IN THE
COMMONWEALTH COURT OF PENNSYLVANIA

NO. 1448 C.D. 2005

THE PENNSYLVANIA STATE UNIVERSITY/
THE PMA INSURANCE GROUP
Petitioners

v.

WORKERS' COMPENSATION APPEAL BOARD
(ROBERT HENSAL)
Respondent

BRIEF FOR AMICUS CURIAE, PENNSYLVANIA DEFENSE INSTITUTE IN SUPPORT OF BRIEF OF PETITIONERS ON REARGUMENT EN BANC

On Petition for Review from the Opinion and Order of the Workers' Compensation Appeal Board dated June 20, 2005, Docketed at A05-2995, Affirming the November 30, 2004 Decision and Order of WCJ Robert Vonada, Disallowing the Modification Petition of the Pennsylvania State University/The PMA Insurance Group

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I. STATEMENT OF JURISDICTION

This Honorable Court has jurisdiction over the instant Petition for Review of the final Order of the Workers' Compensation Appeal Board pursuant to Section 763(a)(1) of the Judicial Code[1].

[1] Act of July 9, 1976, P.L. 586, No. 142.

II. STATEMENT OF INTEREST OF AMICUS CURIAE

The Pennsylvania Defense Institute ("PDI") is a statewide association of defense counsel, insurance representatives and self-insured entities - including the School Districts Insurance Consortium, a non-profit entity that administers workers' compensation claims for public school districts throughout Pennsylvania - that develops public policy for and exchanges ideas on issues of concern to its constituents. The PDI represents its members and constituents in a variety of forums, including the Pennsylvania Legislature and various Pennsylvania courts, in matters affecting the interests of insurers, self-insurers and employers conducting business in the Commonwealth of Pennsylvania.

Through the collective judgment of its Amicus Curiae Committee, the PDI seeks to advance the interests of its constituents, and promote the welfare of the Commonwealth, through the submission of well-reasoned legal analysis supported by reasonable and thoughtful public policy.

III. SCOPE OF REVIEW

This Honorable Court's scope of review on appeal from a decision of an administrative agency is limited to determining whether any constitutional rights have been violated, whether any errors of law have been committed or whether any necessary findings of fact are not supported by substantial evidence. See Section 704 of the Administrative Agency Law[2]; Davis v. Workmen's Compensation Appeal Board (Swarthmore Borough), 561 Pa. 462, 751 A.2d 168 (2000); Waugh v. Workers' Compensation Appeal Board, 558 Pa. 400, 737 A.2d 773 (1999).

In 2002, the Pennsylvania Supreme Court expanded the scope of appellate review in administrative cases such as this one to include a "capricious disregard" assessment where, for example, the workers' compensation judge chooses not to consider uncontroverted evidence[3] or to apply well-settled law. Leon E. Wintermeyer, Inc. v. Workers' Compensation Appeal Board (Marlowe), 571 Pa. 189, 812 A.2d 478 (2002); *see also* FOP Conference of Pennsylvania Liquor Control Board Lodges the Pennsylvania Labor Relations Board, 557 Pa. 586, 735 A.2d 96 (1999).

In terms of its standard of review, this Honorable Court, as an appellate tribunal, may not assess credibility or re-weigh evidence since the authority to do so rests exclusively with the workers' compensation judge. Taulton v. Workmen's Compensation Appeal Board (USX Corp.), 713 A.2d 142 (Pa. Cmwlth. 1998).

In examining questions of law, however, this Honorable Court's standard of review is plenary, Phillips, et al. v. A-Best Products, et al., 542 Pa. 124, 665 A.2d 167

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[2] Act of April 28, 1978, P.L. 202, No. 53.

[3] Section 422(a) of the Act provides in pertinent part that "[u]ncontroverted evidence may not be rejected for no reason or for an irrational reason; the workers' compensation judge must identity that evidence and explain adequately the reasons for its rejection."

(1995); Young v. Young, 507 Pa. 40, 488 A.2d 264 (1985), and, in the context of a statutory construction question, must undertake "to ascertain and effectuate the intention of the Legislature; to the extent the legislative definition is not explicit, [to] also consider, among other matters, the occasion and necessity for the statute, the circumstances under which it was enacted, the mischief to be remedied, the object to be attained, the former law, if any, including other statutes upon the same or similar subjects, the consequences of a particular interpretation, the contemporaneous legislative history, and the legislative and administrative interpretations of the statute." Commonwealth of Pennsylvania, Higher Education Assistance Agency, et al. v. Abington Memorial Hospital, et al., 478 Pa. 514, ____, 387 A.2d 440, ____ (1978), *citing* Statutory Construction Act of 1972, 1 Pa. C.S.A. § 1921[4].

[4] Act of December 6, 1972, P.L. 1339, No. 290.

IV. ORDER IN QUESTION

"The Appeal of Defendant is **DENIED**. The Decision and Order of the Judge is hereby **AFFIRMED**."

(Order of Workers' Compensation Appeal Board dated June 20, 2005)

V. STATEMENT OF QUESTION INVOLVED

Whether defendant was improperly denied a defined benefit pension offset where the uncontroverted evidence of record established the extent to which it funded the pension plan at issue, in accordance with the requirements of Section 204(a) of the Act.

(Answered in the negative by the Appeal Board below)

VI. STATEMENT OF CASE

On February 21, 2002 respondent, Robert Hensal ("claimant") sustained a left shoulder sprain/strain injury while in the course of his employment duties with petitioner, The Pennsylvania State University, ("defendant") whose workers' compensation administrator thereafter issued a Notice of Compensation Payable on March 8, 2002, accepting his injury as compensable and providing him total disability benefits at a rate of $336.34 per week, based upon a pre-injury average weekly wage of $504.51. (See Appendix "A", Finding of Fact No. 1).

On December 30, 2003, claimant completed an Employee's Report of Benefits form, indicating that as of October 2002, he began receiving a pension benefit in the amount of $1,065.18 per month. (R. 1a).

On January 20, 2004, defendant filed a Modification Petition alleging an entitlement to a pension offset for those benefits claimant was receiving through the State Employees' Retirement System ("SERS") as of February 22, 2002, pursuant to Section 204(a) of the Act.

On March 24, 2004, defendant's administrator issued a Notice of Workers' Compensation Benefit Offset form pursuant to Section 123.4(b) of the Act 57 Regulations perfecting defendant's pension offset at a rate of $155.42 per week, and a credit for past pension benefits received by claimant as of February 22, 2002 pursuant to Section 123.5 of the Regulations. (R. 2a-5a).

On May 6, 2006, claimant filed a Penalty Petition challenging defendant's entitlement to the pension offset[5].

[5] Claimant is apparently pursuing a Constitutional challenge to the self-executing provision of the Act 57 offset Regulations. (See Claimant's Brief at p. 23). While the PDI recognizes that a

In support of its Modification Petition and Notification of Offset, defendant presented the testimony of Linda Miller, Director of Benefits Determination Division of SERS, who described the agency's defined benefit pension plan and the methodology for determining the extent of defendant's funding of the plan, (R. 21a-77a) and the testimony of Brent M. Mowery, a senior consultant at the Hay Group of Arlington, Virginia who, as the SERS plan actuary, further described the calculations used in determining the extent to which defendant funded the plan. (R. 79a-155a).

Defendant also submitted the "15th Investigation of Actuarial Experience for the State Employees' Retirement System" prepared by the Hay Group addressing the five-year period, January 1, 1996 through December 31, 2000. (R. 159a-252a).

Claimant did not present a fact witness or an expert actuarial witness in opposition to defendant's Modification Petition or in support of his Penalty Petition.

A. SUMMARY OF WCJ ADJUDICATION

By Decision and Order circulated November 30, 2004, the WCJ below disallowed defendant's Modification Petition; set aside defendant's Notice of Workers' Compensation Benefit off-set and disallowed claimant's Penalty Petition on the basis of the following Conclusions of Law: (1) the testimony of the Director of Benefits Determination Division of SERS and the testimony of the senior consultant at the Hay

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Constitutional challenge to the validity of a statute under the Act cannot be raised or pursued before a WCJ or the Appeal Board, but may be raised for the first time before this Honorable Court, Kramer v. Workers' Compensation Appeal Board (Rite Aid Corp.), 584 Pa. 309, 883 A.2d 518 (2005); Lehman v. Pennsylvania State Police, 576 Pa. 365, 839 A.2d 265 (2003); Lucas v. Workers' Compensation Appeal Board (Kleen All of America, Inc.), 727 A.2d 599 (Pa. Cmwlth. 1999), it appears that claimant did not do so in this case - through the filing of a timely cross-appeal per Rule 903(b) of the Rules of Appellate Procedure - meaning that the issue has been waived in this proceeding. Regardless, it is respectfully submitted that the challenge should nevertheless fail in light of the Pennsylvania Supreme Court ruling in Kramer v. Workers' Compensation Appeal Board (Rite Aid Corp.), supra, (the offset provisions set forth in Section 204(a) of the Act do not violate the Equal Protection Clauses of the U.S. and Pennsylvania Constitutions).

Group, actuary for SERS "did not establish what the Employer contributed. Accordingly, the Employer has failed to meet its burden to establish that it is entitled to a benefit off-set for SERS benefits" (See Appendix "A," Conclusion of Law No. 1); (2) "the regulations and the Schulz case cited above indicate that it is the net amount contributed by the Employer and received by the employe (sic) that must be established under current law" (See Appendix "A," Conclusion of Law No. 1; and (3) the imposition of penalties is not appropriate in this case because "the validity of the Employer's calculation of the pension benefit off-set is undetermined by a court Order under Article Five of the Constitution of the Commonwealth of Pennsylvania. Accordingly, the Employer did not violate the terms of the Workers' Compensation Act and Regulations by taking the unilateral off-set in this case" (See Appendix "A," Conclusion of Law No. 2).

B. SUMMARY OF WORKERS' COMPENSATION APPEAL BOARD ADJUDICATION

By Opinion and Order dated June 20, 2005, the Workers' Compensation Appeal Board affirmed the ruling of the WCJ on the basis of the following: (1) "Section 204(a) of the Act, using the past tense, indicates that an employer is entitled to a credit for benefits from a pension plan to the extent 'funded' by the employer, but Defendant provided no evidence of any such amounts funded"; (2) defendant failed to "to establish the amount it contributed to the pension fund in order to be entitled to an off-set"; and (3) Section 123.2 of the Act 57 Regulations does not sanction the use of "after-the-fact estimates of how much the employer may possibly have contributed" (See Appendix "B" at pp. 6-8).

By Memorandum Opinion issued through a three-member panel on March 9, 2006, this Honorable Court initially affirmed the ruling of the Workers' Compensation

Appeal Board on the basis of its earlier ruling in Department of Public Welfare/Polk Center v. Workers' Compensation Appeal Board (King), 884 A.2d 343 (Pa. Cmwlth. 2005).[6]

By Order dated May 2, 2006 this Honorable Court granted defendant's Application for Reargument and vacated its March 9, 2006 Opinion and Order.

[6] In dismissing the methodology relied upon by SERS, the majority panel reasoned, in part, that "Employer reaps the full benefit of varying rates of interest, when conceivably Employer may never have even contributed a cent to an employee's plan." As is discussed below, the referenced varying rates of interest have no relevance to or effect upon employer liability for the funding of the subject defined benefit plan. The projected rate of investment return of 8.5%, which has been an approved actuarial assumption since 1996, is used to establish employer funding liability by projecting investment returns for both employee and employer contributions. That perhaps in certain years the employer may not perhaps provide contributions to the defined pension plan is irrelevant to the issue in this case since the question presented addresses employer liability for funding the plan – once the employee annuity benefit is established upon retirement, employer liability for funding the benefit becomes reality, regardless of what contributions it might have made years earlier.

VII. SUMMARY OF ARGUMENT

The policy that culminated in the enactment of those offsets contemplated by Section 204(a) of the Act, seeks to reduce the costs of Pennsylvania work injuries by prohibiting injured employees from receiving double wage loss benefits to the extent the employer bears liability for those benefits.

The position advanced by claimant in this case seeks a result that will necessarily eliminate the Section 204(a) pension offset for injured employees who are members of "defined benefit pension plans."

Pension administration agencies SERS and PSERS have implemented similar methodologies derived from the statutorily-based means of determining employer liability for funding the injured employee's pension annuity, that not only establishes the extent to which the employer must fund the annuity, but that represents the only methodology for doing so – a methodology that has been endorsed by authorities in the study of employee pension benefits, and that has been prescribed by the Internal Revenue Code.

In light of the foregoing it is respectfully submitted that the WCJ committed error below by disallowing defendant's pension offset.

VIII. ARGUMENT

A. SINCE THE UNCONTROVERTED EVIDENCE OF RECORD ESTABLISHES THE EXTENT TO WHICH THE EMPLOYER BELOW FUNDED CLAIMANT'S DEFINED BENEFIT PENSION PLAN, THE EMPLOYER WAS IMPROPERLY DENIED A PENSION OFFSET UNDER SECTION 204(A) OF THE ACT.

This case involves review of the administration of a fundamental component of "Act 57 of 1996," - remedial legislation that sought to reduce the cost of Pennsylvania work injuries – employer offsets for post-injury receipt of defined benefit pension annuity payments.

The position advanced by claimant in this case, one that has been embraced by numerous claimants in Pennsylvania, seeks a result that will necessarily eliminate the Section 204(a) offset for injured employees eligible for "defined benefit pension plan" annuities.

The PDI has joined amici, SERS and PSERS – pension administrators that have independently derived the same methodology challenged by claimant in this case – in urging this Honorable Court to maintain the viability of the defined benefit pension offset.

The PDI respectfully submits that the very character of a defined benefit plan necessitates the use of the actuarial methodology that has been independently advanced by SERS and PSERS, and that has been endorsed by authorities in the study of employee pension benefits, for calculating the extent to which the employer funded the particular plan.

Indeed, the methodology at issue in this case represents the only mechanism available for effectuating the intention of the Pennsylvania Legislature – a mechanism that has been prescribed by the Internal Revenue Code.

Before addressing the merits of the issue raised by Petitioner's Petition for Review, the PDI believes that it is important to first consider that the pertinent facts underlying this appellate proceeding are not in dispute.

Indeed, there is no dispute that: (1) claimant's date of birth is October 17, 1948 (R. 43a); (2) claimant was an employee of defendant for twenty-two years (3) he earned specified wages during the course of his employment history with defendant; (4) he joined SERS on December 31, 1995 (R. 46a); (5) in doing so, he became a member of the SERS defined benefit plan (R. 25a); (6) claimant was a "Class AA" employee (R. 32a) meaning that effective 2001, his pension plan accrual rate increased from 5% to 6 ¼%; (7) during the course of his employment with defendant, claimant made contributions to the pension plan totaling $14,429.75 (R. 46a) (8) on the basis of a work injury occurring on February 21, 2002, he was awarded total disability benefits under Act at a rate of $336.34 per week; (9) he thereafter filed for a "joint and survivor disability pension benefit" (R. 30a); R. 32a); (10) on that basis, effective February 22, 2002, he was awarded pension benefits at a rate of $1,065.18 per month (R. 1a); and (11) claimant did not challenge the SERS calculation of his monthly pension benefit entitlement amount[7].

[7] The State Employees' Retirement System Member Handbook instructs that a member of the pension plan has the right to request a review by the SERS' Appeals Committee if he or she believes that he or she has been denied a right or benefit to which he or she is entitled under the Retirement Code. More specifically, the Appeals process allows the member to pursue his or her position with the Executive Director of the State Employees' Retirement System, the Appeals Committee, a hearing examiner presiding over an administrative hearing and this Honorable Court.

1. The Statutory Provision at Issue

The statutory provision at issue in this case, Section 204(a) of the Act, provides, in pertinent part, as follows:

> "The severance benefits paid by the employer directly liable for the payment of compensation and **the benefits from a pension plan to the extent funded by the employer** directly liable for the payment of compensation which are received by the employe shall also be credited against the amount of the award made under sections 108 and 306**,** except for benefits payable under section 306(c)…" (emphasis supplied).

2. The Remedial Policy Considerations Underlying the Act 57 Pension Offsets

The enactment of "Act 57 of 1996" represented the culmination of Pennsylvania workers' compensation reform that began with the advent of "Act 44 of 1993," which saw the introduction of what has been described as "medical cost containment" through the establishment of medical fee caps, utilization review and healthcare self-referral prohibitions.

Three years later, in an effort to further reduce the cost of Pennsylvania work injuries, the Pennsylvania Legislature promulgated Act 57, which aimed to reduce employer indemnity liability through the establishment of "Impairment Ratings," "Compromise and Release" settlements and a series of "offsets[8]" designed to prohibit

[8] Offsets for pension payments were available to employers before the enactment of Act 57. In order to obtain the credit back then, however, the employer was required to prove that pension payments had been made to the injured worker in lieu of the payment of workers' compensation indemnity i.e. on the basis of the employee's inability to work. See Murphy v. Workers' Compensation Appeal Board (City of Philadelphia), 871 A.2d 312 (Pa. Cmwlth. 2005) *citing* Bethlehem Steel Corp. v. Workers' Compensation Appeal Board (Gounaris), 557 Pa. 641, 732 A.2d 1211 (1998); Toborkey v. Workmen's Compensation Appeal Board (H. J. Heinz), 655 A.2d 636 (Pa. Cmwlth. 1995) *petition for allowance of appeal denied*, 541 Pa. 655, 664 A.2d 544 (1995). The advent of Act 57 saw the elimination of the common law "in lieu of workers' compensation" requirement.

injured workers' from receiving wage loss "double recoveries." See Kramer v. Workers' Compensation Appeal Board (Rite Aid Corporation), 584 Pa. 309, 883 A.2d 518 (2005); Township of Lower Merion v. Workers' Compensation Appeal Board (Tansey), 783 A.2d 878 (Pa. Cmwlth. 2001).

In addressing the policy underlying the offsets afforded by Section 204(a), the Pennsylvania Supreme Court explained most recently in Kramer, supra, that "the subject legislation serves a legitimate state interest **in reducing the cost of workers' compensation benefits in Pennsylvania by allowing employers to avoid paying duplicate benefits for the same loss of earnings.** Because the subject legislation is reasonably related to accomplishing that interest, the legislation passes equal protection scrutiny under the rational basis test and is constitutionally sound." 584 Pa. 309, ___, 883 A.2d 518, ___ (2005).[9]

Indeed, the Supreme Court has recognized that the Section 204(a) offsets can effectively reduce the cost of work injuries:

[9] As is discussed by the Supreme Court in Kramer, virtually every individual workers' compensation insurance policy written in Pennsylvania is directly impacted by what is commonly referred to as the "Experience Modification Factor" – a mathematical calculation that is generated by the Commonwealth of Pennsylvania Rating Bureau – a non-profit organization created in 1915 pursuant to the Pennsylvania Insurance Law. The Experience Modification Factor is calculated and applied to individual Pennsylvania employers on the basis of their workers' compensation history or "experience" over the course of multiple years. The adjustment factor is calculated for an individual employer based on prior years' payroll and loss data – essentially comparing the loss data of that particular employer to the average loss data for all other employers in the state who share the same classification code. Most Experienced Modification Factor calculations use loss data from three prior policy years. The typical window used for payroll and loss data looks back four years for the first policy year and also encompasses the next two policy years, while the most recently completed policy year is excluded from the calculation. The employer's experience is not qualitative – the greater the number of dollars paid in medical and indemnity benefits for each claim, the less favorable the employer's "experience" and the more expensive the employer's workers' compensation coverage. Accordingly, the employer's experience becomes favorable as the injured employee's receipt of indemnity benefits is eliminated or reduced either by returning the employee to gainful employment or by having the employee declared fully recovered from the effects of his or her injury, or by taking those offsets contemplated by Section 204(a) of the Act.

> "This is so because premiums for insurance coverage for workers' compensation are based not only on the classification of the type of business and its annual payroll, but also on the company's prior "experience modification" or claims history….Accordingly, any reduction in claims pay out, including reductions resulting from severance off-sets [afforded by Section 204(a) of the Act] should result in lower future insurance premiums for the privately-insured employer."

584 Pa. 309, ____, 883 A.2d 518, ____, (2005).

The pension benefit that claimant received in this case is more specifically characterized as a "disability retirement benefit" (See 2005 SERS Member Handbook at p. 4) or "disability annuity[10]" obtained on the basis of his physical inability to work, resulting from the effects of his compensable work injury.

In Pennsylvania, the word "disability" is a term of "workers' compensation art" that does not refer simply to a physical assessment of the employee's ability to work, but to the confluence of two distinct concepts – "work injury" and "wage loss". See Dillon v. Workmen's Compensation Appeal Board (Greenwhich Collieries), 536 Pa. 490, 640 A.2d 386 (1994).

In other words, the workers' compensation "disability" benefit that claimant is presently receiving, serves the same purpose as the pension benefit that he is receiving on a concurrent basis.

Accordingly, claimant is presently receiving what the Pennsylvania Legislature has deemed to be an impermissible double recovery of wage loss benefits.

[10] See Section 5704 of the Retirement Code.

3. The Administrative Application of Section 204(a)

In accordance with its legal responsibility to "explain and enforce the provisions of this Act,"[11] the Bureau of Workers' Compensation issued a series of Regulations on January 17, 1998[12] administering the remedial changes brought about by Act 57.

Section 123.8 of the Act 57 Regulations confirms the application of Section 204(a) to both defined benefit plans and defined contribution plans:

> "(a) Workers' compensation benefits otherwise payable shall be off-set by the net amount an employe receives in pension benefits **to the extent funded by the employer directly liable for the payment of workers' compensation**. (emphasis supplied).
>
> (a) The pension off-set shall apply to amounts received from the **defined-benefit** and **defined-contribution plans**. (emphasis supplied).

Section 123.2 of the Regulations acknowledges that in connection with a defined benefit plan the extent of employer funding of the plan is **necessarily variable** and **must be calculated by an actuary:**

> "*Defined Benefit Plan* – A pension plan in which the benefit level is established at the commencement of the plan and **actuarial calculations determine the varying contributions necessary to fund the benefit at an employee's retirement**." (emphasis supplied).

Consistent with the foregoing, Section 123.10 of Regulations recognizes that actuarial calculations must necessarily be used to determine the extent to which the employer funded the defined pension plan[13]:

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[11] See Section 435(a)(b) of the Act.
[12] See 28 Pa. Bulletin 329 (No. 3, Sat., January 17, 1998).
[13] The quoted Regulation applies to "multiemployer" plans, which under the definition set forth in Section 123.2 refers to plans maintained under a collective bargaining agreement. Because the SERS plan is maintained pursuant to statute and not a collective bargaining agreement, it does not by definition, fall within the scope of the quoted Regulation. The instruction contained in Section 123.10 must, nevertheless, apply to any defined benefit plan, however, because only an

> "(a) When the pension benefit is payable from a multi-employer pension plan, only that amount which is contributed by the employer directly liable for the payment of workers' compensation shall be used in calculating the off-set to workers' compensation benefits.
>
> (b) **To calculate the appropriate off-set amount, the portion of the annuity purchased by the liable employer's contributions shall be as determined by the pension fund's actuary**. The ratio of the portion of the annuity purchased by the liable employer's contribution to the total annuity shall be multiplied by the net benefit received by the employee from the pension fund on a weekly basis. The result is the amount of the off-set to be applied to the workers' compensation benefit on a weekly basis. (emphasis supplied).

The Bureau's instruction that in the context of a defined benefit plan, the extent to which the employer funded the plan is to be determined by the plan's actuary, particularly when viewed in conjunction with the actuarial methodology independently advanced by two state agencies, SERS and PSERS, should carry significant weight in this proceeding.

Indeed, as the Supreme Court of Pennsylvania has explained, the interpretation of a statute advanced by the agency charged with the responsibility for construing its meaning, cannot be regarded lightly. Rather, the Court has instructed "the contemporaneous construction of a statute by those charged with its execution and application, especially when it has long prevailed, **is entitled to great weight** and should not be disregarded or overturned except for cogent reasons, and unless it is clear that such construction is erroneous." Commonwealth of Pennsylvania, Pennsylvania Higher Education Assistance Agency, et al. v. Abington Memorial Hospital, et al., 478 Pa. 514, ____, 387 A.2d 440, ____, (1978) *quoting* Federal Deposit Insurance Corp. v.

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actuary – using economic and demographic assumptions or projections - can determine the employer's liability for funding the employee's retirement annuity.

Board of Finance and Revenue of Commonwealth, 368 Pa. 463, 471, 84 A.2d 495, 499 (1951)(emphasis supplied).

Moreover, even where the administrative interpretation at issue has not long prevailed, the Supreme Court of the United States has declared that the statutory construction advanced by the agency responsible for explaining and enforcing the statutory scheme at issue should be afforded substantial deference:

> "[u]ndoubtedly questions of statutory interpretation, especially when arising in the first instance in judicial proceedings, are for the Courts to resolve, **giving appropriate weight to the judgment of those whose special duty is to administer the questioned statute."**

Id. *quoting* National Labor Relations Board v. Hearst Publications, Inc., 322 U.S. 111, 130-31, 61 S. Ct. 851, 860, 88 L. Ed. 1170 (1944) (emphasis supplied).

As this Honorable Court has recognized, as a state agency charged with the responsibility for applying and executing the Pennsylvania State Employees' Retirement Code, the SERS Board is "entitled to considerable deference in its construction of the retirement statute and the regulations promulgated thereunder" See The Pennsylvania State University et. al. v. State Employees' Retirement System, 880 A.2d 757 (Pa. Cmwlth. 2005).

Although this proceeding does not presume to construe the Retirement Code itself or any regulation promulgated under the Code, the fact is that the state agency to which this Honorable Court has deferred in matters arising out of the administration of the State Employees' Retirement System at issue in this case, and PSERS, the agency responsible for administering the Public School Employees' Retirement System, have independently concluded that the actuarial methodology at issue in this case is the

appropriate method for calculating the extent to which the employer funded the particular defined benefit plan.

It is respectfully submitted that the methodology referenced by the Bureau and implemented by SERS and PSERS, as detailed below, should be sanctioned by this Honorable Court.

In order to fully appreciate why actuarial methodology implemented by SERS and PSERS is required in cases such as this one, a brief review of the essential features of a defined benefit pension plan would seem appropriate.

4. The Essential Features of a Defined Benefit Pension Plan

Pension plans are, in essence, long-term contracts between employers and the "members" of the plan – employees – who forego current salary in one form or another in exchange for future retirement benefits payable by the plan. Pensions in the Public Sector, Edited by Olivia S. Mitchell and Edwin C. Hustead[14], Univeristy of Pennsylvania Press at p. 6.

"In the case of a defined benefit plan, the retirement promise is financed by contributions and returns on invested assets." Id.

In a defined benefit plan, benefits are established in advance, in accordance with an agreed upon "formula" stated explicitly in the plan document - the two most common formulas being the "unit benefit[15]" formula and the "flat benefit" formula.

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[14] Mr. Hustead is an actuary employed by the Hay Group. He and Brent M. Mowery (R. 3a-77a) developed the SERS methodology at issue in this case. He also signed the 2005 SERS Actuarial Report referenced below.

[15] In a "unit benefit plan" a unit of benefit is credited for each year of recognized service with the employer. Fundamentals of Private Pensions, 8th Ed. at p. 236. In a "flat benefit plan", the formula typically provides a benefit based upon a specific percentage of compensation, without regard to the employee's length of employment. Or, less commonly, the formula will afford a flat dollar benefit to all employees who establish a minimum period of employment, without

Fundamentals of Private Pensions, pp. 235-36, Eighth Edition, McGill, Brown, Haley Schieber (Oxford Press, 2005); The Handbook of Employee Benefits, pg. 1230, Sixth Edition, Edited by Jerry S. Rosenbloom (McGraw Hill 2005).

The typical "benefit formula" represents a combination of factors, including years of service, wages earned, Social Security benefits, age at retirement and other relevant factors[16]. The Handbook of Employee Benefits, 6th Ed. p. 1230.

Because the benefit formula and the employee's contribution to the plan are both known factors, it is the necessarily true that employer contributions to the plan "are treated as the variable factor." Fundamentals of Private Pensions, 8th Ed. at p. 236.

Indeed, what makes defined benefit plans quite different from "defined contribution" plans, is that the formula for former is necessarily established and known during the employee's period of employment, while the eventual benefit payable to the employee **– and therefore the liability of the employer** - cannot be determined until he or she actually retires. Fundamentals of Private Pensions, 8th Ed. at p. 260.

In other words, in a defined benefit plan scenario, "**the employer's cost is whatever is necessary to provide the benefit specified"** meaning that "investment risk and reward are assumed by the employer." Pension Planning: Pensions, Profit Sharing and Other Deferred Compensation Plans, 5th Edition, at pp. 57, 59, Everette T. Allen, Jr., Joseph J. Melone, Jerry S. Rosenbloom (Richard D. Irwin, Inc. 1984).

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regard for individual compensation or length of employment. Fundamentals of Private Pensions, 8th Ed. at p. 245.

[16] The SERS benefit plan focuses on the member's final average salary and years of credited service. Pensions in the Public Sector, Chapter 14 – "Pension Governance in the Pennsylvania State Employees' Retirement System" at p. 318. Section 5102 of the Retirement Code defines "final average salary" as the highest average compensation received by a member during any three nonoverlapping periods of four consecutive calendar quarters during which the member was a state employee"

It is for that reason that the "**the very core of the process of** costing and **funding defined benefit retirement programs** is the concept of **actuarial present value**. This involves computing **how much money should be set aside today to pay certain benefits in the future**. The Handbook of Employee Benefits, 6th Ed. at p. 1232.

It has been observed that the primary considerations "in the concept of an actuarial present value are those of probability and interest" – that in any defined benefit plan, the plan's total expected cost is determined by "a series of contingent future events under which benefits will be paid" including the particular employee's years of service and age at retirement. Id.

The role that actuarial assumptions play in the employer's funding of a defined benefit plan cannot be understated, Pensions in the Public Sector, at p. 6, since they determine the plan's "actuarial present values and resulting cost" by providing projections as to future events through "demographic assumptions" that project rates of termination before retirement, rates of retirement, disability incidence and mortality, and "economic assumptions" that project rates of inflation, salary scales and rates of investment return. The Handbook of Employee Benefits, 6th Ed. at pp. 1233-34.

Ultimately, **the plan's actuary is charged with the responsibility for determining the amount of money the employer must set aside today in order to pay the plan's pension obligations when they come due - an amount that has been characterized as the "present value of future benefits"** The Handbook of Employee Benefits, at pp. 1233, 1236. See also Pensions in the Public Sector, at p. 6.

In other words it is impossible to assess the extent of the employer's pension liability or the extent to which the employer has funded a defined benefit plan for a particular employee over the course of the employee's working career. Rather, the

assessment must be made as of the date of retirement in conjunction with the actuary's determination of the "present value of future benefits," which, as noted above, requires implementation of demographic and economic projections.

The actuarial analysis is, as noted, "at the very core" of the determination of employer funding of the plan**.**

That, of course, is not what occurs in connection with a "defined contribution" pension plan where both the employee and employer **contribute to an individual account**, such as a 401K account – and where the employee typically directs the investment, assumes the risk of account performance and receives benefits based that performance. Fundamentals of Private Pensions, 8th Ed. at pp. 273-74, The Handbook of Employee Benefits, 6th Ed. at p. 1229.

Because a defined contribution plan necessarily involves an individual account to which the employer contributes, an actuarial assessment of employer funding liability is a non-sequitor.

Since claimant's disability pension application in this case was not made under a defined contribution plan, but under a defined benefit plan, the SERS actuary was necessarily required to determine the extent of the employer's funding of the plan – the employer's pension liability - in accordance with what is a universally accepted actuarial methodology.

Before reviewing the details and the appropriateness of that methodology, it would seem fitting to first review the pertinent statutory features of the Pennsylvania State Employees' Retirement System.[17]

5. The Pennsylvania State Employees' Retirement System

The Pennsylvania State Employee's Retirement System was established by the Pennsylvania General Assembly in 1923. See 2005 SERS Member Handbook, at p. 2.

The Retirement System administers two retirement plans – a cost-sharing multiple-employer defined benefit plan that is the subject of this proceeding and a defined contribution, Internal Revenue Code, Section 457 Deferred Compensation plan. Id.

As of December 31, 2005 the SERS defined benefit plan had over 100,000 active members, over 100,000 annuitants and beneficiaries, a market assets funded status of 99.6% and over $28 billion in assets. See 2005 SERS Actuarial Report, Defined Benefit Plan, Hay Group, April 26, 2006.

The Retirement System is administered by an eleven-member "independent administrative board," which has the authority to make all decisions relating to the implementation of the Pennsylvania State Employees' Retirement Code, See 71 Pa. C.S.A. § 5101 *et seq.*[18] See also 2005 SERS Member Handbook, at p. 2.

Section 5931(e) of the Retirement Code provides that the members of the SERS board have a fiduciary obligation to active and retired members of the defined benefit

[17] Much of this summary of the Retirement System is provided by John Brosius' Chapter 14 contribution, "Pension Governance in the Pennsylvania State Employees' Retirement System", to Pensions in the Public Sector, supra. He is the former Executive Director of SERS.
[18] Act of March 1, 1974, P.L. 125, No. 31.

plan in terms of the investments and distributions of the Retirement Fund. See 2005 SERS Handbook, at p. 2.

Section 5901(c) of the Retirement Code requires board members to take an oath agreeing to diligently and honestly administer the affairs of the board **and to not willingly or knowingly permit any applicable provisions of law to be violated.**

In meeting its statutory obligations, the board is responsible for administration; benefit determination, funding and investment practices.

The Retirement Code makes available to plan members five types benefits: (1) the normal retirement benefit, referred to as the "superannuation annuity"; (2) an early retirement benefit, referred to as a "withdrawal annuity;" (3) a disability benefit – the benefit at issue in this case; (4) a death benefit and (5) a return of the employee's contributions plus all interest accrued on that amount.[19]

The SERS defined benefit plan is financed by three sources: (1) employee contributions; (2) employer contributions and (3) investment earnings. See 2005 SERS Member Handbook, at p. 2.

Section 5902(k) of the Retirement Code requires that the "**amounts paid annually to the Retirement Fund as employer contributions are determined each year by the board with the assistance of the SERS actuary"** See Public Pensions, "Governance in the Pennsylvania State Employees' System," at p. 320 (emphasis supplied).

The role of the SERS actuary can be summarized as follows: (1) in accordance with the requirements of Section 5902(j) of the Retirement Code, the actuary conducts an experience study once every five years; (2) the actuary includes in the study, a projected

[19] See Sections 5701-10 of the Retirement Code.

rate of investment return[20], projected average career salary growth and projected salary schedules; (3) **the actuary recommends appropriate employer contribution rates to the board every year;** See Section 5507(a);[21] and (4) the actuary determines the funded status of the plan every year. See Section 5902(h).

In the SERS 16th Investigation of Actuarial Experience issued by the Hay Group on March 15, 2006, the following relevant observation encapsulates quite well the central role that actuarial analysis plays in the operation of the SERS fund:

"If a retirement system is to operate on a sound actuarial basis, the funds on hand together with the expected future contributions must be adequate **to cover the value of future promised benefit payments**. Each year the actuary projects the expected value of future benefits and the stream of contributions needed to meet the benefits payments. **The [actuarial] projection serves as a basis for the determination of the needed employer contributions to the retirement fund.**" See SERS 16th Investigation of Actuarial Experience, 3/15/06 at p. 1 (emphasis supplied).

The SERS board relies upon actuarial projections that have been described as "moderately conservative" - that are close to the actual experience "but are conservative enough to protect against small deviations from past experience." See SERS 16th Investigation of Actuarial Experience, at p. 2.

The recommendations of the actuary are presented to the board for approval under Section 5902(k) of the Retirement Code.

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[20] The projected rate of investment return has been 8.5% compounded annually. See 2005 SERS Actuarial Report, Hay Group, dated April 26, 2006 at p. 44. The rate has been used since 1996.

[21] The contributions made by employers on behalf of all active members must be computed by the actuary "as a percentage of the total compensation of all active members during the period for which the amount is determined and shall be so certified by the board." The employer contribution shall consist of the employer "normal contribution rate" and "accrued liability contribution rate," both calculated on the basis of actuarial analysis, See 71 Pa. C.S.A. § 5508(a)(b)(c).

Each year the board adopts a Five-Year Investment Plan that establishes asset allocation and sets specific goals for each asset class in which SERS is investing. Pensions in the Public Sector ,"Governance in the Pennsylvania State Employees' Retirement System", at p. 322.

In order to achieve its investment objectives, the board employs in-house investment professionals including directors of private equity, real estate, public markets and fixed income, and hires outside consultants specializing in general investment, private equity investment and real estate investment. Pensions in the Public Sector "Governance in the Pennsylvania State Employees' System", at p. 323.

Finally, in accordance with Section 5902(m) of the Retirement Code, the board is obligated to issue a formal Report outlining the financial condition of the fund every year.

6. The Actuarial Methodology

All of the foregoing leads to an inescapable conclusion - that only the actuary can determine the extent to which the employer is liable for funding a defined benefit pension plan.

That conclusion necessarily answers the fundamental question raised in this case – how to measure the extent to which the employer has funded the SERS defined pension plan, or how to measure the extent of employer liability for the injured employee's annuity.

Indeed, the triggering eventuality for the offset contemplated by Section 204(a) is **employer liability** for both workers' compensation wage loss replacement and pension wage loss replacement**.**

In other words, the application of Section 204(a) is based upon employer "liability" for wage loss replacement – in two forms.

The discussion above makes clear that regardless of the promulgation of Section 204(a), the basic character of the defined benefit plan and the law implementing the SERS plan have always required actuarial analysis in order to determine employer liability.

Indeed, the methodology administered by SERS and PSERS is suitable and appropriate because it is the only means available for calculating employer liability for annuity funding.

To ignore or dismiss that fundamental element of a well-established method of providing superannuation wage loss replacement would be to rescind a crucial feature of Act 57 since it would effectively eliminate offsets for those employers providing injured workers with defined benefit annuities.

The methodology is as follows:

(1) As he or she does for any member of the plan, even those not receiving workers' compensation benefits, the actuary calculates the injured employee's benefit annuity;

(2) The actuary then calculates the amount of money the employer will have to set aside now, in order to fully fund the injured employee's annuity i.e. the "present value funding benefit" – in doing so, the actuary assumes a return on investment of 8.5% - the rate approved by the SERS board in calculating employer funding liability;

(3) The actuary then calculates the injured employee's actual contributions to the plan plus the aforementioned approved return on investment rate of 8.5%;

(4) The actuary then subtracts the injured employee contribution, plus the assumed return on investment rate, from the present value of the employee's annuity; and

(5) The resulting figure necessarily equals the employer's pension liability or the extent to which the employer must fund the employee's annuity entitlement.

The notion suggested by petitioner and the Pennsylvania Trial Lawyers Association that the actuarial calculation of employer liability is somehow "speculative" misapprehends the role the actuary plays in the administration of the SERS plan and ignores the fact that the methodology independently employed by SERS and PSERS is universally accepted in the pension community.

In his treatise Fundamentals of Private Pensions, 8th Ed., Dan M. McGill of the Wharton School of the University of Pennsylvania explains that a basic rule of pension plan design is that participants must be assured that they or their beneficiaries will eventually recover all of the contributions that the employee made to the pension plan. Professor McGill notes that Section 203(a)(1) of Employee Retirement Income Security Act ("ERISA") and Section 411(a)(1) of the Internal Revenue Code make clear that an employee's right to those accrued benefits derived from their own contributions to the pension plan are non-forfeitable.

Before the advent of ERISA, most defined plans provided that if a terminating employee were to exercise his or her right to withdraw his or her own contributions with interest, the employee would forfeit all rights to any pension benefits attributable to employer contributions to the plan even where the employee had acquired a vested interest in the accrued benefits financed by employer contributions. Fundamentals of Private Pensions, 8th Ed. at p. 260.

Section 203(a)(3)(D) of ERISA, however, denies the covered employer the right to cancel the benefit accruals attributable to employer contributions that have previously vested with certain exceptions[22].

Professor McGill has explained that with the advent of ERISA, the United States Congress has prescribed **the same methodology employed by SERS and PSERS for attributing the employee's accrued benefits to employer contributions**:

> Having decided to preserve the employer-finance benefits of employees who cash out the benefits financed with their own contributions, Congress found it necessary to develop rules for determining the respective proportions of an employee's accrued benefits allocable to employer and employee contributions. For purposes of dividing the accrued benefit into employer-and employee-financed portions, **the law presumes that all benefits are financed by the employer, except those that can be attributed to employee contributions**. Thus, the statutory rules pertain only to the calculation of the benefits that can be attributed to the employee contributions; **the difference between this amount and the total accrued benefits is thus attributable to employer contributions.**"

Fundamentals of Private Pensions, 8th Ed., at pp. 260-61. (emphasis supplied).

It cannot be overstated that the methodology referenced by Professor McGill is the same methodology applied by the SERS actuary in determining the employer's pension liability, or the extent to which the employer has funded the plan, in this case.[23]

[22] As noted below, ERISA is the primary body of law that governs the administration of private pension plans and therefore does not directly apply to the state system at issue in this case. In fact, Sections 5311 and 5701 of the Retirement Code provide that members who withdraw their contributions prematurely forfeit any benefit that would ordinarily accrue from employer funding. Still, the federal statute has rules that are consistent with those that apply to SERS (R. 8a) and therefore can provide logical guidance when reviewing the administration of the system.

[23] Again, because SERS is a state system, ERISA and Section 411 of the Internal Revenue Code do not control or apply to its administration. (R. 8a). Still, the logic underlying the federal statutes applies in this case – there is only one logical means for calculating employer funding liability in a defined benefit pension plan.

In fact, the United States Congress has prescribed by statute the same actuarial methodology implemented by SERS and PSERS.

Section 411(c)(1) of the Internal Revenue Code instructs as follows:

> "(C) Allocation of accrued benefits between employer and employee contributions.
>
> (1) **Accrued benefit derived from employer contributions. For purposes of this section**, an employee's accrued benefit derived from employer contributions as of any applicable date **is the excess, if any, of the accrued benefit for such employee as of such applicable date over the accrued benefit derived from contributions made by such employee as of such date.** (emphasis supplied)
>
> (2) Accrued benefit derived from employee contributions
>
> * * *
>
> (B) Defined Benefit Plans
>
> In the case of a defined benefit plan, the accrued benefit derived from contributions made by an employee as of any applicable date is **the amount equal to the employee's accumulated contributions expressed as an annual benefit commencing at normal retirement age, using an interest rate which would be used under the plan under Section 417(e)(3) (as of the determination date).**(emphasis supplied).

Accordingly, the methodology applied in this case is the methodology endorsed by the leading authorities in the study of pensions and is required by the United States government – it is the law of the land.

While petitioner and the Pennsylvania Trial Lawyers Association offer a series of lay grievances that perhaps afford some visceral appeal[24] they are, in reality, misguided

[24] For example, the suggestion that employer contributions simply be totaled using simple arithmetic, fails to appreciate that funding of individual retirement accounts does not occur in a defined benefit plan but only in a defined contribution plan. Moreover, it ignores the fact that employer liability in a defined benefit plan – the amount the employer will have to set aside today in order to fund the employee's annuity - can only be determined as of the date of retirement through application of actuarial projections. Finally, the notion that since

"red herrings" that have no relevance to the standard administration of defined benefit plans.

Indeed, they can be dismissed rather easily.

Since there can be no question that the methodology applied by SERS and PSERS is consistent with that required by the Bureau, involves a fundamental calculation employed in the normal operation of a defined benefit plan, has been endorsed by the leading authorities in the field and is required by the Internal Revenue Code for covered plans, it is respectfully submitted that the methodology should be accepted by this Honorable Court.

Commonwealth "employers" other than The Pennsylvania State University, participate in the SERS plan claimant's annuity must account for contributions made by those entities, fails to appreciate the fundamental basis for the application of the Section 204(a) offset in this case – the individual employer's pension liability for its injured employee.

IX. CONCLUSION

The methodology applied in this case is derived from the statutorily-based operation of the SERS defined benefit pension plan. It establishes as a matter of fact, defendant's liability for the employee's annuity at issue, has been endorsed by the leading authorities in the study of private and public pensions and is the same methodology required by the Internal Revenue Code for covered plans. It is, therefore, respectfully requested that this Honorable Court accept the methodology and reverse the ruling of the WCJ below, by reinstating defendant's offset entitlement.

CERTIFICATE OF SERVICE

I, Andrew E. Greenberg, Esquire, do hereby certify that I have serviced a true and correct copy of the within Brief for Amicus Curiae, The Pennsylvania Defense Institute, via United States First Class Mail, postage pre-paid upon the following:

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