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Commonwealth Of Kentucky

Court Of Appeals

NO. 1997-CA-000565-MR

BOARD OF TRUSTEES OF THE UNIVERSITY OF KENTUCKY — APPELLANT

v. APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE WILLIAM L. GRAHAM, JUDGE
ACTION NO. 80-CI-0523

GIFFORD BLYTON; LESLIE L. MARTIN; HELEN H. DENBO, AS PERSONAL REPRESENTATIVE OF THE ESTATE OF BRUCE F. DENBO; and DR. A. LEE COLEMAN — APPELLEES

OPINION
AFFIRMING IN PART, REVERSING IN PART, AND REMANDING

* * *

BEFORE: BUCKINGHAM, KNOX, AND SCHRODER, JUDGES.

SCHRODER, JUDGE: The Board of Trustees of the University of Kentucky (Board) appeals from a final judgment of the Franklin Circuit Court, ordering the Board to pay appellees damages for breach of the terms of the 1964 Retirement Plan that included a supplemental payment to retired faculty. Appellants argue that the supplement is not an enforceable contract, that certain members of the class of appellees should have been dismissed, that the court erred in failing to consider parol evidence indicating a modification of the terms of the supplement, and that certain voluntary payments made to the appellees should be

credited against the supplement. We find merit only in the second contention.

Appellees represent 139 retired faculty members and administrators of the University of Kentucky. The retirement plan includes a supplement which insures a minimum retirement benefit should the retiree's investment choice fail to yield same. When the appellees learned in 1977 of the appellant's use of a calculation assumption to determine the amount of supplemental retirement income, they sued for breach of contract, declaratory judgment, and injunctive relief.

The 1964 Retirement Plan provides in relevant part:

> X. Group I Retirement Benefits Each Group I participant in TIAA[1] will receive from TIAA a guaranteed, fixed monthly income for life which shall be the actuarial equivalent of the full value of his annuity accumulation at the time of his retirement. Each participant in CREF will also receive from CREF each month for life a guaranteed number of CREF annuity units, the dollar value of which will change from year to year reflecting primarily changes in the market prices and dividends of the common stocks owned by CREF. Just before retirement, each participant will choose from several options available the manner in which he would like to have his retirement income from TIAA-CREF paid. All of these options provide a lifetime income and all but one provide income for the participant's beneficiary in the event of his early death.

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[1] TIAA is an abbreviation for Teachers Insurance Annuity Association, while CREF stands for College Retirement Equities Fund. The employees had the choice of investing in either TIAA and/or CREF. TIAA is the more stable of the two, being based on fixed annuity contracts, guaranteed to pay at least the stated rate of interest. CREF annuities are much more variable, based on a stock market fund.

These options are set forth in the individual annuity contracts issued to participants.

XI. Group I Supplemental Retirement Income
For all Group I staff members who were age 40 or older prior to July 1, 1964, and who were eligible to participate in the Group I plan on July 1, 1964, the University will provide a supplemental retirement income during the lifetime of the staff member, where necessary, to assure a minimum benefit under this plan equal to the salary received by him at the time he reaches the age of 65* multiplied by the percentage stated in the next paragraph of this Section. The amount of this supplemental income will be reduced by the "primary insurance amount" of Social Security retirement income to which the employee is entitled from date of retirement to age 72. Thereafter this supplement will be in addition to all Social Security income benefits. In determining the Supplemental Retirement Income as provided above, the following percentages of the salary at age 65* shall be used:

(a) 20% plus 1% for each year of service ** to the University

plus

(b) For those employees who had attained age 56 prior to July 1, 1964: 1% for each full year by which retirement precedes the end of the fiscal year in which the employee's 70th birthday is attained.

or

(c) For those employees who had attained age 51, but not age 56 prior to July 1, 1964, the following percentage:

Age	Percentage
51	1
52	2
53	3
54	4
55	5

> In no event shall the applicable percentage of salary at age 65 exceed 20% plus 1% for each fiscal year between the date of employment and the end of the fiscal year in which the employee attains age 70.

In a February 6, 1992 order, the lower court found that the Board breached the express terms of the retirement plan when it failed to pay supplemental retirement income in an amount sufficient to meet the minimum retirement benefit provided under the terms of the plan. In the February 5, 1997 final judgment, the court awarded each employee, or his or her estate, compensatory damages to be determined by a formula set forth in the judgment, as well as prejudgment and postjudgment interest.

Appellants first argue that the portion of the retirement plan addressing the supplement is not an enforceable contract because it violates §§ 49 and 50 of the Kentucky Constitution. They maintain that because the supplement is paid from UK's general operating budget, which is appropriated biennially by the General Assembly, the Board has no authority to contract away the General Assembly's right to decline to appropriate money for the supplement. Appellants contest the circuit court's designation of the supplement as a "necessary government expense," excluded from §§ 49 and 50, on the basis that a supplemental fringe benefit for a retired professor is not a necessary component of education, especially since it obligates future legislatures to underwrite unpredictable stock market losses. We disagree.

Sections 49 and 50 provide that the Legislature cannot contract debts in excess of $500,000 or incur additional debt without the vote of the people of the Commonwealth. Rhea v. Newman, 153 Ky. 604, 156 S.W. 154, 158 (1913). Specifically, § 49 states, in relevant part:

> The General Assembly may contract debts to meet casual deficits or failures in the revenue; but such debts, direct or contingent, singly or in the aggregate, shall not at any time exceed five hundred thousand dollars, and the moneys arising from loans creating such debts shall be applied only to the purpose or purposes for which they were obtained, or to repay such debts[.]
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> Section 50 provides:
>
> No act of the General Assembly shall authorize any debt to be contracted on behalf of the Commonwealth except for the purposes mentioned in section 49, unless provision be made therein to levy and collect an annual tax sufficient to pay the interest stipulated, and to discharge the debt within thirty years; nor shall such act take effect until it shall have been submitted to the people at a general election, and shall have received a majority of all the votes cast for and against it: Provided, The General Assembly may contract debts by borrowing money to pay any part of the debt of the State, without submission to the people, and without making provision in the act authorizing the same for a tax to discharge the debt so contracted, or the interest thereon.

We begin with the proposition that any doubt is resolved in favor of constitutionality. Agricultural & Mechanical College v. Hager, 121 Ky. 1, 87 S.W. 1125, 1129 (1905). Whether an appropriation is a debt is determined by the manner of the payment (is it for more than $500,000 in a year?)

and the character of the appropriation. James v. State University, 131 Ky. 156, 114 S.W. 767, 772 (1908).

In Rhea v. Newman, 153 Ky. 604, 156 S.W. 154, 158 (1913), our highest Court ruled that § 49 of the Constitution does not apply to ordinary expenses of the government, and public schools and state universities must be maintained regardless of the condition of the treasury. A state's educational institutions must continue to function in order for the state to exist. Billeter & Wiley v. State Highway Commission, 203 Ky. 15, 261 S.W. 855, 860 (1924). Therefore, the Rhea Court reasoned, an appropriation made in support of a state institution is not a debt.

We believe that the proper funding of the pension plans of state university faculty promotes loyalty of staff and helps to ensure their longevity at the institutions. In turn, students benefit from experienced teachers. The supplement, guaranteeing a minimum retirement benefit, rewards professors for their faithful service. See Board of Education of Louisville v. City of Louisville, 288 Ky. 656, 157 S.W.2d 337, 346 (1941). Thus, we believe that the supplement aids in maintaining the university every bit as much as equipment and physical upkeep do. See James v. State University, supra, in which it was held that money appropriated to equip or repair a state university does not require a special levy, as such does not create an indebtedness against the Commonwealth. Consequently, we do not consider the

supplement to constitute a debt subject to § 49 of our Constitution.

Appellant next argues that the claims of members who retired after the April 5, 1977 restatement of the plan should have been dismissed because that amendment clearly set forth that the supplement would be calculated on the assumption that every member invested in TIAA. The circuit court denied appellant's motion for partial summary judgment on this issue, having previously ruled that the Board had breached the terms of the 1964 Retirement Plan. We disagree with the lower court.

The 1977 amendment to the plan stated that in determining whether each participant's elected plan (TIAA and/or CREF) had not reached the minimum annual retirement, thus entitling the participant to a supplement, the Board would assume that all contributions, from both the employee and the University, were invested in TIAA, regardless of whether any were actually invested in CREF. Under the modification, no employee would be entitled to a supplement as long as TIAA generated enough money to meet the minimum annual retirement.

Appellant maintains that the following sentence from the 1964 Retirement Plan allows for the above modification: "The University reserves the right to change the contribution rates for Group I or at any time modify either of the plans in any way that is not in conflict with the participant's accrued contractual rights." The Board believes that the appellees had no accrued right in the supplement or the method by which it was

calculated because the supplement is wholly funded by the state. Appellant also contends that the date of retirement, not employment, governs the plan provisions applicable to each participant.

We disagree with appellant's reasoning. Although there is no Kentucky case on point, we approve of the approach taken by the Nebraska Courts. The term "accrued contractual rights" refers to accrual or vesting in a legal sense because what is being determined is the creation of a legally protected right, not the fulfillment of specified, qualifying conditions which determine when a participant's right to a benefit becomes effective. Calabro v. City of Omaha, 247 Neb. 955, 967, 531 N.W.2d 541, 550 (1995). The participants' contractual rights to the supplement accrued or vested before they became eligible to collect their pensions.

Nor do we believe that the noncontributory nature of the supplement denies the participants an accrued right in it. Calabro, supra, involved a supplemental benefit plan whose cost was paid by the city without any employee contribution. It provided cost-of-living increases to the pension benefits and was found to constitute a pension. The Court found the supplemental benefit plan directly related to the pension plan since an employee had to qualify for the latter before he could receive the former. The Court further determined that the pension plan benefits were fixed when conferred; only their payment was deferred to a later date. We find this reasoning cogent and

therefore adjudge that the plan participants had an accrued contractual right in the supplement.

The analysis does not end here. We are next faced with the question of whether the Board may nonetheless unilaterally modify the terms of the retirement plan so as to reduce participants' benefits. If the Board may do so, the Board has not modified the plan so as to conflict with an accrued right. Moreover, the question of whether the modification was supported by consideration becomes moot.

While our research has not disclosed any case directly on point with the one sub judice, there are many cases from various states in which pension plan modifications were attacked as violating the Contract and Due Process Clauses of the United States Constitution. These cases involve alterations of governmental retirement plans by either the legislature or a governmental body. In order to borrow from the reasoning utilized in these cases, we must first adjudge whether the supplement can be considered a governmental pension plan.

The Board of Trustees of the University of Kentucky was created by KRS 164.131, and its members are appointed by the Governor. It is an independent, public agency and an instrumentality of the Commonwealth. Board of Trustees of University of Kentucky v. Public Emp. Council No. 51 American Federation of State, County and Municipal Emp. AFL-CIO, Ky., 571 S.W.2d 616, 618 (1978); KRS 164.225. The Board is an arm of state government. See Com. Ex rel. Cowan v. Wilkinson, Ky., 828

S.W.2d 610, 619 (1992) (Liebson, J. dissenting). The University of Kentucky is an agency of the state and enjoys sovereign immunity. KRS 44.073(1); Withers v. University of Kentucky, Ky., 939 S.W.2d 340, 343 (1997). In fact, the Board has been found to enjoy sovereign immunity, which can only be waived by the General Assembly. See Board of Trustees of University of Kentucky v. Hayse, Ky., 782 S.W.2d 609, 617 (1989), cert. denied, 497 U.S. 1025, 110 S. Ct. 3273, 111 L. Ed. 2d 783 (1990) and 498 U.S. 938, 111 S. Ct. 341, 112 L. Ed. 2d 306 (1990). Thus, we consider the appellees to have been public employees and their pension to be governmental, and although the Board's amendment of the supplement was not attacked as violating either the Contract Clause or Due Process, we find the case law to be didactic.

In general, courts view pensions in one of three ways: (1) contractual in nature and subject to modification under appropriate circumstances; (2) strictly contractual, and thus not unilaterally modifiable; and (3) mere gratuities from the government, alterable unilaterally at any time. Davis v. Mayor and Alderman of the City of Annapolis, 98 Md. App. 707, 715, 635 A.2d 36, 40 (1994).

The vast majority of states follow the first theory and allow for modification by the governmental body if the changes are reasonable, but if they result in disadvantages to the participants, counterbalancing advantages must be provided. Singer v. City of Topeka, 227 Kan. 356, 607 P.2d 467 (1980); Moorhouse v. City of Wichita, 259 Kan. 570, 913 P.2d 172 (1996);

Halpin v. Nebraska State Patrolmen's Retirement System, 211 Neb. 892, 320 N.W.2d 910 (1982); Calabro, supra; Davis, supra; Taylor v. State and Education Employees Group Insurance Program, 897 P.2d 275 (Okla. 1995); Nonnenmacher v. City of Warwick, 1997 WL 839913, 1997 R.I. Super. 314 (1997); Gatewood v. Board of Retirement, 175 Cal. App. 3d 311, 220 Cal. Rptr. 724 (1985). Arizona employs the second view. Yeazell v. Copins, 98 Ariz. 109, 402 P.2d 541 (1965). We have found no cases espousing the third theory. In fact, the idea of a pension coming from the largess of the sovereign has been roundly criticized as medieval. Davis, 635 A.3d 36, 40.

We perceive the majority view to be the most logical and adopt it here. We are benefitted by Nonnenmacher, supra, wherein the Rhode Island Court instructed that an alteration is reasonable if it advances the public interest in keeping the system sound and flexible; that is, the adjustments coincide with changing conditions consonant with fiscal responsibility, yet retain the plan's integrity.

The changes made to the supplement were certainly reasonable. Under the prior scheme, there was no incentive for a participant to invest in TIAA. The more aggressive CREF plan could result in higher yields as it was tied to the stock market, but if it did not, participants were assured of a minimum benefit amount. The 1977 restatement eliminated UK's underwriting the stock market. We agree with appellant that the taxpayers should not have to indemnify plan participants based on vagaries of the

financial world. The change to the supplement coincided with the bear market years, yet retained the plan’s integrity. Participants were put on notice in 1977 that their risky investments in CREF would no longer be underwritten. They had the opportunity to switch their investments to TIAA. If TIAA did not produce the minimum retirement benefit, the supplement would still be used to ensure that amount. The Board balanced the public interest in fiscal responsibility with the interest of the retirement participants in receiving a minimum retirement benefit despite their choices of investment.

We also believe the changes clear the final analytical hurdle. Appellees were still entitled to substantially the same level of pension benefits even after the 1977 restatement. They simply had to change their CREF investments to TIAA to ensure themselves of the minimum retirement benefit. Otherwise, they knowingly took the risk that CREF would not yield the minimum retirement benefit, and the supplement would not be available to boost it to that amount. Accordingly, the 1977 restatement of the supplement was permissible, and appellees who retired after its effective date should have been dismissed.

Appellant’s third argument is abstruse. Appellant seems to contend that the lower court erred by not allowing the Board to introduce oral statements made about the TIAA assumption. Yet the body of appellant’s brief clearly also raises the assertion that parol evidence regarding the University’s conduct between 1964 and 1977 should have been

admitted to establish how to calculate the supplement based on the second assumption adopted in 1977:

> That the retiring employee elected the single life annuity option the value of which is computed on the basis of the employee's age at the time of retirement (regardless of the options(s) actually elected at retirement).

Appellant maintains that the plain language of the 1964 plan fails to take into account such factors as delayed withdrawal, voluntary contributions, employment other than at UK, and the effect of payout elections, all of which, the Board claims, influence calculation of the supplement.

Appellees moved in limine to exclude any parol evidence which would bear on the TIAA assumption. In response, the Board stated its desire to introduce a brochure and oral statements made, beginning at an April 1964 faculty meeting, which, together with the contract, define the obligations made to the employees. The lower court ruled "that neither Plaintiffs nor Defendant shall be permitted at the trial of this action to introduce any evidence, whether parole [sic] or otherwise, of antecedent understandings and negotiations for the purpose of varying or contradicting the July 1964 Retirement Plan, as amended." Appellant asserted that this evidence would prove that even in 1964, it was both parties' understanding that the TIAA and single life-annuity assumptions would be used to calculate supplements.

The motion in limine plainly sought to exclude parol evidence relating to the TIAA assumption, and we find no error in the court's ruling thereon. Section XI of the 1964 plan sets

forth a very clear method of calculating the supplement for all participants who retired between 1964 and the effective date of the 1977 restatement. As the plan was clear and unambiguous on its face and fully integrated, it would have been a violation of the parol evidence rule to allow introduction of the proposed extrinsic evidence. Potter v. Citizens Fidelity Bank & Trust Co., Ky. App., 554 S.W.2d 397 (1977); England v. Spalding, Ky., 460 S.W.2d 4, 9 (1970) (citing Restatement of the Law, Contracts, § 237 at 331).

Furthermore, appellant's argument regarding the second part of the assumption was never challenged by appellees in their complaint or amended complaint. Therefore, that issue was never before the lower court, and we pretermit discussion of same.

Appellant's final argument is that it should be credited with voluntary increases in the supplement, namely cost of living increases, unisex increases, and interest rate increases against supplement payments.

In its August 11, 1993 Order, the court concluded:

> No relationship can be discerned between [the voluntary] payments and the University's contractual obligation to pay an amount of SRI sufficient to achieve the Minimum Benefit. Nor has the University presented any evidence that these voluntary payments were made in consideration of its obligation under the Contract or that when made they were intended or understood to the supplemental retirement income as contemplated by the Plan. And, although the University correctly states that the University did not "formally amend the definition of the 'Minimum Benefit' in the 1964 Retirement Plan to include any of the

> voluntary increases[,"] the same can be said of the absence of any definitional expansion of "supplemental retirement income" to include the increases. Accordingly, as payments distinct from the supplemental retirement income payments required by the Plan, the "voluntary" additional payment made by the University shall not be used to reduce or offset Plaintiffs' eventual damages.
>
> Defendants would contend that if Plaintiffs' damages are not reduced by the amount of the University's voluntary payments, Plaintiffs will be put in [a] better position than would have been the case had the contract not been breached. . . .
>
> However, in this case the disallowance of the University's claim for credit or reduction will not place the Plaintiffs in such a better condition. Rather they will be placed in the same position they would be and would have been if the University had paid them the proper amount of supplemental retirement income in the first place. Had the University done so, the Plaintiffs would have received the required amount of supplemental retirement income plus the amount of all additional payments made by the University — the identical position in which they will be placed under this ruling.

We agree with the lower court's reasoning and result. The retirement plan is contractual, and, therefore, the rights of the parties to it are bound by the contract. Nothing in it mentions offsets for the voluntary payments made by the Board here.

We also find some guidance in the law of workers' compensation. Pension plans, like workers' compensation benefits, are part of the wage-loss system. Williams v. Eastern Coal Corp., Ky., 952 S.W.2d 696, 698 (1997). In workers' compensation, an employer is entitled to an offset of benefits

when a long-term disability plan, for example, provides benefits which duplicate workers' compensation benefits. The purpose of the benefit must be assessed. Theoretically, retirement benefits compensate retirees during a time in their lives when, due to age, they are no longer able to work full-time. The benefits are paid as a consequence of many years of service and had been contributed to by the employee, thus having reduced his or her net pay during those working years. None of the voluntary payments in this case--cost-of-living, unisex, and interest rate increases--duplicate the purpose of the retirement benefits, although they may certainly enhance them. Therefore, we agree with the trial court that the Board is not entitled to any offset for these payments.

Accordingly, the February 5, 1997 final judgment of the Franklin Circuit Court is affirmed in part, reversed in part, and remanded for further consideration consistent with this opinion.

ALL CONCUR.

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