d 970 (Cal. 1977)). And the court observed that while the legislature cannot destroy pension rights, it can modify them because "[t]he right to modify inheres in the inalienable rights of government." *Id.* at 383.

Throughout the opinion, the court also found a broad ability to modify pension benefits, concluding that "there are acceptable changes aplenty that fall short of 'destroying' an employee's anticipated pension. 'Reasonable' modifications can encompass reductions in promised benefits. Or changes in the number of years [of] service required. Or a reasonable increase in the employee's contributions." *Id.* at 387-88 (citations omitted). Thus, the court concluded that a public employee "does not have a right to any fixed or definite benefits but only to a substantial or *reasonable* pension," and that "*reasonable* modifications and changes" may be made "before the pension becomes payable." *Id.* at 388. Applying this rule, the court found that the anti-spiking provisions in the law were valid because they were "quite modest" and "purely prospective." *Id.* at 390, 393.

The *Marin Association* holding is a far cry from the traditional California Rule—which guarantees public employees a right to future pension accruals at no less than the rate that was available to them when they were hired—and it demonstrates that even the California courts no longer believe in the soundness of the California Rule. If even California does not believe in the California Rule, why should Kentucky? Simply put, it should not. Rather, the Commonwealth should follow the rule that is presently prevailing among state and federal courts, referred to herein as the Prevailing Rule—*i.e.*, the rule that protects accrued pension benefits, but permits prospective changes.

B. The Court should follow the Prevailing Rule instead.

Given the disastrous results of the California Rule, it is no surprise that courts are rejecting it from coast to coast. Indeed, some states that had previously adopted it have now abandoned it. Significantly, it has been rejected in many states that have statutory protections for pension benefits that are similar to Kentucky's inviolable contract. And, perhaps even more significantly, the Prevailing Rule is more consistent with the manner in which Kentucky's statutory "inviolable contract" language has been treated over the years.

1. The Prevailing Rule is more consistent with Kentucky's past treatment of the inviolable contract.

There is little authority in Kentucky on how the term "inviolable contract" should be interpreted. But there is not a complete absence of authority, and the authority that exists supports the application of the Prevailing Rule instead of the California Rule.

In 1973, Kentucky's highest court addressed municipal employees' inviolable contract rights in *Holsclaw v. Stephens*, 507 S.W.2d 462 (Ky. 1973). At issue in that case was the plan to create the Lexington-Fayette Urban County Government and abolish the City of Lexington as a legal entity. One aspect of the plan was the creation of a combined retirement system that would include employees of both Fayette County and the old City of Lexington. A group of employees and retirees of the City of Lexington argued that the plan would impair their inviolable contract rights, which were provided by KRS 90.400. *Holsclaw*, 507 S.W.2d at 478. Specifically, they contended that the creation of the new pension system would impair or dilute the value of the contributions they previously had made. The Court pointed out that there is never a guarantee that cities will remain in existence, and that once a city ceases to exist, employees have no right to continued employment. *See id.* at 479. By implication, this means that employees also have no right to future accrual of pension benefits once a city ceases to exist. The Court then made it clear that the required protection for the city employees' pension rights was backward-looking protection focused on their accrued benefits, not forward-looking protection for future accruals. The court held:

> As concerns pension rights, it is of course true that the termination of the existence of the City of Lexington will not extinguish the assets of the pension funds, and those active or

> retired members of the pension systems by and for whom contributions were made will have vested rights in those assets. *But the continued existence of the pension system in its previous form and strictly in accordance with the previous statutes governing city pension systems is not essential to the protection of those vested rights.*

Id. (emphasis added). Thus, the court held that the protection provided by the inviolable contract was the protection of already-accrued benefits, not future accruals.[10] This plainly is an application of the Prevailing Rule.

The Kentucky courts next had occasion to address inviolable contract rights in *Jones v. Board of Trustees of Kentucky Retirement Systems*, 910 S.W.2d 710 (Ky. 1995). In *Jones*, the Board of Trustees of the Kentucky Retirement Systems sued the Governor and several other officials because the 1992 budget bill did not fund the state pensions at the level recommended by the Board. *See id.* at 712. In rejecting the Board's claims, this Court made several observations that indicate the Prevailing Rule, rather than the California Rule, is the correct method of interpreting the inviolable contract. First, the Court found that "[t]he contract between the Commonwealth and its employees is for retirement funding. It is not a contract which denies the General Assembly the ability to fashion its ways or means in providing pension funds." *Id.* at 713-14. Thus, the court acknowledged that changes to the pension systems are not prohibited by the inviolable contract. It reiterated this point in the very next sentence by adding, "[t]he appellees' argument that the retirement statutes forever removed legislative power to amend those statutes runs afoul of our holding in *Legislative Research Commission v. Brown*, 664 S.W.2d 907 (1984)." *Id.* at 714. Finally, the Court held that "[a]t the simplest level, appellees have the right to the pension benefits they were promised as a result of their employment, at the level promised by the Commonwealth." *Id.* 715. This is perhaps the

[10] *Holsclaw* was later disapproved of on other grounds, pertaining solely to taxation, in *Jacobs v. Lexington-Fayette Urban County Government*, 560 S.W.2d 10, 14 (Ky. 1977). But *Holsclaw*'s holding about pension rights has not been disapproved of or reversed.

clearest indication that this Court viewed pension rights through the lens of the Prevailing Rule rather than the California Rule. After all, the Court did not hold that state employees are entitled to the pension benefits they were promised as a result of their employment *plus the pension benefits they expected to accrue as a result of their future employment.* The reference to employment, but not future employment, is significant. Moreover, it is striking that the Court used the past tense in referring to promised benefits. Specifically, the Court found that employees have a right to "the pension benefits they were promised," not to the benefits that *are or will be promised if their employment continues in the future.* The Court's use of the past tense indicates that the inviolable contract is a backward-looking provision, protecting what has already been accrued—*i.e.*, what was promised—but not protecting future accruals.

The General Assembly's historical treatment of the inviolable contract also demonstrates that the Prevailing Rule is the correct rule. The General Assembly has made many changes to the public pension systems over the years, many of which have reduced members' benefits on a prospective basis. For example, KERS members were required to contribute 4 percent of their salaries to the pension system when the inviolable contract was created in 1974, *see* 1966 Ky. Acts ch. 35, § 5, but in 1986, the required contribution rate was raised to 5 percent going forward, *see* 1986 Ky. Acts ch. 293, § 4. Likewise, the General Assembly has increased the required contribution rate for KTRS members several times, raising it from 7.7 percent to 7.84 percent in 1979, then to 9.32 percent in 1984, and then 9.6 percent later that same year, and, finally, to 9.855 percent in 1988. *See* 1978 Ky. Acts ch. 152, § 8; 1982 Ky. Acts ch. 326, § 7; 1984 Ky. Acts ch. 253, § 15; 1988 Ky. Acts ch. 240, § 3. Requiring employees to pay more for their pension benefits undoubtedly affects the value of those benefits, but the General Assembly obviously did not see a problem with that.

In addition, on multiple occasions, the General Assembly has *completely repealed* a benefit that was available to KERS members under the inviolable contract. In 1988, the General Assembly offered a 10 percent service credit bonus to certain employees, but placed a sunset provision on that benefit. *See* KRS 61.596 (repealed by 2000 Ky. Acts ch. 385, § 42). In other words, they made a benefit available for a limited time, and then made it completely unavailable from that point forward. The General Assembly clearly did not believe that once a benefit had been offered, it had to continue being offered so that employees could accrue it in the future.

Similarly, in 2000, the General Assembly repealed KRS 61.554, which had allowed LRC employees to purchase service credit after working six legislative bienniums. *See* 1990 Ky. Acts ch. 480, § 6 (repealed by 2000 Ky. Acts ch. 385, § 42). Eliminating this benefit would be a violation of the inviolable contract under the California Rule. The fact that it was repealed clearly indicates that the General Assembly never intended the inviolable contract to be interpreted according to such a rule.

Finally, the Prevailing Rule is the only one that is consistent with the age-old rule that one legislature cannot bind another. As this Court held in *Jones*, the "argument that the retirement statutes forever removed legislative power to amend those statute runs afoul of our holding in *Legislative Research Commission v. Brown, Ky.*, 664 S.W.2d 907 (1984)."

2. The Prevailing Rule is also in line with recent trends from other states, and is the only rule accepted under federal law.

Kentucky's pension crisis is the worst in the nation, but Kentucky is not the only state dealing with this issue. In response to crushing pension debt, state and municipal governments from coast to coast have undertaken pension reform. In many instances, these efforts have led to litigation. And the overriding theme coming out of those cases is that employees' accrued benefits cannot be reduced, but unaccrued benefits can be reduced prospectively because employees do not have a right to future accruals. That is, states are generally adopting the Prevailing Rule. As one commentator observed, "[a] common theme can be seen emerging from the case law, no matter what the putative holding: employees have a right to pension benefits that they have already accrued, but not necessarily to the accrual of future benefits." Stuart Buck, "The Legal Ramifications of Public Pension Reform," 17 Tex. Rev. L. & Pol. 25, 57 (2012). Recent decisions in Florida, Wisconsin, Oregon, and Michigan demonstrate the soundness of the Prevailing Rule, and Kentucky should follow these states' reasoning.

To begin, Florida's experience is illustrative. In response to rising budgetary pressures, the Florida legislature enacted pension reforms in 2011. In particular, the legislature "converted the Florida Retirement System (FRS) from noncontributory by employees to contributory, required all current FRS members to contribute 3 percent of their salaries to the retirement system, and eliminated the retirement cost-of-living adjustment for creditable service after the effective date of the act." *Scott v. Williams*, 107 So. 3d 379, 381 (Fla. 2013). FRS members sued, arguing that those reforms violated their contractual rights.

Florida law has a preservation-of-rights statute, which—much like Kentucky's inviolable contract statutes—provides that "the rights of members of the retirement system established by this chapter are declared to be of a contractual nature, entered into between the member and the state, and such rights shall be legally enforceable as valid contract rights and shall not be abridged in any way." *Id.* at 383 (quoting Fla. Stat. § 121.011(3)(d)). The Florida Supreme Court rejected the plaintiffs' argument that the reforms violated this provision. In doing so, it clearly rejected the California Rule and followed the Prevailing Rule.

The plaintiffs argued that the reforms should be evaluated under the California Rule:

> It is contended, without dispute, that even though the actual changes in the plan occur at a future date, the changes diminish the total expected retirement benefits that could have accrued over the entire projected life of a member's employment who continue their employment after the amendments. Thus, the challengers contend, the rights to a noncontributory plan and

> to a continuing COLA were part of the contract established under section 121.011, Florida Statutes (1974), as it has been continually enacted, and are rights to be honored over the life of their employment with the State.

Id. at 386. Florida's highest court gave this argument short shrift. It concluded "that the preservation of rights statute was enacted to give contractual protection to those retirement benefits already earned as of the date of any amendments to the plan." *Id.* at 388. The court further stated that "the preservation of rights statute was not intended to bind future legislatures from prospectively altering benefits for future service performed by all members of the FRS," and that the reforms at issue were valid because they were "prospective changes within the authority of the Legislature to make." *Id.* at 389. The court arrived at this holding based on the following key observations:

> [T]he rights provision was not intended to bind future legislatures from prospectively altering benefits which accrue for future state service. To hold otherwise would mean that no future legislature could in any way alter future benefits of active employees for future services, except in a manner favorable to the employee. *This view would, in effect, impose on the state the permanent responsibility for maintaining a retirement plan which could never be amended or repealed irrespective of the fiscal condition of this state.* Such a decision could lead to fiscal irresponsibility. It would also impose on state employees an inflexible plan which would prohibit the legislature from modifying the plan in a way that would be beneficial to a majority of employees, but would not be beneficial to a minority.

Id. at 388 (quoting *Florida Sheriffs Ass'n v. Dept. of Admin.*, 408 So. 2d 1033, 1037 (Fla. 1981)). Thus, Florida has unequivocally rejected the California Rule and adopted the Prevailing Rule, thereby allowing prospective changes to pensions while protecting already-accrued benefits.

The Wisconsin Supreme Court applied the same reasoning and reached the same result in *Stoker v. Milwaukee County*, 857 N.W.2d 102 (Wis. 2014). In Wisconsin, counties with a population of 500,000 or more are required by state statute to provide pension plans for their employees. *See id.* at 104 (citing Ch. 201, Wis. Laws of 1937). Wisconsin law provides—much like Kentucky's inviolable contract—that those pension benefits "shall not be diminished or impaired by subsequent legislation or by any other means without [members'] consent." *Id.* at 105 (quoting Ch. 138, Wis. Laws of 1945). Under another statute, counties can make changes to their pension systems when necessary, but "no such change shall operate to diminish or impair the annuities, benefits or other rights of any person who is a member of [the pension system] prior to the effective date of any such change." *Id.* at 106 (quoting § 1, Ch. 405, Wis. Laws of 1965). Acting pursuant to these laws, Milwaukee County created a pension system for its employees. Like Kentucky's pension systems, Milwaukee County's pension system "calculates pension payments for its retired employees by multiplying a retiree's final average salary by a certain percentage known as a multiplier, and the resulting number is then multiplied by the retiree's total years of county service." *Id.* at 103.[11] In 2000, Milwaukee County raised its "multiplier from 1.5 percent to 2 percent for service rendered on and after January 1, 2001." *Id.* (citing Milwaukee Cnty., Wis. Gen. Ordinance § 201.24(5.15)(1)(a) (2000)). Subsequently, Milwaukee County "reduced the multiplier from 2% to 1.6% for all county service performed on and after January 1, 2012." *Id.* at 104 (citing Milwaukee Cnty., Wis. Gen. Ordinance § 201.24(5.1)(2)(f) (2011)). The 2 percent multiplier continued to apply to service rendered from 2001 through 2011. Nevertheless, employees sued on the ground that their rights had been impaired because they had a right to continue accruing future benefits with a 2 percent multiplier. *See id.* The Wisconsin Supreme Court rejected this argument, decisively adopting the Prevailing Rule.

The plaintiffs in *Stoker* essentially argued that Wisconsin should follow the California Rule, *see id.* at 109, but the Wisconsin Supreme Court firmly rejected that argument. Indeed, it

[11] This is essentially the same formula used to calculate pension payments in Kentucky's pension systems. *See, e.g.*, KRS 61.595.

found that adopting a rule that prohibits prospective changes to pensions would lead to "absurd results." *Id.* The court concluded that "[b]ecause the multiplier is 'a form of deferred compensation that is earned as the work is performed,' it 'can be changed, but only as it is related to work not yet performed.'" *Id.* at 113 (quoting *Champine v. Milwaukee Cnty.*, 696 N.W.2d 245 (Wis. App. 2005)). The court also noted that its "conclusion that Milwaukee County may prospectively modify benefits before they vest is consistent with the anti-cutback rule of the Employee Retirement Income Security Act ("ERISA") of 1974. The anti-cutback rule allows employers subject to ERISA to modify benefits with respect to future service because those benefits have not yet accrued." *Id.* (citing *Cent. Laborers' Pension Fund v. Heinz*, 541 U.S. 739, 747 (2004)). Thus, in light of these considerations, the court held that reducing the multiplier "did not breach [the plaintiffs'] contractual right to retirement system benefits earned and vested because it had prospective-only application to future service credits not yet earned." *Id.* at 116.

Also instructive is the Oregon Supreme Court's decision in *Moro v. State of Oregon*, 351 P.3d 1 (Or. 2015). Oregon had previously adopted the California Rule in *Oregon State Police Officers' Association v. State of Oregon*, 918 P.2d 765, 773 (Or. 1996), where the court held that public employees' pension benefits "vest on acceptance of employment or after a probationary period, with vesting encompassing not only work performed but also work that has not yet begun." But the Oregon Supreme Court abrogated this holding in *Moro*, abandoning the California Rule in favor of the Prevailing Rule. *See Moro*, 351 P.3d at 37.

At issue in *Moro* was a pension reform bill that reduced the cost-of-living adjustment applied to benefits received under the Oregon Public Employee Retirement System. *See id.* at 7. The ultimate issue, as in the cases discussed above, was whether the state was required to allow employees to continue accruing the COLA benefit in the future at the pre-reform rate, or whether it could reduce that benefit prospectively. *See id.* at 33-34. The court concluded that employees had "a contractual right to receive the pre-amendment COLA for benefits that they earned *before* the effective dates of the amendments—that is, benefits that are generally attributable to work performed before the amendments went into effect," *id.* at 8, but that employees had "no contractual right to receive the pre-amendment COLA for benefits that they earned *on or after* the effective dates of the amendments—that is, benefits that are generally attributable to work performed after the amendments went into effect," *id.* The court acknowledged its previous holding in *Oregon State Police Officers' Association*, *id.* at 34-35, but abrogated it, rejecting the position that pension benefits "cannot be changed prospectively," *id.* at 35. The court found that "[t]he PERS contract binds a participating employer to compensate a member for only the work that the member has rendered and based on only the terms offered at the time the work was rendered . . . ." *Id.* at 23. Accordingly, the court held that the legislature cannot change benefits "that have already accrued," but is well within its rights to change "benefits that might accrue in the future." *Id.* at 37.

Finally, Michigan is also among the recent deluge of states adopting the Prevailing Rule over the California Rule. In 2010, the Michigan legislature modified pension benefits for current public school employees in response to a budget shortfall in the state public school system. *AFT Mich. v. State of Michigan*, 866 N.W.2d 782, 786 (Mich. 2015). Among other things, the pension reform legislation "required all current public school employees to contribute 3% of their salaries to the MPSERS [Michigan Public School Employees' Retirement System] to assist in funding retiree healthcare benefits for current and future public school retirees." *Id.* Prior to the 2010 reforms "public school employees had never been required to pay for these benefits." *Id.* A group of labor unions representing public school employees sued, arguing that the legislation violated their members' contractual rights to pension benefits.

While the litigation over the 2010 reforms was pending, the legislature passed another pension reform bill in 2012. The 2012 bill made changes to the 2010 retiree healthcare provisions—such as allowing employees to avoid paying the 3 percent contribution if they wanted to opt out of retiree healthcare benefits—and also increased the amount that employees were required to contribute to the pension system. *See id.* at 787-88. The unions challenged the 2012 reforms as well, but the Michigan Supreme Court upheld those reforms. Although the unions argued that the reforms violated their members' contract rights with respect to their pension benefits, the Michigan Supreme Court rejected this argument on the ground that public employees had no contractual rights to future pension benefits. *See id.* at 806. Articulating the Prevailing Rule, the court stated that "[a]lthough public school employees have no contractual right to accrue future pension benefits, they do possess a contractual right to receive the pension benefits they have already earned." *Id.* at 808 n.26.

Federal courts also apply the Prevailing Rule instead of the California Rule. For example, in *Van Houten v. City of Fort Worth*, 827 F.3d 530 (5th Cir. 2016), the Fifth Circuit considered whether changes to Fort Worth's pension plan violated Texas law. Prior to the changes, Fort Worth provided retirees with a pension equal to the average of their three highest annual salaries multiplied by their years of service and then subjected to a 3 percent multiplier. *See id.* at 533. The changes reduced the multiplier to 2.5 percent, changed the "high three" factor to a "high five" factor, and changed the cost-of-living adjustment. Employees challenged the reforms, but the Fifth Circuit turned away their challenge. It concluded that "[i]f the changes to the pension plan impact only benefits that have not yet accrued, amendment is permissible." *Id.* at 538. And since the reforms at issue were prospective only, they did not violate the employees' rights. *See id.* at 538-39.

The trend established by these cases is clear: courts across the country recognize that the appropriate rule for evaluating changes to public pension plans is not the California Rule, but the Prevailing Rule—*i.e.*, the rule that says accrued benefits must be protected, but unaccrued future benefits can be changed or reduced. This rule is legally correct, sensible, fiscally responsible, and consistent with Kentucky law. Therefore, this Court should join the overwhelming chorus of states that are following it.

C. Under the Prevailing Rule, none of the challenged provisions of SB 151 are invalid since they all apply to prospective, unaccrued benefits.

All of the challenged provisions in SB 151 are purely prospective in their effect on pension benefits. Not one of those changes affects inviolable contract benefits that members of the pension systems have already accrued. Instead, the changes only affect unaccrued, future benefits. The Plaintiffs have not even attempted to demonstrate otherwise, and, in fact, they have conceded it by not contesting it before the trial court. [Vol. XII, R, 1696-1704]. There is simply no credible argument that SB 151 reduces any accrued benefits that are protected by the inviolable contract. As a result, under the Prevailing Rule, the Court must find that the challenged portions of SB 151 are valid and not in violation of the inviolable contract.

The Plaintiffs have challenged seven particular benefit changes made by SB 151. The following briefly recaps each challenge and explains why each one is prospective, and therefore permissible under the Prevailing Rule:

1. The challenge to § 74 of the bill, which amends KRS 161.623 to limit the number of sick days that KTRS members can accrue after December 31, 2018 for the purpose of enhancing their service credit –

    - Section 74 of the bill does nothing more than limit the ability of KTRS members to accrue sick days *in the future* that can be exchanged for service credit when they retire. Without the amendment, the benefit would not even accrue until the occurrence of two future contingencies: (1) the employee retires, and (2) the employee has unused sick days at that point. The change in § 74 does not, in any way, affect current accrued benefits.

2. The challenge to the portions of §§ 14 and 15 that amend KRS 61.510 and 78.510 to exclude lump-sum payments of compensatory time from the calculation of creditable compensation for those retiring after July 1, 2023 –

    - Sections 14 and 15 eliminate the ability to use unused compensatory time to increase an employee's creditable compensation at retirement. As with the exchange of sick days for service credit, an employee does not accrue this benefit until: (1) the employee retires, and (2) the employee has unused compensatory time at the point of retirement. Accordingly, these changes only affect benefits that might accrue in the future, if at all. *Cf. Cinotto v. Delta Airlines, Inc.*, 674 F.3d 1285, 1296-97 (11th Cir. 2012) (holding that defendant was not required to allow employee to take advantage of increased retirement benefit for employees who continued working past the age of 52 when that benefit was terminated prospectively before the plaintiff reached that age).

3. The challenge to the portions of § 14 and § 15 of the bill that amend KRS 61.510 and 78.510 to exclude uniform and equipment allowances paid after January 1, 2019 from the calculation of creditable compensation –

    - This change only affects how money received *in the future* will be counted in determining employees' retirement allowances when they retire *in the future*. To say that this is a purely prospective change is to state the obvious.

4. The challenge to § 16 and § 17 of the bill, which amend KRS 61.546, KRS 78.616, and KRS 16.645 to prohibit the use of sick leave credit to determine retirement eligibility for Tier I KERS, CERS, and SPRS members retiring after July 1, 2023 –
    - This change, like the other changes to sick leave and compensatory time, only affects benefits that might accrue *in the future*. The right to use unused sick leave to determine retirement eligibility cannot accrue until an employee who is not otherwise eligible for retirement accumulates enough unused sick leave to become eligible for retirement. These are contingent *future events*. If an employee has presently accrued this right and wants to enforce it, the employee can do so. If an employee has not presently accrued this right, then eliminating the ability to accrue it in the future is obviously not an impairment of an accrued benefit.
5. The challenge to § 30 of the bill, which amends KRS 61.702(2)(b), KRS 78.545, and KRS 16.645 to require a 1 percent deduction of the creditable compensation for Tier I KERS, CERS, and SPRS members hired after July 1, 2003 for the purpose of funding retiree health insurance –
    - The obvious answer to this challenge is that retiree health benefits are expressly excluded from the terms of the inviolable contract for employees hired after July 1, 2003. *See* KRS 61.702(8)(e). In addition, § 30 simply raises the employee contribution rate, which the General Assembly has done many times throughout the history of the public pension systems, as summarized above.
6. The challenge to the portions of § 14 and § 15 of the bill that amend KRS 61.510 and KRS 78.510 to make clear that, for retirements occurring after January 1, 2019,

the calculation of Tier I members' "high three" and "high five" must be based on three and five complete fiscal years, respectively –

- As an initial matter, it is important to note that the Plaintiffs are making a facial challenge to SB 151. Thus, they must establish that there are no circumstances under which the bill can be valid. They clearly have not done so here. Even if one were to assume for the sake of argument that it might reduce some employees' benefits to change "high three" and "high five" to mean three and five complete fiscal years—and there actually is no evidence that would permit such an assumption—one could not assume that it would necessarily reduce employees' benefits in *all instances*. There may be employees who retire on January 2, 2019 using a "high five" made up of five complete fiscal years who would have received exactly the same retirement allowance if it had been calculated using a "high five" made up of the previous 49 months. The Plaintiffs have offered no evidence on this point even though it is their burden to prove invalidity. Regardless, the amendment at issue does not impair employees' accrued contractual rights. The changes to "high three" and "high five" only take effect *in the future*—that is, for retirements after January 1, 2019. Anyone who has already accrued the right to retire with the old "high three" and "high five" calculation is free to do so until January 1, 2019. Anyone who has accrued that right but does not desire to use it prior to that date obviously has no grounds on which to complain. More to the point, if such individuals ultimately retire and receive a retirement allowance that is at least as large as what they would have received had they retired before January 1, 2019, then their pension benefits obviously have not been reduced by the new "high three" and "high five" calculation. *See Cinotto*, 674 F.3d at 1296-97.

7. The challenge to § 19 of the bill, which amends KRS 61.597 and KRS 78.545 to reduce the guaranteed interest credit for any KERS or CERS Tier I and Tier II members who opted into the hybrid cash balance plan in 2014 –

   - The obvious problem with this challenge is that there is not a single Tier I or Tier II member who opted into the hybrid cash balance plan. [*See* Vol. VIII, R. 1129-30]. Indeed, the opportunity to opt into the plan was never even offered to Tier I and Tier II members because the statute provided that opting into the plan was contingent on the retirement systems' receipt of a private letter ruling from the IRS, and such a private letter ruling was never sought. *See* KRS 61.5955(6). Given that no Tier I or Tier II members ever opted into the hybrid cash balance plan, it is clear that no Tier I or Tier II members' rights are affected by the reduction in the guaranteed return for that plan. Moreover, the statute provided that if any Tier I or Tier II members ever opted into the hybrid cash balance plan, they would do so "in lieu of the benefits he or she is currently eligible to receive from the systems." KRS 61.5955(1). Thus, even if there were opt-ins—which there are not—they would have waived their inviolable contract rights upon opting in.

D. SB 151 does not impair any contractual rights, but even if it did, it would not violate the Contracts Clause of the Kentucky Constitution.

The Plaintiffs contend that SB 151 violates public employees' contractual rights, and therefore also violates the Contracts Clause of Section 19 of the Kentucky Constitution. First, as explained above, SB 151 does not violate any contractual rights. Second, even if it did violate contractual rights, it would not be in violation of the Contracts Clause, and therefore would still be valid.

Section 19 of the Kentucky Constitution—the Contracts Clause—provides that the General Assembly may not enact any law "impairing the obligation of contracts." Ky. Const. § 19. This provision, which mirrors its federal counterpart, "is not an absolute bar to subsequent modification of a State's own financial obligations." *See U.S. Trust Co. of New York v. New Jersey*, 431 U.S. 1, 25 (1977). A legislature "cannot bargain away the police power of a State," and "the Contract Clause does not require a State to adhere to a contract that surrenders an essential attribute of its sovereignty." *Id.* at 23. For this reason, courts universally hold that a state runs afoul of the Contracts Clause only if it *substantially* impairs the contract at issue. *See Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978) ("[T]he first inquiry must be whether the state law has, in fact, operated as a substantial impairment of a contractual relationship."); *Maryland State Teachers Ass'n, Inc. v. Hughes*, 594 F. Supp. 1353, 1360 (D. Md. 1984). And even then, "an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose." *U.S. Trust Co.*, 431 U.S. at 25.

SB 151 does not breach the inviolable contract, but even if it did, the changes do not constitute a "substantial impairment." More importantly, the changes in SB 151—along with other legislation passed by the General Assembly—were reasonable and necessary to allow the Commonwealth to begin to undo decades of structural deficiencies and underfunding that have put the state retirement systems in jeopardy.

1. None of SB 151's changes constitute a "substantial impairment" of the inviolable contract.

When applying the Contracts Clause, "the first inquiry must be whether the state law has, in fact, operated as a substantial impairment of a contractual relationship." *Allied Structural*

Steel Co., 438 U.S. at 244. The Plaintiffs have skipped right past this step. But this threshold question is critical because "[t]he severity of the impairment measures the height of the hurdle the state legislation must clear." *Id.* at 245. "Minimal alteration of contractual obligations may end the inquiry at its first state." *Id.* It is insufficient, in other words, to demonstrate only that the state impaired a contract. *Substantial* impairment is required.

As discussed above, the Plaintiffs challenge seven changes made to Kentucky's retirement systems in SB 151. In short, the Plaintiffs contend that these changes constitute substantial impairments of the inviolable contract:

- Amending KRS 161.623 to limit the number of sick days that KTRS members can use to enhance the service credit calculation to days accumulated up through December 31, 2018.
- Amending KRS 61.510 and KRS 78.510 to exclude lump-sum payments of compensatory time from the calculation of creditable compensation for employees retiring after July 1, 2023.
- Amending KRS 61.510 and KRS 78.510 to exclude uniform and equipment allowances paid after January 1, 2019 from the calculation of creditable compensation.
- Amending KRS 61.546, KRS 78.616, and KRS 16.645 to prohibit the use of sick leave credit to determine retirement eligibility for Tier I KERS, CERS, and SPRS members retiring after July 1, 2023.
- Amending KRS 61.702(2)(b), KRS 78.545, and KRS 16.645 to require a 1 percent deduction of the creditable compensation for Tier I KERS, CERS, and SPRS members hired after July 1, 2003 for the purpose of funding providing retiree health insurance.

- Amending KRS 61.510 and KRS 78.510 to make clear that the calculation of Tier I members' "high three" and "high five" must be based on three and five complete fiscal years, respectively.
- Amending KRS 61.597 and KRS 78.545 to alter the guaranteed interest credit for any KERS or CERS Tier I and Tier II members that opted into the hybrid cash balance plan in 2014.

None of these marginal changes are substantial, and the Plaintiffs have altogether failed to prove otherwise.

The substantial impairments that the Plaintiffs allege have no factual basis whatsoever. For example, the Plaintiffs contend that SB 151 violates the inviolable contract by limiting the use of accrued sick days to calculate service credit under KRS 161.623 for KTRS members after December 31, 2018. What the Plaintiffs fail to mention is that this change has no practical effect on any public school teacher or local school board employee in Kentucky. There are not any public school employees who are even eligible for service credit under KRS 161.623. [Vol. VIII, R. 1132-34]. The right to receive service credit for sick days under KRS 161.623 is not granted to individual employees. Instead, participating school districts must choose to offer the benefit to their employees. *See* KRS 161.623(2). But members receiving service credit for sick days cannot also receive compensation under the salary-spiking provision of KRS 161.155(10), which often provides more lucrative benefits. Every public school district has therefore chosen not to offer service credit under KRS 161.623. The Plaintiffs, in other words, contend that the limit on sick leave accrual for service credit is a substantial impairment of the inviolable contract *even though no current public school teachers are eligible for this benefit anyway.* [Vol. VIII, R. 1132-34]. Whatever the definition of substantial is, it certainly is not this. Furthermore, the fact that KRS 161.623 gives local school districts the *option* of allowing their teachers to use unused sick days for service credit underscores that teachers have *no contractual right* to such service credit. How can teachers have a contractual right in something that their school district employers can decide to give, or not give, them? They cannot.

The remaining alleged substantial impairments that the Plaintiffs identify similarly suffer from a lack of factual support. In fact, the Plaintiffs make almost no effort to provide any real evidence about the effect of the changes in SB 151.[12] Instead, their brief contains one unsupported allegation after another. When discussing the changes to sick leave, for example, the Plaintiffs' cite an article from a newsletter written in 2001 to support their claim that the change "has clear and material costs." [*See* Vol. III, R. 373]. But the article contains only back-of-the-envelope calculations about the value of sick leave. There is no data about the number of employees eligible to use this benefit after 2023; no data on the total value of the benefit for actual employees eligible to use it. There is no evidence supporting the claim that the change "has clear and material costs"—nor could there be, given that the Plaintiffs successfully persuaded the circuit court to stay all discovery. [Tab 3 at 15-17].

Likewise, the Plaintiffs object to the change in interest credits for Tier I and Tier II members who opted into the hybrid cash balance plan in 2014. But there is not one Tier I or Tier II member who opted into the hybrid cash balance plan. [Vol. VIII, R. 1129-30]. As with

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[12] The only "evidence" the Plaintiffs relied on to prove many of their factual assertions regarding the effect of SB 151 is an article from a newsletter that was written in 2001—almost twenty years ago. [*See* Vol. III, R. 373]. The article was written by an unknown author with unknown credentials who cites unverified facts to conclude that state workers could accumulate $16,500 worth of sick leave over a lifetime of employment. The assertions made in the article are not within the realm of admissible or competent evidence. *See Hubble v. Johnson*, 841 S.W.2d 169, 171 (Ky. 1992) (rejecting a party's attempt to rely wholly on inadmissible evidence "to support a motion for summary judgment"); *James v. Wilson*, 95 S.W.3d 875, 898 (Ky. App. 2002) ("'Evidence' necessarily implies evidence that would be admissible at trial."); CR 56.01; CR 56.05.

the change to KRS 161.623, this change cannot possibly be a substantial impairment—it impairs no one's rights.

The lack of seriousness underpinning the Plaintiffs' allegations continues as they discuss other changes in SB 151. The Plaintiffs throw out allegations about "average life expectancy" with no factual support whatsoever. [Vol. III, R. 373]. They contend that a recession "could cost the member [of a hybrid cash balance plan] their entire retirement," but rely only on a general citation to the KRS Comprehensive Annual Financial Report that in no way supports their claim.[13] [Vol. III, R. 374]. The record does not support any of the Plaintiffs' assertions about the effects of SB 151 on public employees' benefits, yet they insist that this Court must find that each and every change amounts to a substantial impairment.

Even when the Plaintiffs do provide financial information, the largest number they can come up with is a reduction of 5.5 percent for some members' creditable compensation.[14] They contend that the limitation on expense allowances for uniform and equipment could amount to 5.5 percent reduction in creditable compensation for some employees. [Vol. III, R. 374]. These numbers purportedly are based on an average salary (that the Plaintiffs provide with no supporting documents), along with a one-page excerpt from a collective bargaining agreement. [*Id.*] Even assuming that the numbers are accurate, the worst case scenario is a 5.5 percent reduction in creditable compensation. In other words, this is not a case in which the General Assembly is cutting benefits in half or suspending payments altogether—actions that might certainly be substantial. While employees might not want one component of the pension

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[13] Nor could it because the hybrid cash balance plans under SB 151 still protect any participating members from market losses.

[14] This is the highest number the Plaintiffs could come up with. Some members might only have a 1 percent deduction to pay for their health insurance, while most will see no change at all.

formula to be reduced, a 5.5 percent reduction of that component will not make a substantial impact in pension payments for anyone. Moreover, these changes are not retroactively reducing the retirement benefits of employees or already-retired members. The changes are *prospective* and only affect employees who have not yet left the workforce. If a 5.5 percent reduction in the prospective calculation of one component of the pension formula is considered "substantial," this Court might as well throw out the requirement of "substantiality" altogether because no change will ever survive that standard. The Plaintiffs cannot demonstrate a substantial impairment—not even with their many unsubstantiated factual allegations—and their claim must be dismissed.

2. The changes in SB 151 are reasonable and necessary to save Kentucky's ailing pension system and make it solvent for current and future retirees.

Finally, if the Court were to find that SB 151 did substantially impair the inviolable contract, the impairments are nonetheless justified because they are reasonable and necessary to serve an important public purpose: ensuring the solvency of Kentucky's retirement systems and guaranteeing the state's current and future retirees will receive retirement benefits through their lifetime. It is difficult to imagine a greater public purpose than the preservation of the state's retirement system, and the changes in SB 151 along with related legislation from the 2018 Regular Session ensure just that.

Kentucky's pension fund is the most underfunded in the nation. [*See* Vol. V, R. 719; *see also* Vol. VIII, R. 1109]. The structural problems built into the system have caused an unfunded liability of somewhere between $33 billion and $84 billion. [*See* Vol. V, R. 718]. And these problems were not primarily caused by chronic underfunding. One recent report indicated that underfunding by the General Assembly over the last decade caused only 15 percent of the total deficit, and that structural problems contributed to the remaining 85 percent. [Vol. V, R. 722]. The system, in other words, is broken. Until recently, the KERS Non-Hazardous plan had a negative cash flow going back to at least 2002, and "[o]ver the longer-term, such negative cash flows can ultimately threaten the solvency of the plan." [Vol. V, R. 723]. Legislators in the past wrote checks that we simply cannot continue to cash today, but the 2018 General Assembly recognized the dire situation our public employees face.

A substantial impairment remains constitutional if it "is reasonable and necessary to serve a legitimate and important public purpose." *Jones*, 910 S.W.2d at 717. "[A] State is not free to impose a drastic impairment" to solve a public crisis, but minimal impairments to resolve serious problems will survive scrutiny under the Contracts Clause. *See Hughes*, 594 F. Supp. at 1370–71 (quoting *United States Trust Co.*, 431 U.S. at 31). And while "complete deference to a legislative assessment of reasonableness and necessity is not appropriate" with respect to a financial obligation of the state, "pension reform, unlike the area of municipal bonds," is not "purely financial" because of the many layers of issues at play. *Id.* (quoting *U.S. Trust Co.*, 431 U.S. at 25-26). For this reason, "once the facts are brought to light the court should not act as a super legislature and attempt to second guess which legislative act would have better solved the perceived problem." *Id.* at 1371. "The legislature has the responsibility and the discretion to act on the facts and information at its disposal." *Id.*

The Plaintiffs' sole basis for denying that the changes in SB 151 are reasonable and necessary is their contention that the General Assembly "openly refused to consider any additional revenue measures to address pension obligations." [Vol. III, R. 376]. The Attorney General, KEA, and FOP strongly favor a big tax increase. They cite several bills that they contend would have provided the revenue necessary to solve a sixty-billion-dollar problem. But, of course, they provide no actuarial analysis, no expert report, *no facts whatsoever* to show that the General Assembly had a viable option to fund the pension problem and chose to ignore it. As with their other claims, the Plaintiffs ask the Court to just take their word for it and declare the pension reform bill unconstitutional on its face.

The Plaintiffs bear the burden of proof on this issue to show that an impairment of contract rights is both substantial and unreasonable or unnecessary.[15] *See United Auto., Aerospace, Agr. Implement Workers of Am. Int'l Union v. Fortuno*, 633 F.3d 37, 41-42 (1st Cir. 2011). They have not met—and cannot meet—that burden. The Plaintiffs have not produced one iota of competent and admissible evidence to show that any impairment of contract rights is both substantial *and* unreasonable or unnecessary. Their failure to produce the evidence necessary to sustain their Contracts Claim means that they cannot possibly prevail on this issue.

But even in the face of the Plaintiffs' many unsupported factual assertions, there is no dispute that SB 151 survives the challenge under the Contracts Clause because it is a reasonable and necessary step to protect the public interest. This case bears a strong resemblance to *Hughes*, the landmark case from Maryland upholding the legislature's reasonable modifications to its failing pension system in the early 1980s. As here, many publicly available reports showed the dire situation for Maryland's retirement system. *Hughes*, 594 F. Supp. at 1368–69. The *Hughes* court reviewed the evidence in the record and found the marginal changes to the state's pension system, such as limiting the employees' cost-of-living adjustments, were reasonable and necessary to address the problem:

> The 1984 Act was a reasonable response to an important public concern. It addressed the perceived cause of the problem, the unlimited COLA, and did so with little or no impairment to State employees or teachers. "The extent of impairment is certainly a relevant factor in determining

[15] This comports with the general rule that statutes are presumed to be constitutional and that it is the plaintiff's burden to prove otherwise. *See, e.g., Star v. Commonwealth*, 313 S.W.3d 30, 37 (Ky. 2010) (citing *Cornelison v. Commonwealth*, 52 S.W.3d 570, 572-73 (Ky. 2001)).

> reasonableness." This court has found the impairment to be minimal at worst.

Id. at 1370 (citing *U.S. Trust Co.*, 431 U.S. at 27); *see also Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362, 371-72 (2d Cir. 2012) (finding a wage freeze reasonable because it was "relatively minimal" and only operated prospectively); *Baltimore Teachers Union, American Fed'n of Teachers Local 340, AFL-CIO v. Mayor and City Council of Baltimore*, 6 F.3d 1012, 1018-21 (4th Cir. 1999) (similar). The Contracts Clause is not a straightjacket, preventing reasonable action while the ship sinks. Maryland acted reasonably, and so has Kentucky. For this reason, SB 151 must be upheld.

Just as in Maryland, public reports released in Kentucky show that a lack of funding alone was not the cause of the unfunded pension liability and that 85 percent of the problem was created by structural deficiencies with the system. [Vol. V, R. 722]. This means that, contrary to the Plaintiffs' unsubstantiated assertions, funding alone cannot solve the problem. The General Assembly understood this, which is why it implemented small structural changes in addition to providing record funding in the 2018-2020 biennium budget.

The Plaintiffs are simply wrong in arguing that SB 151 was unreasonable because the General Assembly did not pass one of the handfuls of bills that the Plaintiffs believe would provide additional revenue. [Vol. III, R. 377]. "[I]t is always the case that to meet a fiscal emergency taxes conceivably could be raised." *Buffalo Teachers Fed'n*, 464 F.3d at 372 ("[W]e find no need to second-guess the wisdom of picking the wage freeze over other policy alternatives, especially those that appear more Draconian, such as further layoffs or elimination of essential services."); *Baltimore Teachers Union*, 6 F.3d at 1020 (finding it insufficient to argue that the city "*could have* raised taxes" because "these courses are always open, no matter how unwise they may be"). Not only do the Plaintiffs fail to provide any actuarial analysis of those bills, they ignore that the General Assembly passed SB 151 along with unprecedented increases in recommended funding for the pensions. The General Assembly did not simply cut benefits with SB 151; it did its best to move the Commonwealth toward full contributions to Kentucky's retirement plans. The Plaintiffs obviously would have preferred different policy decisions, and they want this Court to overrule the General Assembly and implement the Plaintiffs' preferred policies—or at least prevent their disfavored policies from taking effect. But that is not an appropriate role for a court.

The Plaintiffs also ignore that the General Assembly passed SB 151 *to rescue* the pension system from insolvency. SB 151 protects the pensions of the public employees that the Plaintiffs claim to represent. In *U.S. Trust Co.*, the United States Supreme Court explained that a state's impairment of a contract is reasonable when doing so is necessary to save the underlying obligation. *U.S. Trust Co.*, 431 U.S. at 25, 29-31. The issue in *U.S. Trust Co.* was whether New York and New Jersey could repudiate their contracts with a group of bondholders for the public purpose of promoting mass transportation, energy conservation, and environmental protection. *Id.* at 28-29. The Supreme Court acknowledged that such goals are "important and of legitimate public concern," but still found that they were insufficient to justify impairing the states' contracts. To reach this holding, the Supreme Court distinguished it from a prior case that upheld an impairment of bond contracts. *Id.* at 28 (citing *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942)). That case, the Supreme Court explained, was different because the contractual impairments were necessary to save the underlying obligation. *Id.* Or as the Supreme Court stated, "as a practical matter the city could not raise its taxes enough to pay off its creditors under the old contract terms. The composition plan enabled the city to meet its financial obligations more effectively." *Id.* The effect was that, although the city's actions technically impaired its contracts, it did so "with the purpose and effect of protecting the creditors." *Id.*

To the extent the Court finds a constitutional impairment here, the same can be said of this case. The General Assembly passed SB 151 to protect the benefits for current and retired public employees. The law makes marginal changes to the system to save the vast majority of the benefits promised. Such changes are axiomatically reasonable and necessary for the public good, and this Court should find as much and uphold the validity of SB 151.

II. The Plaintiffs' claim that SB 151 violates the "three-readings" requirement of Section 46 is unavailing.[16]

Aside from challenging the substance of SB 151, the Plaintiffs also make a number of procedural challenges. First, they argue that SB 151 is unconstitutional because it does not comply with the "three-readings" clause in Section 46 of the Constitution, which states that "[e]very bill shall be read at length on three different days in each House . . . ." This claim is a thinly veiled invitation for the judiciary to micro-manage the legislative process. The three-readings requirement is undoubtedly a procedural requirement imposed by the Constitution, but the point that was lost on the circuit court is that the Constitution leaves it to the General Assembly to determine how this requirement must be met. In fact, the Constitution does so expressly. Section 39 provides that "[e]ach House of the General Assembly may determine the rules of its proceedings." And the reasons for this are obvious. The Constitution establishes certain procedural requirements for the legislature—such as the three-readings requirement—but it does not spell out exactly how those requirements are to be met. Its lack of specificity naturally leads to a number of questions: For example, what exactly constitutes a "reading"? And how, when, and where is it to be accomplished? Must a bill be read out loud, word for word, in the midst of every single legislator? What if the reader accidentally skips a line? What

[16] The Governor preserved this argument. [*E.g.*, Vol. IX, R. 1220-21, 1227-37; Vol. X, R. 1416-21, 1423-24, 1426-27, 1428-30].

if a few legislators exit the chamber? What if everyone reads it silently rather than out loud? For the judiciary to answer such questions would be an unthinkable act of judicial supremacy, and would show a remarkable lack of respect for a coordinate branch of government. It would effectively allow the courts to oversee the legislative process, thereby severely disrupting Kentucky's separation of powers, which are among the strongest in the nation. *See, e.g.*, *Sibert v. Garrett*, 246 S.W. 455, 457 (Ky. 1922). This is precisely why Section 39 of the Constitution allows the General Assembly—and only the General Assembly—to determine its own rules of proceedings. Because such questions simply are not within the province of the courts, the Plaintiffs' "three-readings" claim is not justiciable.

Nevertheless, even if the Court were to tread upon the General Assembly's turf by considering the merits of this claim, it would have to find that the legislature satisfied the three-readings requirement. It is undisputed that SB 151, in some form, received three readings in both legislative chambers. The Constitution requires nothing more. Additionally, the purpose of the three-readings requirement is to ensure that legislators know what they are voting on, and there is absolutely nothing in the record to demonstrate that this goal was not satisfied in the passage of SB 151. To the contrary, pension reform had been extensively debated throughout the 2018 Regular Session—and during much of the preceding interim period—and legislators were not confused about the contents of SB 151.

A. The "three-readings" claim is not justiciable.

It has been understood from the earliest days of the American republic that some constitutional questions are simply beyond the reach of courts. For example, in *Marbury v. Madison*, 5 U.S. 137 (1803), the United States Supreme Court held:

> By the Constitution of the United States, the President is invested with certain important political powers, in the exercise of which he is to use his own discretion, and is accountable only to his country in his political character and to his own

> conscience. . . . [B]eing entrusted to the executive, the decision of the executive is conclusive. Questions, in their nature political, or which are by the constitution and laws, submitted to the executive can never be made in this court.

Id. at 165-66.

More recently, in *Philpot v. Haviland*, 880 S.W.2d 550 (Ky. 1994), this Court refused to consider whether the Kentucky Senate was violating Section 46 of the Kentucky Constitution. In relevant part, Section 46 provides that if "a Committee refuses or fails to report a bill submitted to it in a reasonable time, the same may be called up by any member, and be considered in the same manner it would have been considered if it had been reported." A group of senators claimed that Senate Rule 48 violated this constitutional provision. Senate Rule 48 provided that if a member petitioned to call a bill out of committee under Section 46 because it was being held for an unreasonable time, the bill would be considered as if it had been reported by committee only if a majority of senators agreed it had been held in committee for an unreasonable time. *See Philpot*, 880 S.W.2d at 552. Applying the political-question doctrine, the Court refused to consider whether Senate Rule 48 was inconsistent with Section 46 of the Constitution. It held that "the determination of what is a 'reasonable time' in this context, is a matter for the legislature to determine . . . ." *Philpot*, 880 S.W.2d at 553. The Court further held that "[f]or [the courts] to presume to define a 'reasonable time' would result in the judiciary usurping the power of the Senate to determine for itself through its own rules when a committee has failed to report a bill within a reasonable time." *Id.*

Philpot is directly on point. The issue there was whether a Senate Rule was consistent with the requirements of Section 46 of the Constitution. And the issue here is whether the House and Senate Rules about committee substitutes are consistent with the three-readings requirement under Section 46. The issues could not be more analogous. As a result, the rule from *Philpot* should be applied here as well. To do otherwise would do lasting harm to the

Commonwealth's robust separation of powers. As this Court has noted on multiple occasions, Kentucky's separation of powers is "among the most powerful in the country." *Appalachian Racing, LLC v. Commonwealth*, 504 S.W.3d 1, 4 (Ky. 2016) (citing *Legislative Research Commission v. Brown*, 664 S.W.2d 907, 911-12 (Ky. 1984)). "The essential purpose of separation of powers is to allow for independent functioning of each coequal branch of government within its assigned sphere of responsibility, free from risk of control, interference, or intimidation by other branches." *Id.* at 4-5 (quoting *Nixon v. Fitzgerald*, 457 U.S. 731, 760-61 (1982)). For the Court to field the Plaintiffs' three-readings claim would obliterate this principle by allowing the judiciary to supervise and control the functioning of the legislature.

As this Court has held, our government is one of three separate and *coequal* branches. It is *not* a government with three unequal branches, two of which are subordinate to the judiciary. The courts are not the overlords of the other two branches. Under our system of checks and balances, there are undoubtedly many instances in which the courts get the final word on whether legislation or government action complies with the Constitution. And rightly so. But that is not true in all instances. For example, no reasonable person could argue that the Governor's duty under Section 81 of Constitution to "take care that the laws be faithfully executed" gives rise to any justiciable questions. In fact, the United States Supreme Court has held that it would be an "absurd and excessive extravagance" for the courts to attempt to determine whether the President has complied with his identical duty to see that the laws are faithfully executed. *Mississippi v. Johnson*, 71 U.S. 475, 499 (1866). To hold such questions justiciable would elevate the courts to a position of supremacy over another branch. The same is true of the Plaintiffs' three-readings claim.

Nevertheless, the circuit court found that claim to be justiciable. And it did so by illogically comparing the three-readings issue with the 51-votes issue, which is discussed in detail below. As the Governor readily concedes, the 51-votes issue—which was not even properly before the circuit court, and is not properly before this Court—is justiciable because the question of whether a bill received a sufficient number of votes is objectively verifiable and judicially administrable—*i.e.*, the final vote tally can be simply and indisputably determined without showing disrespect to a coordinate branch of government by second-guessing its wisdom or judgment. Relying on this point, the circuit court illogically reasoned that "if the question of whether a particular bill received an adequate number of votes is objective, then the question of whether a bill received an adequate number of readings is also objective." [Tab 1 at 15]. The obvious fault in the circuit court's reasoning is that it did not make an apples-to-apples comparison. Instead, it made an apples-to-oranges comparison.

To understand why this is so, it is essential to note that both the 51-vote requirement and the three-readings requirement involve two separate questions. For the 51-vote requirement, the questions are:

(1) What constitutes a vote?; and

(2) Were there a sufficient number of those things to pass the bill?

For the three-readings requirement, the questions are:

(1) What constitutes a reading?; and

(2) Were there a sufficient number of those things to pass the bill?

Obviously, the first question in both cases is not justiciable. If it were, then this Court would be called upon to determine questions like whether a senator's "aye" was yelled loudly enough to constitute a vote. This would be the height of frivolity, and completely inconsistent with separation of powers. And that question is not at issue in this case. Instead, for the 51-vote issue, only the second question is at issue here—and this question has been held to be justiciable. *See D & W Auto Supply v. Department of Revenue*, 602 S.W.2d 420, 422 (Ky. 1980).

And rightly so. It makes sense that the second question would be justiciable. Unlike the first question, the question of whether a bill received a sufficient number of votes is objectively verifiable and judicially administrable. Moreover, the question does not require the courts to second-guess any judgment calls or discretionary decisions made by the legislature. Thus, determining whether a bill has received a sufficient number of votes does not entail a showing of disrespect to the judgment of a coequal branch of government.

The same analysis holds true for the two identical questions pertaining to the three-readings requirement. The second question is perhaps justiciable, but that question is not at issue here. Instead, unlike the 51-vote requirement, only the first question is at issue with respect to the three-readings requirement. Everyone agrees that three of something happened in each legislative chamber, but the issue is whether those three things were "readings" of SB 151. [*See* Vol. III, R. 346-47]. To put it more simply, the first question under each requirement is a matter that can be open to debate, but once the first question is resolved, the second question is simply a matter of counting. As a result, the first question must be left to the General Assembly as part of its authority to determine its own procedures. *See* Ky. Const. § 39; *see also Philpot*, 880 S.W.2d at 552-54. To determine what constitutes a reading—or what constitutes a vote—would allow judicial intrusion into the legislative process and would be wholly inconsistent with Kentucky's separation of powers.

The circuit court seemed to acknowledge this point when it stated that "[w]hile the judiciary may defer to the legislature on the *mode of reading* . . . the requirement of three readings 'on three different days' is objective and enforceable." [Tab 1 at 15 (emphasis added)]. But the circuit court either failed to acknowledge that it is the "mode of reading"—not the number of readings—that is at issue here, or else it simply ignored this point. Either way, the circuit court was wrong. For the courts to adjudicate the "mode of reading" or the definition of a "reading" would allow the courts to usurp power that does not belong to them. This is obviously inconsistent with the appropriate role of the judiciary in a republican form of government with three separate and *coequal* branches.

The circuit court seemed to base its conclusion—at least in part—on its convictions that only the judiciary can have the final say on whether any constitutional requirement is satisfied, and that the General Assembly cannot possibly be allowed to provide the definitive ruling on a constitutional issue when it is "the very branch accused of violating those constitutional provisions." [Tab 1 at 16]. It is indisputable, however, that some constitutional questions are beyond the scope of what courts can answer. This is the whole point of *Philpot.* Moreover, *Philpot* actually considered the circuit court's point of view and rejected it. *See Philpot*, 837 S.W.2d at 554-55 (Wintersheimer, J., dissenting) ("It is the obligation of this Court to defer to the plain meaning of Section 46 of the Kentucky Constitution. The argument that it is the Senate and not the courts which has the authority to determine when a bill has been held an unreasonable time would have the net effect of nullifying Section 46 of the Kentucky Constitution by placing the Senate in the sole position to interpret the Kentucky Constitution in this regard, thus violating the traditional function of the judicial branch in this respect.").

And this Court is not the only court that has rejected the circuit court's reasoning. In fact, the Mississippi Supreme Court rejected it in a nearly identical case just last year. In *Gunn v. Hughes*, 210 So. 3d 969 (Miss. 2017), the court was confronted with an appeal testing the limits of its "judicial power to review the manner in which the Legislature carries out its procedural constitutional responsibilities." *Id.* at 970. More specifically, the case concerned Article 4, Section 59 of the Mississippi Constitution, which "provides that in the Mississippi Legislature, 'every bill shall be read in full immediately before the vote on its final passage upon the demand of any member.'" *Id.* A state representative sued because he claimed that bills were not actually being read in compliance with the constitutional requirement. *Id.* It appears that the Mississippi Speaker of the House, rather than having an individual read bills out loud in full, would cause bills to be read artificially by an electronic device set at such a high speed "that no human ear nor mind can comprehend the words of the bills." *Id.* at 971. The trial court entered a temporary restraining order against that practice. *Id.* The Mississippi Supreme Court reversed. The court, in words that could have been written about this case if the names were changed, held that:

> By requesting the courts to force Speaker Gunn to read bills in a particular manner, Rep. Hughes seeks to involve the judiciary in legislative procedural matters. The text of our state Constitution that imposes upon the Legislature the obligation to read bills upon a member's request, necessarily commits upon the Legislature the obligation to determine how that requirement will be carried out. So this case must be dismissed, not as a matter of judicial discretion, but because we are without constitutional authority to adjudicate it. The constitutional authority, and duty, to decide the matter lies squarely within the legislative branch of our government.

Id. at 974.

The same reasoning applies here. The three-readings requirement under Section 46 necessarily commits to the General Assembly the obligation to determine how that requirement will be met. The authority to decide this matter lies solely with the legislature. Indeed, this point is even truer here because Section 39 of the Constitution expressly gives the General Assembly the sole authority to determine its own rules of procedure.

B. Regardless of justiciability, the Plaintiffs' "three-readings" claim is unavailing.

Section 46 of the Constitution provides that "[e]very bill shall be read at length on three different days in each House . . . ." Beyond this succinct statement, neither the Constitution nor subsequent case law sets out any requirements regarding the form or contents of a bill when it receives those three readings. Under Kentucky Constitution Section 39, "[e]ach House of the General Assembly may determine the rules of its proceedings." The House of Representatives, both through its Rules of Procedure and custom, has determined that a committee substitute, when passed, is the original bill, and that a bill need only receive the three readings at some point during the legislative process. There is simply no requirement under Kentucky law that a bill "as passed" receive three readings in each chamber.

It is undisputed that SB 151, in some form, received three readings in both legislative chambers. [*See* Vol. III, R. 346-47]. The legislative record shows that SB 151 received its first Senate reading on March 12, 2018; its second Senate reading on March 13; and its third reading on March 16. SB 151 then received its first reading in the House on March 20 and its second reading on March 21. Subsequently, both a committee substitute and a title amendment were passed with respect to the bill, which removed the original wastewater provisions and inserted the retirement system amendments. The bill then received its third reading in the House and passed that chamber. It then passed the Senate, as amended.[17] This procedural history makes clear that SB 151 was read three times in each chamber. The only remaining question, then, is whether SB 151 was required to have three *additional* readings in both chambers after the House passed the committee substitute and title amendment.

As outlined above, this is not a question for the Court to decide. "Such a determination is a political question, which traditionally courts have declined to address in the exercise of proper restraint, and have left to the appropriate branch of government." *Philpot*, 880 S.W.2d at 554. The General Assembly has determined for itself that bills need not receive three readings as finally passed, and this Court should not usurp its authority to so determine.

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[17] The procedural history of SB 151 is detailed in the 2018 Legislative Record, available from the Legislative Research Commission at http://www.lrc.ky.gov/record/18RS/record(14-4-2018).pdf (last visited Aug. 26, 2018).

But even if the Court could appropriately pass on the question, the Plaintiffs have yet another hurdle: there is no reason to believe that the three-reading requirement cannot be satisfied by reading a bill in its then-existing form into the Journal, which is the longstanding practice of the General Assembly. [Vol. IV, R. 569-84]. Contrary to the Plaintiffs' suggestions, there is nothing in the Constitution that requires bills to be read out loud. Nor is there anything in the Constitution that requires a bill to be re-read after it has been amended. Accomplishing the three-reading requirement by reading the title of a bill as it then exists out loud and then reading the bill as it then exists at length into the Journal is consistent with the text of Section 46, as well as the purposes behind Section 46 and the General Assembly's historical practices and interpretation of Section 46.

The General Assembly's practice squares with the purposes behind Section 46 as articulated in the constitutional debates: ensuring that all legislators had access to proposed bills, and that the legislators intended to cast their votes the way they did. As the Plaintiffs have pointed out, the Framers were indeed troubled by various abuses; however, a more thorough reading of the debates demonstrates that the real rub for the Framers was not merely the legislature's choice to pass a bill with haste but with the passing of a bill before the members even had an opportunity to know that they were voting, much less what they were voting on:

> We all know that many abuses exist in legislative bodies in the passage of acts. There are now on the statute books of Kentucky not less than two hundred railroad charters granting the most extraordinary privileges. *Not one of those has been passed upon a call of the yeas and nays*, and yet they involve the interest of the people in every section of the State. There was, in the opinion of the Committee, a very serious abuse of the legislation in the haste with which bills are passed. . . . On one occasion, during the last Legislature, a bill involving large interests, the interests of the people of two large and populous counties, passed through both bodies of the Legislature in

> thirty-five minutes, and was laid before the Executive in a short time after that.
>
> The tenor of that legislation was unknown entirely to almost every person in those two counties, although it involved their interests very materially. It is probable that not more than ten men in the Legislature knew what they were voting on; *yet, if their attention had been called it to by a yea and nay vote the bill would not have been passed.*

3 Debates of Constitutional Convention 3868 (1891) (emphasis added). The severity of the problem at the time is summarized by Delegate Buckner's statement that: "I say that because, on its return to the Legislature, the veto was sustained with unanimity." *Id.* at 3869.

This excerpt makes clear that, prior to 1891, the General Assembly was actually passing bills without legislators knowing what they were voting on—so much so that when the Governor would veto a bill and state his objections, the General Assembly would unanimously sustain that veto, deriving the contents of the bill for the first time from the Governor's objections. *Id.* This is plainly not a problem faced by the 2018 General Assembly, which voted to override multiple gubernatorial vetoes. *See, e.g.*, HB 200; HB 366. Undoubtedly, the Framers' real concern was not with haste, or with the time spent debating legislation, but rather with *access* and with the legislators' abilities to know the subject matter of a bill. Thanks to computer technology and the General Assembly's practice of incorporating the full text of every bill into the Journal, which is available to all legislators at the touch of a computer key, there is simply no access problem in the present day.

More specifically, there was no access problem with SB 151. Just like with all other pieces of legislation, the full text of the committee substitute was available to all members of the House and Senate for their review prior to voting. Moreover, all of the members were thoroughly familiar with SB 1.[18] Indeed, no subject was more heavily debated during the 2018 legislative session than pension reform. All of the legislators in both chambers clearly recognized that casting a vote for SB 151 on March 29, 2018 was a vote in favor of pension reform, and to the extent any individual members felt that they had insufficient time to review the committee substitute's contents [*see* Vol. III, R. 341 (quoting Representatives Greer and Wayne)], those members could choose for themselves whether to vote for or against the bill.

In reality, the General Assembly frequently passes bills the same way as SB 151, and for good reason. By necessity in a part-time citizen legislature, crucial work is accomplished during the final week of the legislative session, and requiring the General Assembly to start the three-readings process over again after every committee substitute or title amendment would hamstring time-sensitive legislative activity. Even the most cursory review of the legislative record for past sessions reveals the flurry of amendments that pass during a session's final days on the Commonwealth's most critical pieces of legislation. The Kentucky Education Reform Act ("KERA")—the most comprehensive overhaul of public education in the nation—was significantly amended over the course of the 1990 legislative session but was never re-read three times in the House and Senate after those amendments. To the contrary, after KERA received its first two readings in the House, thirteen floor amendments were passed, and the bill then proceeded to the Senate where it received two readings before ten additional amendments were passed—not to mention the committee amendments

[18] The Plaintiffs have been quick to quote Representatives Carney and Miller who both emphasized that SB 151 was distinct from SB 1. [*See* Vol. III, R. 336 (quoting Miller as stating "[t]his is not Senate Bill 1")]. The Plaintiffs, however, ignore that the reason SB 151 was "not Senate Bill 1" is that SB 151 removed numerous provisions of the original legislation *at the Plaintiffs' request*—namely, COLA reductions.

incorporated in both chambers throughout the process.[19] A ruling in favor of the Plaintiffs calls the validity of KERA, the most pivotal education legislation enacted in Kentucky's recent history, into serious question. Yet that would be the mere tip of the iceberg.[20]

The Plaintiffs try—unconvincingly—to differentiate the KERA amendments from SB 151's committee substitute and title amendment on the basis that the latter was not germane to the original bill. [Vol. III, R. 335, 348]. The out-of-state case law relied upon by the Plaintiffs is simply not the law of Kentucky. Nowhere in the Constitution, Kentucky case law, or House and Senate Rules of Procedure does it state that the General Assembly must start the three-readings process anew when an amendment that is not "germane" to the original bill passes. Instead, the House Rules of Procedure contemplate both committee substitutes and title amendments, and key laws have been passed after receiving both with support from each side of the aisle. *See* House Rule 60 (contemplating a committee substitute, which "upon its adoption, shall be considered as the original bill" and a title amendment, which "shall be presented to the body immediately after adoption of the bill").[21]

For example, in 2017, the General Assembly passed a committee substitute and title amendment to Senate Bill 12, initially styled "an act relating to responsible real property

[19] The procedural history of KERA, House Bill 940 of the 1990 regular session of the General Assembly, is available from the Legislative Research Commission at http://www.lrc.ky.gov/lrcsearch (last visited Aug. 26, 2018).

[20] Even the circuit court acknowledged what a shock to our tripartite system of government its three-readings ruling would bring. In a footnote, the circuit court declined to consider "under what circumstances amendments may be so minor that the previous readings may be deemed to sufficiently inform the legislature of the bill." [Tab 1 at 11]. Thus, the circuit court envisioned—indeed, invited—future litigation about how much the General Assembly can amend a bill without triggering an obligation to re-start the three-readings process.

[21] The Rules of Procedure for the 2018 Regular Session of the House of Representatives are publicly available from the Legislative Research Commission at http://www.lrc.ky.gov/house/ HouseRules2018.pdf (last visited Aug. 26, 2018).

ownership," and thereby converted the bill to "an act relating to public postsecondary education governance and declaring an emergency."[22] The Plaintiffs may not like the fact that the General Assembly "turn[ed] a dog biting bill into higher education law" [*see* Vol. III, R. 349], but this was a legitimate legislative tactic. And, important for present purposes, SB 12 did not have three new readings in each chamber after the committee substitute and title amendment—same as SB 151. The same tactic was used in 2015 for Senate Bill 192, a bill that originally related to inmate health care. SB 192 ultimately became the bipartisan anti-heroin bill ceremonially signed into law by then-Governor Beshear less than 12 hours after it passed the General Assembly.[23] Like SB 151, SB 192 did not receive three new readings after a committee substitute and title amendment were adopted. The same goes for the 2018 CERS phase-in bill for employer contributions[24]—an essential bill for cities' and counties' solvency—as well as countless other bills passed throughout the Commonwealth's history.[25]

Indeed, this practice has been commonplace in the General Assembly for probably the better part of the last century, and likely longer. [*E.g.*, Vol. IV, R. 583-84 (discussing the 1955 LRC report)]. To declare this practice unconstitutional at this juncture would call into

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22 *See* SB 12, 2017 Legislative Record, *available at* http://www.lrc.ky.gov/record/17RS/record(30-3-2017).pdf (last visited Aug. 26, 2018).

23 *See* SB 192, 2015 Legislative Record, *available at* http://www.lrc.ky.gov/record/15rs/rec_docs.htm (last accessed Aug. 26, 2018); Kerri Richardson & Terry Sebastian, "Gov. Beshear Signs Landmark Anti-Heroin Bill" (Mar. 25, 2015), *available at* http://kentucky.gov/Pages/Activity-Stream.aspx?viewMode=ViewDetailInNewPage&eventID=%7B3B6958E7-F44D-4293-A774-F3670DF3D F24%7D&activityType=PressRelease (last visited Aug. 26, 2018).

24 *See* HB 362, 2018 Legislative Record, *available at* http://www.lrc.ky.gov/record/18RS/HB362.htm (last visited Aug. 26, 2018).

25 Some of those instances are summarized in the record of the consolidated 18-CI-414 matter. [*See* 18-CI-414, Vol. 1, R. 122-Vol. II, R. 159].

question the validity of hundreds, or more likely thousands, of laws. And it is no answer to say that those laws are not at issue here. This Court is the final arbiter of the Kentucky Constitution. While the scores of previous bills passed just like SB 151 might not be directly challenged in the present lawsuit, a ruling in favor of the Plaintiffs would be the yardstick by which all of these previous bills would be measured. It is wishful thinking to suggest that a ruling by this Court in favor of the Plaintiffs would not lead to a bevy of separate challenges to other bills, and there would be no principled way to avoid striking down these other bills. Consistency in the application of the law, after all, is the touchstone of the rule of law. *See, e.g.*, *Trinity Lutheran Church of Columbia, Inc. v. Comer*, --- U.S. --- 137 S. Ct. 2012, 2026 (2017) (Gorsuch, J., concurring) ("[O]ur cases are 'governed by general principles, rather than ad hoc improvisations.'" (citation omitted)).

It is important to note that the Governor does not point out the historical procedures of the General Assembly to suggest that longstanding practices must always be adopted wholesale, or to justify the practice based on nothing more than a "this is the way we have always done it" argument. If the Governor were of that mindset, he would never have insisted on pension reform as part of his platform in the first place, and the Commonwealth's retirement systems would continue down the catastrophic trajectory set for them by decades of previous Kentucky lawmakers and governors. No, the Governor points out the historical procedures of the General Assembly to impress upon the Court the novelty and frivolity of the Plaintiffs' arguments, which call into question innumerable laws on Kentucky's books, including even the "inviolable contract" itself.

The longstanding, unquestioned practices of the General Assembly are legally significant. In *Schardein v. Harrison*, 18 S.W.2d 316 (Ky. 1929), this Court's predecessor held that:

> Legislative or executive construction of constitutional provisions adopted and acted upon with the acquiescence of the people for many years are entitled to great weight with the courts and where not manifestly erroneous it will not be disturbed. The injustice that would inevitably result by the disturbing of such construction after a long period of acquiescence therein, during which many rights will necessarily have been acquired, is a very strong argument against it.

Id. at 320 (quoting 12 C.J. 715).

Tellingly, no Kentucky court has ever found that the General Assembly's standard procedures for reading bills three times, or for reading bills at length, are unconstitutional. Further, the Attorney General himself has not raised any of his sweeping process-based claims until now. When the Attorney General has disagreed with something proposed by the General Assembly in the past, he has not hesitated to write to the legislators to inform them of his interpretation of the Kentucky Constitution. [Vol. I, R. 150-Vol. II, R. 161]. Surely if the Commonwealth's chief law officer perceived the standard procedures of the General Assembly to be unconstitutional, he would have long ago brought his concerns to the General Assembly's attention, rather than sit back and let numerous bills pass under those procedures before speaking up. But, since the start of his tenure in January 2016, the Attorney General has never once challenged the General Assembly's longstanding practice of setting out the full text of bills at length in the Journal, or the longstanding practice of using committee substitutes without re-reading the bill three times in each chamber thereafter.

This, of course, is because there have been no procedural violations of the Constitution. The Attorney General has plainly invented novel theories to make an unprincipled challenge to a single law that he does not like. This is an inappropriate waste of time and resources, and the Court should not disturb the time-tested, constitutional procedures of its sister branch of government. In sum, no violation of Section 46's three-readings requirement occurred. For the Court to find otherwise would be to impose a never-before-seen proscription on the General Assembly—one that infringes on the General Assembly's right to determine the rules of its own proceedings, that violates the Commonwealth's commitment to tripartite government, and that inserts concepts into the Constitution that do not exist.

III. SB 151 neither appropriates money nor creates a debt.[26]

Although the circuit court struck down SB 151 as both an appropriation of money and the creation of a debt that failed to receive 51 votes in favor in the House, the Plaintiffs failed to plead such a claim in their Verified Complaint. It therefore was not properly before the circuit court, and likewise is not properly before this Court. But if the Court nevertheless reaches the merits of this unpreserved claim, it should reverse the circuit court because SB 151 lacks the hallmarks of an appropriation of money or the creation of a debt.

A. The Court should not decide whether SB 151 received the requisite number of votes.

But for the circuit court's advocacy, this Court would not be deciding whether SB 151 is invalid because it only received 49 votes in the House. It is undisputed that the Plaintiffs did not think enough of this claim to plead it in their Verified Complaint. [Vol I, R. 8-40]. The circuit court *sua sponte* raised this issue during a preliminary hearing by taking the extraordinary step of prompting the Attorney General to argue that SB 151 is void because it did not receive 51 votes. [VR 4/19/18; 10:36:45-10:40:45]. Not only that, but the circuit court identified *Fletcher v. Commonwealth*, 163 S.W.3d 852 (Ky. 2005), as the applicable case on the topic and even discussed the passage from *Fletcher* that could apply to invalidate SB 151. [VR 4/19/18; 10:38:04-10:40:30]. The circuit court blandly described this issue as one that "occurred to the Court." [*Id.* at 10:40:40-10:40:45].

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[26] Governor Bevin preserved this issue. [*E.g.*, Vol IX, R. 1221-26; Vol. X, R. 1425-26].

Even after the circuit court's not-so-subtle hint, the Plaintiffs still failed to amend their pleading to raise a 51-vote claim. Instead, they simply asked that they be awarded summary judgment on the basis that trial court told them to brief. [Vol. III, R. 350-53]. There can be little surprise that the circuit court thereafter invalidated SB 151 because it failed to receive 51 votes in the House. [Tab 1 at 23-26]. More specifically, the circuit court struck down SB 151 as contrary to *Fletcher*—the case that the circuit court located for the Plaintiffs. [*Id.* at 24-26]. In sum, the circuit court played both advocate and judge, first identifying the Plaintiffs' claim and case law for them, and then sustaining that claim based upon the case law it identified.

To state the obvious, that is not how litigation, especially of a constitutional dimension, should work. In our adversarial system, the court simply decides the claims pled by the plaintiff, not the claims that the court wishes that the plaintiff had raised. As the Court of Appeals recently explained, "[t]he premise of our adversarial system is that . . . courts do not sit as self-directed boards of legal inquiry and research, but essentially as arbiters of legal questions presented and argued by the parties before them." *Delahanty v. Commonwealth*, --- S.W.3d ---, 2018 WL 2372794, at *8 n.16 (Ky. App. May 25, 2018) (quoting *Carducci v. Regan*, 714 F.2d 171, 177 (D.C. Cir. 1983)) (motion for discretionary review filed). In our system of justice, the plaintiff pleads his claims, the defendant opposes those claims, and the court adjudicates them.

This bedrock tenet of our adversarial system should be especially true in high-stakes litigation between constitutional officers, as here. By statute, the Attorney General is the "chief law officer of the Commonwealth of Kentucky." KRS 15.020. Surely the "chief law officer" does not need a trial court to plead constitutional claims for him and to do legal research for him. The fact that the Commonwealth's "chief law officer" chose not to plead a constitutional claim must have meaning, especially where the Attorney General declined to amend his pleading after the circuit court *sua sponte* raised the issue. This should be doubly true in a case, such as this, where the Attorney General seeks to invalidate a popularly enacted statute. Although this Court has previously allowed the Attorney General to attack the constitutionality of Kentucky statutes, many (correctly) view that as irreconcilable with the Attorney General's statutory duty as the Commonwealth's "chief law officer."[27] Regardless, when the "chief law officer" sues to invalidate a statute that is presumed to be constitutional—a truly extraordinary occurrence—the Judicial Branch should not prosecute the Attorney General's case and do his legal research for him. Rather, the Judicial Branch should decide exactly what the Attorney General pleads and nothing more.

To do otherwise would raise unprecedented separation-of-powers problems. It is well established that Kentucky's separation of powers is among the strictest in the country. *See, e.g.*, *Sibert v. Garrett*, 246 S.W. 455, 457 (Ky. 1922). If this Court invalidates SB 151 based upon a constitutional claim raised by the Judicial Branch and not pled by the Attorney General, the Commonwealth's separation of powers will be a thing of the past, with judicial supremacy taking its place. It is hard to overstate the significance of the Judicial Branch being both an advocate against and the arbiter of the prerogatives of coordinate branches of government. As this Court has held, the judiciary should avoid "creat[ing] a perfect storm, an unprecedented collision of the constitutional powers accorded the three separate branches of government." *Beshear v. Haydon Bridge Co., Inc.*, 416 S.W.3d 280, 296 (Ky. 2013). If the Court affirms the circuit court's 51-vote holding, those words will ring hollow. The perfect storm will be the Court

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[27] In a recent oral argument in the Sixth Circuit, a federal circuit judge expressed disbelief that the Attorney General would not defend a Kentucky statute. *See EMW Women's Surgical Center v. Beshear*, 17-6151, 17-6183, at 16:24-16:34 (6th Cir. July 25, 2018) ("This is kind of weird, isn't it? The Attorney General of the State of [Kentucky], you don't defend the laws of the legislature?"), *available at* http://www.opn.ca6.uscourts.gov/internet/court_audio/aud1.php (last visited Aug. 23, 2018).

invalidating a bill passed by Republican majorities and duly signed by a Republican Governor on a basis not pled by a Democratic candidate for Governor but instead raised by a circuit judge who views it as part of his constitutional oath to rule against the Governor.[28] This will mix law and politics in the public's mind. The Court should be loath to let the judiciary's legitimacy be harmed by one circuit judge's advocacy.

The Attorney General likely will argue in response that the Court has discretion to decide a constitutional issue that he failed to plead. He will cite cases like *Elk Horn Coal Corp. v. Cheyenne Resources, Inc.*, 163 S.W.3d 408, 424 (Ky. 2005), and *Parker v. Webster Cnty. Coal, LLC*, 529 S.W.3d 759, 770 (Ky. 2017). These cases, of course, did not involve the Court giving the "chief law officer" a constitutional win on an issue he did not plead. Moreover, *Elk Horn Coal* recognized that "[a]s a general rule, a court will not inquire into the constitutionality of a statute . . . on its own motion, but only those constitutional questions which are duly raised and insisted on, and are adequately argued and briefed will be considered." 163 S.W.3d at 424 n.73 (citation omitted). In the past, when this Court has invalidated a statute on a basis it raised *sua sponte*, it generally has done so only on an alternative basis for striking down the statute. *See id.* at 411-24 (invalidating statute on two alternative grounds); *Parker*, 529 S.W.3d at 770 (same); *see also Delahanty*, 2018 WL 2372794, at *7 ("Only after the Kentucky [Supreme] Court [in *Elk Horn Coal*] decided the constitutional issue posed by the parties . . . did it take up the [unpreserved] issue."). Here, however, if the Court rejects all of the Attorney General's claims but sustains the unpreserved 51-vote claim, it will strike down a popularly enacted statute on

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[28] The circuit court has publicly stated in a newspaper interview that he views his job as "to serve as a check and a balance on the exercise of government power." *See* Rosalind Essig, "Judge Philip Shepherd named SJ Newsmaker of the Year," *The State Journal*, (Dec. 31, 2016), *available at* https://m.state-journal.com/2016/12/31/judge-phillip-shepherd-named-sj-newsmaker-of-the-year/ (last visited Aug. 24, 2018). That sentiment evidences a dangerous misunderstanding of the Commonwealth's separation of powers.

a basis that the trial court raised and essentially briefed for the Attorney General. The Court should not take this momentous step and instead should hold—simply—that the Plaintiffs are limited to the claims pled in their Verified Complaint, just the same as any ordinary plaintiff.

B. SB 151 is not an act for the appropriation of money.

But even if this Court were to somehow look past the lack of preservation and consider the merits of the 51-vote claim—which it should not do—it should nonetheless find the claim to be unavailing. A bill normally passes the General Assembly if it receives the votes of "at least two-fifths of the members elected to each House, and a majority of the members voting." Ky. Const. § 46. The Constitution establishes an exception for an "act or resolution for the appropriation of money," which must receive "the votes of a majority of all the members elected to each House." *Id.* This means that an "act or resolution for the appropriation of money" must receive at least 51 votes in the House. The House passed SB 151 by a vote of 49-46. Thus, the question raised by the circuit court is whether SB 151 is an "act or resolution for the appropriation of money" under Section 46. It is not for the reasons that follow.

The textbook case on whether a bill qualifies as an "appropriation of money" is *D & W Auto Supply v. Department of Revenue*, 602 S.W.2d 420 (Ky. 1980). There, the House passed the Litter Control Act by a vote of 48-43—short of the 51 votes required for an "appropriation of money." *Id.* at 421-22. The Litter Control Act, which aimed to reduce litter and littering, gave enforcement power to the Department for Natural Resources and Environmental Protection ("the Department"). *Id.* at 421. To fund the Department's efforts, the Act imposed an assessment on "those industries whose products are 'reasonably related to the litter problem.'" *Id.* Important for present purposes, the Act specifically directed that the assessment, once collected, be disbursed to the Department from the State Treasury so that it could implement the Act. *Id.* at 422.

The *D & W* Court concluded that the Litter Control Act violated Section 46. *Id.* In framing the question of whether the Litter Control Act was an "appropriation of money" under Section 46, the Court relied on two sources. The Court first identified the "legislative definition" of an appropriation, which is "an authorization by the general assembly to a budget unit to expend, from public funds, a sum of money not in excess of the sum specified, for the purposes specified in the authorization . . . ." *Id.* (quoting KRS 45.010(2)). The General Assembly has recodified an analogous definition in KRS 48.010(3)(a). The *D & W* Court next cited the "judicial definition" of an appropriation from *Davis v. Steward*, 248 S.W. 531, 532 (Ky. 1923), which is "the setting apart of a particular sum of money for a specific purpose." *Davis* itself gave meaning to this definition by quoting the appropriation at issue:

> That there be and now is appropriated out of any unappropriated moneys in the treasury of the commonwealth, the sum of six thousand ($6,000.00) dollars for the purpose of improvements to the buildings and grounds of the West Kentucky Industrial College, and to said institution an annual appropriation of fifteen thousand ($15,000.00) dollars for the support and maintenance thereof.

Id.

Both the legislative and judicial definitions of an appropriation on which *D & W* relied share three essential characteristics: (i) giving a budget unit (ii) a specified sum of money from the State Treasury (iii) for a specified purpose. The *D & W* Court found that the Litter Control Act checked all three of these boxes. The Act, the Court reasoned, "specifically directs the Department of Revenue to collect and disburse the monies from a fund 'within the state treasury' to implement the purposes of the Act." 602 S.W.2d at 422. Note the Court's careful language: the Litter Control Act was an "appropriation of money" because the Act "specifically directs" (i) the "disburse[ment]" (ii) of monies from the "state treasury" (iii) so that the Department can "implement the purposes of the Act." *See id.*

D & W stood on solid historical ground when it pegged Section 46 to whether a statute allows a budget unit to take a specified sum of money from the State Treasury for a specified purpose. In the 1890-1891 constitutional debates, Delegate Spalding described his view as: "You cannot pass an appropriation bill through the General Assembly without a majority of all the members elected, and the minority cannot absent themselves, or not vote. Why is that? It is a wise provision *to protect the Treasury*." 2 Debates of Constitutional Convention 1655 (1890) (emphasis added). Delegate Rodes agreed that what became Section 46 is a Treasury-protecting measure, arguing that "a full purse and no expenses indicate a prosperous condition of affairs; but, as the money leaks out; as the sluiceways are open, and *the treasury is emptied*, we feel it." 3 Debates of Constitutional Convention 3861 (1891) (emphasis added). The debates thus confirm what *D & W* later held: Section 46 concerns legislation that allows an agency to withdraw a specified sum of money from the State Treasury for a specified purpose.

Judged by this standard, SB 151 is not an "appropriation of money." SB 151 does not give a specified sum of money to a budget unit from the State Treasury to spend for a specified purpose. The easiest way to think about this issue is to ask whether a budget unit can take SB 151 to the State Treasury and withdraw public money. There can be no dispute about this issue. SB 151 does not authorize a budget unit to take money from the State Treasury. Those who administer the Commonwealth's appropriations process have sworn under oath to this fact. The Department of the Treasury has attested in an affidavit that "our office would not be authorized to withdraw public money from the Treasury based solely on the provisions of SB 151 because that bill does not establish a revolving fund and does not appropriate any money." [Vol. VIII, R. 1137-38]. The Office of the State Budget Director agrees that "SB 151 does not authorize the expenditure of funds from the State Treasury." [Vol. VIII, R. 1135]. The Plaintiffs have adduced no proof to the contrary because none exists. In sum, those who handle Kentucky's appropriations process unanimously agree that if a budget unit asked the State Treasury for money based upon SB 151, the budget unit would come away empty handed. That is dispositive under *D & W*. 602 S.W.2d at 422 (holding that the statute "disburse[d] the monies from a fund 'within the state treasury'").

The circuit court ignored this core holding of *D & W* and collected several provisions of SB 151 that it viewed as "appropriation[s] of money." [Tab 1 at 25-26; Tab 2 at 6-9]. Those provisions essentially fall into four categories: (i) provisions changing the eligibility criteria for receiving a retirement allowance[29]; (ii) provisions mandating employee contributions to a retirement system[30]; (iii) provisions related to employer contributions to a retirement system[31]; and (iv) a provision related to level-dollar funding.[32]

Taking each in turn, under no circumstances can SB 151's changes to the eligibility criteria for receiving a retirement allowance be considered an "appropriation of money." In concluding otherwise, the circuit court cited Sections 16 and 17 of SB 151 [Tab 2 at 7], which limit the ability of certain KERS, SPRS, and CERS members to use unused sick leave to determine eligibility for a retirement allowance. SB 151, §§ 16(4), 17(3)(e) & 5(d). These provisions, however, in no way give a specified sum of money to a budget unit from the State Treasury for a specified purpose, as in *D & W*. If Sections 16 and 17 of SB 151 are an "appropriation of money," so is nearly everything the legislature passes.

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[29] The provisions in this group are Sections 16 and 17 of Senate Bill 151. [Tab 2 at 7].

[30] The provisions in this group are Section 47 and 57 of Senate Bill 151. [Tab 1 at 26].

[31] The provisions in this group are Sections 9, 12, 14, 15, 18, 19, 20, 43, 45, 47, 52, 63, and 77. [Tab 1 at 25-26; Tab 2 at 6-9].

[32] The single provision in this group is Section 14 of Senate Bill 151. [Tab 2 at 6].

The circuit court next concluded that Sections 47 and 57 of SB 151 are an "appropriation of money" [Tab 1 at 26], even though the cited portions relate to employee contributions. *See* SB 151, §§ 47(5)(a)(1), 57(1)(a)-(b). The circuit court offered no explanation for this conclusion. The referenced parts of Sections 47 and 57 deal with employees' money, not the Commonwealth's. It should go without saying that an "appropriation of money" is made by the General Assembly, not by an employee.

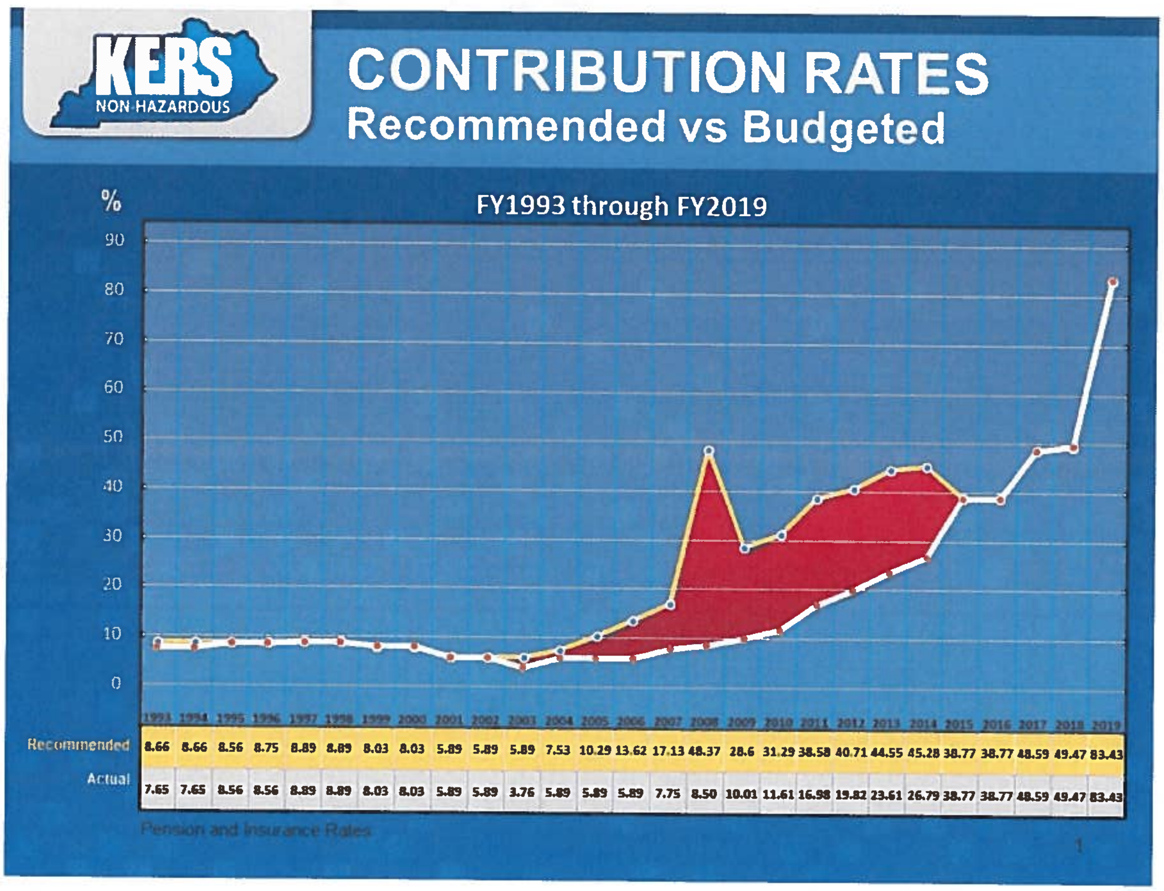
The circuit court also concluded that the parts of SB 151 that concern employer contributions to the retirement systems constitute an "appropriation of money." [Tab 1 at 25-26; Tab 2 at 6-9]. For example, the circuit court identified Section 18 of SB 151 as an alleged "appropriation of money" because it states that employers "shall contribute" to KERS, SPRS, or CERS an amount that is "determined by the actuarial valuation completed in accordance with KRS 61.670 and as specified by this section." SB 151, § 18(1)(a). The circuit court also relied upon Section 43 of SB 151, which sets an "employer pay credit" for KTRS's hybrid cash balance plan, as well as Section 63 of SB 151, which establishes a "base permanent employer contribution" to KTRS. SB 151, §§ 43(2)(b), 63(1)(a). Provisions such as this, the circuit court reasoned, are "appropriation[s] of money" because they "directly specify the amount of state tax dollars that must be set aside to fund the retirement system, in the form of employer contributions . . . ." [Tab 2 at 9].

Respectfully, every single word of this holding is demonstrably wrong. For the 2018-2020 biennium, the bill that—to quote the circuit court— "set[s] aside [monies] to fund the retirement system, in the form of employer contributions" is *not* SB 151. The bill that does this for KERS, SPRS, and KTRS is the executive-branch budget bill—House Bill 200. For KERS and SPRS, Part IV(5) of House Bill 200 appropriates the money that goes to public agencies to pay employer contributions to KERS and SPRS. For KTRS, the two appropriations that become employer contributions are the actuarially defined employer contribution in Part I(A)(28) of House Bill 200 and the employer match in Part I(C)(8) of House Bill 200. It is quite literally impossible to conclude, as the circuit court did, that SB 151, rather than the cited aspects of House Bill 200, appropriates the money that ultimately becomes employer contributions to KERS, SPRS, and KTRS.

For CERS, the issue is even clearer. Generally speaking, it is cities and counties, as opposed to the General Assembly, that make the appropriations that become employer contributions to CERS. These appropriations do not come from the State Treasury, but instead from city and county fiscs. The circuit court nevertheless concluded that SB 151 is an "appropriation of money" to CERS even though it is not funded by money from the State Treasury and is not funded by acts of the General Assembly. Perhaps better than anything else, the circuit court's conflation of the State Treasury with local government treasuries shows just how far the circuit court overreached to sustain the Section 46 claim that it raised *sua sponte*.

All of this is a long way of saying that the employer-contribution provisions of SB 151 are not an "appropriation of money." So what role does SB 151 play in the appropriations process? After all, as the circuit court noted, various sections of SB 151 specify employer-contribution percentages (Sections 43 and Section 63) or methods for calculating employer contributions (Section 18). The short answer to this question is that SB 151's employer-contribution provisions essentially operate as a revised formula or calculator for establishing *recommended* employer contributions to retirement plans going forward. For all of the plans except CERS, the General Assembly, in its discretion, can choose through the budget bill to fund or not to fund the employer contributions calculated by SB 151. *Commw., ex rel. Armstrong v. Collins*, 709 S.W.2d 437, 443 (Ky. 1986) ("We have emphasized the obvious, *viz*, that the

General Assembly may also *suspend or modify* existing statutes in a budget bill."). This is done as a matter of course in the budget bill by what is commonly referred to as "notwithstanding" various Kentucky statutes. *See Jones*, 910 S.W.2d at 713 ("To achieve its determination that contribution rates should remain constant from the previous year, the General Assembly temporarily suspended KRS 61.565 which allows the Board to set contribution rates."). This commonsense point is shown by the below graph, which shows historical contribution rates, both recommended and budgeted, for the KERS Non-Hazardous plan.



SB 151 affects the yellow line (the *recommended* employer contribution) but not the white line (the actually *appropriated* employer contribution). The white line, of course, shows employer contributions that are made following an "appropriation of money" under Section 46—*i.e.*, the executive-branch budget. Under no circumstances, however, can the yellow line of recommended employer contributions, like those from SB 151, be an "appropriation of money," in light of the General Assembly's discretion to determine the actual employer contributions through the executive-branch budget. Proof positive of this discretion is former Governor Beshear's consecutive, three-time failure to sign a budget that fully funded the recommended employer contributions to the Commonwealth's public pensions.[33] The takeaway is this: If the circuit court were correct that the employer-contribution provisions of the Commonwealth's public pension system are in fact "appropriation[s] of money," the Commonwealth would not have grossly underfunded its retirement plans over the past decade because the employer-contribution provisions would have mandated full funding. The reality is that Governor Beshear was able to underfund the retirement plans precisely because the employer-contribution provisions of the pension statutes *are not appropriations*. Thus, the only answer needed to the circuit court's appropriations argument is the historical disparity between the white and yellow lines in the above graph.

In fact, that was the whole point of the *Jones* case, which explicitly differentiated between recommended employer contributions and appropriations that become employer contributions. There, as discussed above, the Kentucky Retirement Systems Board of Trustees recommended a higher rate of employer contributions than the General Assembly was willing to put in the budget. *Jones*, 910 S.W.2d at 712. The Board sued, claiming that the budget bill "usurped the authority of the Board to act independently to set actuarially sound employer contribution rates." *Id.* The Court found that the General Assembly has discretion to set employer contributions regardless of what is recommended. *Id.* at 714 ("Inasmuch as the

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[33] In the 2012 budget, for example, then-Governor Beshear and the General Assembly declined to fund the recommended employer-contribution amounts by "notwithstanding" the applicable statutes. *See* H.B. 265, Part IV(8) (2012) ("Notwithstanding KRS 61.565 and 61.702 the employer contribution rates for Kentucky Employees Retirement Systems from July 1, 2012, through June 30, 2013, shall be . . . .").

General Assembly may set rates of contribution that differ from those recommended by the Board, it also possesses the power to suspend current statutes to accomplish the task."). *Jones* therefore serves as a complete rebuttal to the circuit court's appropriations holding about recommended employer contributions.

The circuit court also concluded that Section 14 of SB 151 is an "appropriation of money" because it defines the term "level dollar amortization method" in KRS 61.510. [Tab 2 at 6-7]. According to the circuit court, "the 'level dollar funding' method of retiring the current unfunded liability in these funds would be meaningless without the bill's requirement for specific annual contributions to the retirement of this deficit." [*Id.* at 9]. This reasoning cannot stand up to scrutiny. Level-dollar funding is not an "appropriation of money" for the same reason, explained above, that the employer-contribution provisions of SB 151 are not an "appropriation of money." With respect to level-dollar funding, SB 151 merely operates as a formula or calculator to recommend annual amortization payments, which the General Assembly can "notwithstand" in the budget. The operative point is that the General Assembly decides how much to appropriate independent of what SB 151 recommends, as the General Assembly has done for the current biennium in House Bill 200. The annual amortization payments for KERS and SPRS are included in Part IV(5) of House Bill 200, whereas the actuarially defined employment contribution for KTRS is in Part I(A)(28) of House Bill 200.

In light of the above discussion, there can be no doubt that the circuit court unmoored Section 46's "appropriation of money" clause from its established meaning, as confirmed by the constitutional debates and *D & W*. If this Court affirms the circuit court's expansive view of an "appropriation of money," the Court will altogether change the way that the People's work is done in Frankfort. This will happen in at least two ways.

First, expanding the scope of "appropriation of money" will make it much harder for the General Assembly to operate in odd-numbered years. Section 36 of the Constitution states, in relevant part: "In any part of the session in an odd-numbered year, no bill raising revenue *or appropriating funds* shall become a law unless it shall be agreed to by three-fifths of all the members elected to each House." Ky. Const. § 36 (emphasis added). Thus, in the upcoming 2019 legislative session, the House and Senate can only pass a "bill . . . appropriating funds" if 60 members and 23 members, respectively, agree. If an "appropriation of money" now includes bills that do not appropriate money from the State Treasury, as the circuit court held, Section 36's super-majority requirements will become much more meaningful in the upcoming session, perhaps hamstringing the General Assembly's ability to pass necessary legislation and, more importantly, calling into question past legislation.

As an example of past legislation that would be subject to challenge as a "bill . . . appropriating funds" that did not receive 60 votes in the House, consider Senate Bill 2 from the 2013 legislative session. SB 2, the Court will recall, was the Commonwealth's previous attempt at pension reform. That bill, however, initially passed the House by a vote of 55-45, short of the 60 votes required by Section 36. If SB 151 is an "appropriation of money," so is SB 2. This simple point demonstrates, perhaps better than anything else, the enormous stakes of a ruling by this Court that SB 151 qualifies as an "appropriation of money" under Section 46. Consequently, if SB 151 is struck down as an "appropriation of money," any current Tier III member created by SB 2, of which there are approximately 50,000, will be incentivized to sue about SB 2 so as to secure Tier II benefits. The consequences of such a follow-on lawsuit are unthinkable.

Second, the circuit court's expansive reading of "appropriation of money" also substantially increases the line-item veto power of the Governor. Under Section 88 of the

Constitution, "[t]he Governor shall have the power to disapprove any part or parts of *appropriation bills* embracing distinct items, and the part or parts disapproved shall not become a law unless reconsidered and passed, as in case of a bill." Ky. Const. § 88 (emphasis added). If the meaning of "appropriation of money" now includes bills that do not in fact appropriate a specified sum of money from the State Treasury for a specified purpose, then the Governor and his successors will have expanded line-item veto powers, including over bills that extend beyond the upcoming biennium. This is a meaningful new power for the Governor to rewrite general bills to his or her liking. Under the paradigm created by circuit court, for example, Governor Bevin could have exercised his line-item veto over SB 151. Although the Governor appreciates the circuit court's gesture and will gladly use this newfound power if the Court affirms on this point, the meaning of "appropriation of money" in Section 46, which has been settled since 1890 and was reaffirmed in *D & W*, should not change.

C. *Fletcher* is beside the point.

The circuit court rested its expansive reading of Section 46's appropriations clause on *Fletcher v. Commonwealth*, 163 S.W.3d 852 (Ky. 2005). *Fletcher*, however, did not even consider Section 46 of the Constitution and arose in an emergency situation that truly was *sui generis*. *Fletcher* therefore cannot bear the enormous weight that the circuit court placed upon it.

In 2004, the General Assembly failed for the third time in a short span of years to pass a biennial budget in a regular session, leaving then-Governor Fletcher in the extraordinary position of deciding what expenditures of public money, if any, could be made to keep the government running. *Id.* at 856-58. The issue in *Fletcher* was not Section 46 of the Constitution, but instead Section 230, which states that "[n]o money shall be drawn from the State Treasury, except in pursuance of appropriations made by law." Ky. Const. § 230. *Fletcher* interpreted Section 230 to allow the Governor to order limited statutory expenditures in the absence of a budget bill—what the Court termed "self-executing appropriations." *Id.* at 865-66. The Court reasoned that "[w]here the General Assembly has mandated that specific expenditures be made on a continuing basis, or has authorized a bonded indebtedness which must be made, such is, in fact, an appropriation." *Id.* at 865. When this occurs, the General Assembly, according to *Fletcher*, has "delegated its constitutional power of appropriation to the executive department." *Id.* This delegation rationale was the linchpin of *Fletcher*'s holding.

After announcing this delegation rule, *Fletcher* listed four statutes that, in the Court's view, "mandate appropriations even in the absence of a budget bill." *Id.* This case has focused exclusively on *Fletcher*'s inclusion of a single pension-related statute in that list. Without any substantive discussion, *Fletcher* identified KRS 61.565(1) (2005) as a self-executing appropriation, which stated that "[e]ach employer participating in [SPRS] . . . and each employer participating in [KERS] . . . shall contribute annually to the respective retirement system . . . ." *Id.* (quoting KRS 61.565(1) (2005)). According to the circuit court, *Fletcher*'s decision to characterize KRS 61.565(1) (2005) as a self-executing appropriation is dispositive of the 51-vote issue. [Tab 1 at 24-25]. This argument fails for at least three reasons.

First, and most obviously, *Fletcher* concerned Section 230 of the Constitution. Section 46 was not implicated in any way. *Fletcher* did not even cite this Court's well-known decision in *D & W*—the paradigmatic case about Section 46's appropriations clause. This is significant because, as summarized above, *D & W* went to great lengths to trace how the term "appropriation" has been understood historically, 602 S.W.2d at 422—a point that could have mattered to *Fletcher* given that Section 230 also uses the term "appropriation." If *Fletcher* thought that *D & W*'s analysis of Section 46 was relevant for purposes of Section 230, *Fletcher* would have said so. But *Fletcher* did not mix and match constitutional provisions.

With good reason. Sections 46 and 230 use the word "appropriation" differently—"appropriation of money" in Section 46 versus "appropriation[] made by law" in Section 230. By using the qualifier "of money" after the term "appropriation," Section 46 places more emphasis on whether the General Assembly has made a direct authorization to spend a specified sum of money out of the State Treasury. *See D & W*, 602 S.W.2d at 422 (noting that the statute "specifically directs" the disbursement of "monies from a fund 'within the state treasury'"). This is a natural distinction given that Section 46 focuses on the number of votes needed in the General Assembly for an "appropriation of money" to be valid. Section 230's "appropriation[] made by law" language, by comparison, focuses more on whether the law allows money to come out of the State Treasury. This is consistent with *Fletcher*'s discussion of whether the General Assembly delegated its power to order an appropriation to the Executive Branch. *Fletcher*, 163 S.W.3d at 865. The different language in Sections 46 and 230, then, connotes different meanings or at least different emphases, as *Fletcher* itself recognized by reiterating that "[t]he basic rule . . . is to interpret a constitutional provision according to what was said and not what might have been said." *See id.* at 863 (citation omitted).

Moreover, *Fletcher*'s test for a self-executing appropriation is markedly different from *D & W*'s test for an "appropriation of money." As summarized above, *D & W* asks whether a statute gives a budget unit authority to withdraw a specified sum of money from the State Treasury for a specified purpose. 602 S.W.2d at 422. *Fletcher*, by contrast, asks, if no budget exists, whether the General Assembly has "mandated that specific expenditures be made on a continuing basis" such that the Governor can order an appropriation. 163 S.W.3d at 865; *see also id.* at 874. Putting *D & W*'s and *Fletcher*'s tests side by side confirms that *Fletcher* created a constitutional test that is both unique to Section 230 and different from the analysis under Section 46. The Court should keep Sections 46 and 230 separate, as *Fletcher* did.

Second, *Fletcher* does not apply here because the exigencies that drove its analysis—the lack of an executive-branch budget—are not present here. *Fletcher* arose in the precarious situation of a Governor trying to keep the Commonwealth running in the absence of an executive-branch budget. *Fletcher* simply asked what a Governor can do in this situation. As the *Fletcher* Court summarized, "[o]n three occasions within a ten-year period, the General Assembly convened itself into a partisan deadlock and adjourned *sine die* without enacting an executive department budget bill." *Fletcher*, 163 S.W.3d at 859. In fact, *Fletcher* expressly conditioned its constitutional analysis on the fact that this deadlock could happen again because, by the time the case was decided, the General Assembly had enacted a budget and ratified the Governor's spending plan. *Id.* The Court emphasized the lack of "assurance that similar partisan brinkmanship will not recur in the General Assembly, resulting in future gubernatorially promulgated budgets." *Id. Fletcher*, then, is a roadmap for future Governors about how to navigate the lack of a budget. *Fletcher* is not, and does not claim to be, a case that applies when the General Assembly has passed a budget in the ordinary course, nor is it a case that defines the circumstances when a bill is required to receive 51 votes in the House.

Fletcher's language and reasoning demonstrate that it does not apply when the General Assembly has passed an executive-branch budget. To begin with, the sentence of *Fletcher* that has drawn so much attention in this case—the one identifying a pension-related statute as a self-executing appropriation—clearly states that "[t]here are statutes that mandate appropriations *even in the absence of a budget bill*." *Id.* at 865 (emphasis added). The italicized language expressly acknowledges the limited scope of *Fletcher*'s holding. Perhaps more importantly, *Fletcher* talked about self-executing appropriations in terms of a delegation to the Executive Branch of the legislature's "constitutional power of appropriation to the executive department." *Id.*. When the General Assembly fails to pass a budget, *Fletcher* reasoned, that delegation becomes operative. That is to say, a legislature that fails to pass a budget leaves it to the Executive Branch to direct agencies to take money from the State Treasury where "the General Assembly has mandated that specific expenditures be made on a continuing basis." *Id.* Logic dictates that the opposite must also be true: When the legislature has passed a budget, its delegation of authority is not operative, and the Executive Branch *cannot* exercise the delegated power of appropriation. *See id.* The upshot is that where a budget has been passed, as here, it does not matter whether some aspect of pension reform could mandate a self-executing appropriation. In other words, a self-executing appropriation, as discussed in *Fletcher*, is not an "appropriation of money" as contemplated in Section 46 of the Constitution, but rather a delegation of authority to make an appropriation in the absence of a budget. In fact, it follows from *Fletcher* that, where a budget bill has been passed, the Governor lacks the authority to use self-executing appropriations because the delegation of authority has been overridden. The General Assembly instead has retained that power for itself. Another way to think about this is that KRS 61.565(1) (2005) is not itself a self-executing appropriation. Instead, it is a bill that delegates the constitutional power of appropriating money to the Governor if the General Assembly fails to pass a budget. *Fletcher*, 163 S.W.3d at 865.

Third, *Fletcher* should not govern because its conclusion that KRS 61.565(1) (2005) is a self-executing appropriation is not actually supported by the text of that statute. As mentioned above, *Fletcher* identified four statutes as self-executing appropriations. *Fletcher*, 163 S.W.3d at 865. *Fletcher* offered no rationale for why these four statutes qualified as such; its analysis on this point, respectfully, gets very close to *ipse dixit.* However, a careful analysis of the four statutes reveals that the lone pension-related statute is wholly unlike the other three statutes in one important respect: the other three statutes expressly mention appropriations, paying funds out of the State Treasury, or both. *See* KRS 18.A.015(2) (2005) ("Appropriations shall be made from the general expenditure fund . . . ."); KRS 44.100 (2005) (discussing paying amounts "out of the general fund of the Commonwealth, upon warrants drawn by the secretary of the Finance and Administration Cabinet upon the State Treasurer"); KRS 45A.275 (2005) (allowing payments "approved by the Finance and Administration Cabinet and paid by the State Treasurer" and stating that "[a]ppropriations for these judgments shall be continued appropriations"). The pension-related statute identified by *Fletcher*, by contrast, does not mention either appropriations or the State Treasury. *See* KRS 61.565(1) (2005) ("Each employer participating in [SPRS] . . . and each employer participating in [KERS] . . . shall contribute annually to the respective retirement system . . . ."). *Fletcher* did not deal with this glaring difference among the statutes, or grapple with the difficulty of characterizing as a self-executing appropriation a statute that mentions neither appropriations nor the State Treasury. Also, if a statute that mentions neither topic can be an "appropriation[] authorized by law," so can a lot of other Kentucky statutes. This conflicts with *Fletcher*'s limitation of its holding that there are "other[]" self-executing appropriations "but they are substantially less than legion." *Fletcher*, 163 S.W.3d at 865. At a minimum, the fact that KRS 61.565(1) (2005) did not mention appropriations or the State Treasury is reason enough to confine *Fletcher* to a situation where a new fiscal year has begun but there is no budget bill. At most, this justifies reconsidering *Fletcher* to the limited extent it may have held that a pension-related statute that merely discusses employer contributions is a self-executing appropriation for all purposes.

D. SB 151 does not create a debt.

The circuit court also held that SB 151 creates a debt [Tab 1 at 26-27], thus requiring 51 votes in favor in the House. *See* Ky. Const. § 46 ("Any act or resolution for . . . the creation of debt shall, on its final passage, receive the votes of a majority of all the members elected to each House."). The circuit court did not cite any provisions in SB 151 that it viewed as the "creation of a debt." [Tab 1 at 26-27]. Nor did the circuit court cite any case law on the topic. [*Id.*]. Perhaps that is because the Attorney General did not plead such a claim in his Verified Complaint or even request summary judgment on the basis that SB 151 creates a debt. [Vol. I, R. 8-40; Vol. III, R. 350-53; Vol. IX; R. 1287-93]. In any event, the circuit court's slipshod reasoning on this point should be summarily rejected.

The circuit court reasoned that SB 151 creates a debt simply because "the Governor has repeatedly referred to the pension program as an 'unfunded liability.'" [Tab 1 at 26]. This is not a serious argument. The fact that the Commonwealth's retirement plans have been chronically underfunded over time, thus creating a breathtaking unfunded liability, does not mean that the legislative response to the unfunded liability *creates a debt.* Generally speaking, a debt in the constitutional sense arises from the General Assembly authorizing the borrowing of money under Sections 49 and 50 of the Constitution. *See, e.g.*, *Stanley v. Townsend*, 186 S.W. 941, 945 (Ky. 1916). Because SB 151 does not authorize the Commonwealth to borrow money, SB 151 does not create a debt.

E. If SB 151 required 51 votes in the House, any offending provisions should be severed.[34]

If the Court concludes that SB 151 received three readings but concludes that part of the bill is an "appropriation of money" or "the creation of a debt," the Court should sever the offending provisions and leave the remainder of the bill intact. "It is a well-established rule that portions of a statute which are constitutional ma[y] be upheld while other portions are eliminated as unconstitutional." *Ky. Mun. League v. Commw. Dep't of Labor*, 530 S.W.2d 198, 200 (Ky. 1975). Kentucky has a general severability statute, KRS 446.090, that has been applied numerous times to preserve constitutional portions of statutes. *See Ky. Mun. League*, 530 S.W.2d

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[34] The Governor preserved this issue. [Vol. XIII, R. 1841, 1888-91].

at 200 (collecting cases). KRS 446.090 requires the Court to leave intact the constitutional parts of a bill unless they are "essentially and inseparably connected with and dependent upon the unconstitutional part" or unless "the remaining parts, standing alone, are incomplete and incapable of being executed in accordance with the intent of the General Assembly."

The Commonwealth's general severability statute is the norm, but the General Assembly, of course, is allowed to change or supplement that norm by including a severability clause that is specific to a bill, as it has done in SB 151. Section 89 of SB 151 states as follows:

> If any section, any subsection, or any provision of this Act is found by a court of competent jurisdiction in a final, unappealable order to be invalid or unconstitutional, the decision of the court shall not affect or impair any of the remaining sections, subsections, or provision of this Act.

SB 151, § 89. Unlike the general severability statute, SB 151's severability clause does not ask whether the severed provisions are essential to the bill or whether the bill can function without the severed provisions. Rather, in SB 151, the General Assembly demonstrated its intent that all constitutional aspects of the bill be enforced as written regardless of which provisions are severed from it and their importance to the overall bill. It is then up to the legislature to respond to any deficiencies in SB 151 created by the Court's ruling.

The circuit court flouted this clear instruction by applying KRS 446.090 and not even mentioning SB 151's severability clause. [Tab 2 at 5-6, 10; *see also* Vol. XIII, R. 1890 (identifying Section 89 for the circuit court)]. This was improper. *See Travelers Indem. Co. v. Reker*, 100 S.W.3d 756, 763 (Ky. 2003) ("[W]hen two statutes are in conflict, one of which deals with the subject matter in a general way and the other in a specific way, the more specific provision prevails."). The General Assembly has unequivocally directed that the constitutional parts of SB 151 must stand regardless of what part or parts this Court strikes down. That is a legislative judgment that the Court cannot ignore, especially in light of Kentucky's strict separation of powers.

Consequently, if the Court reverses the circuit court's three-readings holding, as it should, but nevertheless finds that part of SB 151 constitutes an "appropriation of money" or the "creation of a debt," the Court should apply Section 78's severability clause much like a line-item veto and strike the offending "sections, subsections, or provisions"[35] so that everything else can be enforced. If this process creates enforceability problems, the legislature can fix the severed statute as needed.

Even if the Court concludes that KRS 446.090 applies rather than Section 89 of SB 151, the Court should still sever any offending provisions and uphold the remainder of the statute. In refusing to do this, the circuit court found that "the entire bill is dependent upon" the employer-contribution provisions and level-dollar funding. [Tab 2 at 9]. But, for the 2018-2020 biennium, the General Assembly *has already appropriated the amounts that ultimately will fund the retirement plans. See* H.B. 200, Parts I(A)(28), (C)(8) & IV(5). Moreover, level-dollar funding will not apply in this biennium. *See, e.g.*, SB 151, §§ 18(1)(c), 63(1)(e). Thus, until June 30, 2020, the employer-contribution and level-dollar funding provisions in SB 151 will have no effect whatsoever. That is to say, during that time, SB 151 will operate without any problems if the employer-contribution and level-dollar funding provisions are severed. As an example, the new hybrid cash balance plan for new teachers—one of SB 151's most important reforms—can operate just fine during the remainder of this biennium. Moreover, between the time of the Court's ruling and June 30, 2020, the General Assembly will have two legislative sessions to fix any problems created by the Court's ruling. And the General Assembly will be incentivized to do so to ensure that the employer-contribution and level-dollar-funding

[35] By using this language, the General Assembly demonstrated an intent that the Court sever down to the level of "provisions"—*i.e.*, as narrowly as possible.

provisions—the provisions that recommend how much money goes into the pension system—are in place by the next biennium.

In addition, a severed SB 151 can in fact function effectively without the employer-contribution and level-dollar funding provisions. As explained above, these provisions merely provide recommendations that the General Assembly can accept, reject, or modify. With or without these parts of SB 151, appropriations of specified sums of money for specified purposes can still be made by the General Assembly. Thus, the employer-funding mechanism for public pensions—the biennial budget bill—can in fact work without the employer-contribution and level-dollar funding provisions of SB 151.

Moreover, the aspects of SB 151 that change retirement benefits going forward, discussed in Section I.C of this brief (by way of example only, the use of accumulated sick leave and uniform and equipment allowances), can easily function without SB 151's changes to employer contributions and level-dollar funding. At an absolute minimum, the parts of SB 151 changing retirement benefits going forward should be upheld.

IV. The circuit erred in refusing to disqualify the Attorney General from participating in this case.[36]

The Kentucky Rules of Professional Conduct prohibited the Attorney General and his office from bringing suit regarding the passage and enforcement of SB 151. The bottom line is that the Attorney General provided legal advice to legislators regarding these exact issues, and then he turned around and sued them over the very issues on which he advised them. The Rules do not permit this.

Under the Rules of Professional Conduct, attorneys cannot engage in representation that creates certain conflicts of interest. An impermissible conflict of interest typically arises

[36] The Governor preserved this issue. [*E.g.*, Vol. I, R. 140-49].

when an attorney undertakes a representation adverse to another client without consent. *See* SCR 3.130(1.7). Rule 1.7 states that "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest," which exists if the representation "will be directly adverse to another client[.]" Likewise, Rule 1.9 states that "[a] lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or substantially related matter in which that person's interests are materially adverse to the interests of the former client . . . ." SCR 3.130(1.9)(a). Both rules embody the same common-sense principle that a lawyer cannot provide a client with legal advice only to turn around and sue that same client on that same topic the next week.

That is exactly what has happened here. The Attorney General is the chief law officer and advisor of the Commonwealth and has a statutory duty to provide every state agency and officer with legal advice. *See* KRS 15.020. Pursuant to that duty, on February 28, 2018, the Attorney General in fact provided a six-page legal memorandum to all members of the legislature regarding the legal issues he perceived with the pension-reform measures debated by the General Assembly. [Vol. I, R. 150-Vol. II, R. 155]. One week later, he followed up with a second legal memorandum, again reiterating that he was providing advice to legislators in his capacity as the Commonwealth's chief legal officer. [*See* Vol. II, R. 156-61]. The Attorney General then met with Democratic Party legislative leaders in the General Assembly after SB 151 passed specifically "to discuss legal options on [the] pension bill." [*See* Vol. 1, R. 143].

In sum, the Attorney General repeatedly reached out pursuant to his statutory duties under KRS 15.020 to provide legal advice to the General Assembly regarding SB 151. And the legislators accepted at least some of his advice, omitting from SB 151 certain provisions that the Attorney General had advised them to delete—namely, the COLA provisions from SB 1. Yet, the Attorney General has now filed suit against those same legislators, as well as against the executive-branch agencies lawfully obligated to execute the laws passed by the General Assembly. This is a textbook violation of both Rule 1.7 and Rule 1.9 of the Professional Rules of Conduct. *See People ex rel. Deukmejian v. Brown*, 624 P.2d 1206, 1207 (Cal. 1981) (holding that the California Attorney General could not "represent clients one day, give them legal advice with regard to pending litigation, withdraw, and then sue the same clients the next day on a purported cause of action arising out of the identical controversy").

CONCLUSION

This is perhaps the most momentous case this Court will decide in decades. It will determine whether the Commonwealth can solve its greatest problem—the unfunded pension liability—or whether it will be crushed by it. SB 151 creates a path to solvency by implementing level-dollar funding, and it stops the deepening of the unfunded liability by establishing a hybrid cash balance plan for new teachers. These reforms may not have been popular in all quarters, but they are essential to the Commonwealth's future. That is why the General Assembly, in statesman-like fashion, looked past the noise of the protesters and did what was right. The Attorney General, for reasons known only him, wants to halt these important steps forward. If he prevails, then level-dollar funding will go by the wayside—which may well mean that *less money* will be put into the pension funds, thereby hastening their decline—and new teachers will lose the ability to participate in the hybrid cash balance plan—which has the dual benefits of limiting the Commonwealth's liability and providing teachers with a potentially more generous retirement benefit. Perhaps more importantly, if SB 151 falls, the Commonwealth will eventually find itself in the position of being unable to make pension payments, or else it will have to drastically raise taxes or slash essential government services—or both—to ensure that retirees continue receiving checks. It is unthinkable that the Court would push the Commonwealth to that brink. SB 151 does not have constitutional infirmities, and it does not violate the inviolable contract. The Court should end its analysis there and resist the Attorney General's invitation to engage in policymaking.

Respectfully submitted,

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APPENDIX

Tab Number	Description	Record Location
1	Circuit court's Opinion and Order, entered June 20, 2018	Vol. XII, R. 1735-68
2	Circuit court's Order, entered July 11, 2018	Vol. XIII, R. 1913-23
3	Additional orders of the circuit court	Vol. I, R. 135-36; Vol. II, R. 195-99; Vol. II, R. 298-Vol. III, R. 304; Vol. XII, R. 1654-57; Vol. X, R. 1368-76; Vol. XII, R. 1732-34; Vol. II, R. 221-23 (18-CI-414); Vol. XIII, R. 1901-02