IN THE
SUPREME COURT OF PENNSYLVANIA

NO. 14 EAP 2009

LARRY HARVEY

Appellant

v.

WORKERS' COMPENSATION APPEAL BOARD
(COMMONWEALTH OF PENNSYLVANIA/DEPARTMENT OF PUBLIC WELFARE)

Appellees

BRIEF FOR AMICUS CURIAE, SCHOOL DISTRICTS INSURANCE CONSORTIUM, IN SUPPORT OF BRIEF OF APPELLEE, COMMONWEALTH OF PENNSYLVANIA/DEPARTMENT OF PUBLIC WELFARE

Appeal by Allowance from the Opinion and Order of the Commonwealth Court of Pennsylvania dated November 26, 2008 (Docketed at No. 802 C.D. 2008) Reversing the Opinion and Order of the Workers' Compensation Appeal Board dated April 4, 2008 (Docketed at A07-0986) Reversing the Decision and Order of WCJ Thomas G. Devlin dated April 13, 2007 Disallowing the Review Petition of Larry Harvey

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I. STATEMENT OF JURISDICTION

This Honorable Court has jurisdiction over the instant Appeal pursuant to Section 724(a) of the Judicial Code[1].

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

II. STATEMENT OF INTEREST OF AMICUS CURIAE

School Districts Insurance Consortium ("SDIC") is a non-profit administration and claims service that manages workers' compensation claims for more than eighty public school districts throughout the Commonwealth of Pennsylvania.

Founded in 1979, SDIC is committed to providing high quality loss control and claim management services to its member school districts.

The professional claims personnel of SDIC serves the largest and oldest group self-insured fund in the Commonwealth of Pennsylvania through application and enforcement of the Workers' Compensation Act, including the off-set provisions set forth in Section 204(a) of the Act.

In meeting its responsibilities, SDIC interacts regularly with the Pennsylvania Public School Employees' Retirement System ("PSERS"),[2] while calculating and asserting pension off-sets on behalf of it member school districts.

The methodology utilized by PSERS and SDIC for calculating the kind of pension offset at issue in this case is the same methodology utilized by the Commonwealth of Pennsylvania State Employees' Retirement System ("SERS").[3]

Pursuant to its mission of promoting the interests of its membership, SDIC will from time to time submit Amicus Curiae briefs with the appellate courts of the

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[2] The Pennsylvania Public School Employees' Retirement System was established in 1917 in order to provide retirement benefits to public school employees of the Commonwealth of Pennsylvania. By June 30, 2008, the plan had an active membership of approximately 279,000 with approximately 176,000 retirees and beneficiaries and held net assets totaling $62.7 billion . See 2008 Pennsylvania Public School Employees' Retirement System Comprehensive Annual Financial Report at pp. 6, 9.

[3] In The Pennsylvania State University/The PMA Group v. Workers' Compensation Appeal Board (Hensal), 911 A.2d 227 (Pa. Cmwlth. 2006) both SERS and PSERS submitted Amicus Curiae briefs with the Commonwealth Court endorsing the methodology at issue in this case.

Commonwealth of Pennsylvania in order to explain and promote the concerns of the self-insured pool that it represents.

Through the submission of this Amicus Curiae brief, SDIC is seeking to assist this Honorable Court in construing the Act in a manner that advances the continuing legislative policy consideration of providing equitable wage loss benefits to injured workers while reducing the costs of Pennsylvania work injuries.

III. SCOPE/STANDARD 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[4]; 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, this Honorable 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[5] 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).

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

[5] 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."

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 (1995); Young v. Young, 507 Pa. 40, 488 A.2d 264 (1985).

Finally, in the context of a statutory construction question, this Honorable Court will 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[6].

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

IV. <u>ORDER IN QUESTION</u>

"AND NOW, this 26th day of November, 2008, the order of the Workers' Compensation Appeal Board, dated April 4, 2008, is hereby REVERSED and the order of the Workers' Compensation Judge, dated April 13, 2007, is REINSTATED and MODIFIED to read as follows:

> AND NOW, this 4th day of April, 2007, the Claimant's Review Petition is DENIED and DISMISSED. Defendant is entitled to a monthly offset of $1,644.95 based upon the retirement benefits received by Claimant."

(Order of the Commonwealth Court dated November 11, 2008)[7]

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[7] Commonwealth of Pennsylvania, Department of Public Welfare v. Workers' Compensation Appeal Board (Harvey), 960 A.2d 957 (Pa. Cmwlth. 2008).

V. STATEMENT OF QUESTIONS INVOLVED

Whether the Commonwealth Court erred:

1. By affirming its decisions in Pennsylvania State University/PMA Insurance Group v. Workers' Compensation Appeal Board (Hensal), 911 A.2d 225 (Pa. Cmwlth. 2006) and Department of Public Welfare/Western Center v. Workers' Compensation Appeal Board (Cato), 911 A.2d 241 (Pa. Cmwlth. 2006), and holding that an employer meets its burden of proof by only presenting evidence of an actuarially assumed rate of annual return on an employer's contribution rather than evidence confirming the actual rate of return on the pension;

and

2. By disregarding the plain language of Section 204(a) of the Workers' Compensation Act, 77 P.S. § 71(a), which grants an employer a credit against an employee's pension **only** "to the extent [the pension is] funded by the employer directly liable for the payment of workers' compensation.

(Answered in the negative by the Commonwealth Court below)

VI. STATEMENT OF CASE

On July 24, 2001 appellant, Larry Harvey ("claimant") sustained injury to his left shoulder in the course of his employment when he was assaulted by a patient at the Norristown State Hospital.

On that basis, appellee, the Commonwealth of Pennsylvania/Department of Public Welfare ("defendant") issued a Notice of Compensation Payable on August 15, 2001 accepting claimant's work injury as a "left shoulder tendonitis" and providing him total disability benefits at a rate of $439.40 per week, based upon a pre-injury average weekly wage of $659.10. (See Appendix A, Findings of Fact Nos. 1, 2).

Pursuant to Section 204(a) of the Act, defendant filed a Notice of Workers' Compensation Benefit Offset on June 10, 2005 asserting an entitlement to an offset for those pension benefits that claimant became eligible to receive through the SERS effective July 9, 2005. (See Appendix A, Finding of Fact No. 2).

On September 1, 2005 claimant filed a Petition to Review Benefit Offset alleging that the "Employer improperly calculated an offset for Claimant's pension benefits." (See Appendix A, Finding of Fact No. 3).

In response to claimant's Petition, 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. 1a-59a, R. 343a-353a) 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. 60a-201a).

Defendant also submitted the Commonwealth of Pennsylvania State Employees' Retirement System 2004 Actuarial Report prepared by the Hay Group (R. 204a-342a),[8] the Commonwealth of Pennsylvania State Employees' Retirement System 15th Investigation of Actuarial Experience, addressing the five-year period, January 1, 1996 through December 31, 2000 (R. 275a – R.298a) and the Commonwealth of Pennsylvania State Employees' Retirement System 16th Investigation of Actuarial Experience addressing the five-year period, January 1, 2001 through December 31, 2005, respectively.(R. 299a-R. 342a).[9]

Claimant did not present fact testimony or expert actuarial testimony in support of his Review Petition.

By Decision and Order circulated April 13, 2007, the WCJ below disallowed claimant's Review Petition on the basis of the following Findings of Fact and Conclusions of Law: (1) he accepted as credible the uncontroverted fact testimony of Ms. Miller; (2) he accepted as credible the uncontroverted testimony of defendant's actuarial expert, Mr. Mowery and (3) he concluded that the offset proposed by defendant was properly calculated and administered under the controlling Bureau Regulations and controlling case law. (See Appendix "A," Finding of Fact No. 6 and Conclusion of Law No. 1).

By Opinion and Order dated April 4, 2008, the Workers' Compensation Appeal Board reversed and remanded the ruling of the WCJ explaining that the "Judge's five 'Findings of Fact' consist only of procedural history of the matter and of summaries of the testimony of Mr. Mower and Ms. Miller, which are not helpful in performing

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[8] This submission references more recent SERS publications including the State Employees' Retirement System 2008 Actuarial Report issued by the Hay Group on June 3, 2009.
[9] Both the 15th Investigation and 16th Investigation were prepared by the Hay Group.

effective appellate review. The Judge failed to make 'critical' findings of fact listed by the [Commonwealth] court in Cato and failed to make any credibility determinations concerning those witnesses. Therefore a remand is warranted for the Judge to issue critical findings of fact, conclusions of law and credibility determinations with respect to the essential issues presented by the evidence in this matter." (See Appendix "B")(R. 368a-369a)

By Opinion and Order issued on November 26, 2008 the Commonwealth Court reversed the Appeal Board and reinstated the Decision and Order of the WCJ below, concluding that "this Court already decided that the expert evidence presented in Hensal and Cato was legally sufficient; therefore, the legal sufficiency of identical evidence in the present appeal is governed by controlling precedent. The Board erred in remanding the matter back to the WCJ for the submission of additional evidence on the actual rate of return on Claimant's contributions [to the SERS pension fund]. (See Appendix "C")(R.348a)

By Order dated May 13, 2009 this Honorable Court granted claimant's Petition for Allowance of Appeal.

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 would effectively eliminate the Section 204(a) pension offset for injured employees who are members of "defined benefit" pension plans.

Pension administration agencies such as SERS and PSERS have implemented identical methodologies, derived from the statutorily-based process of calculating employer liability for funding the pension annuities of participating employees. The methodology implemented by SERS and PSERS not only establishes the extent to which the employer must fund the annuity, but represents the only methodology for doing so. Indeed, it is 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 Commonwealth Court has correctly applied Section 204(a) of the Act.

VIII. ARGUMENT

A. SINCE THE METHODOLOGY ACCEPTED BY THE COMMONWEALTH COURT ESTABLISHES THE EXTENT TO WHICH DEFENDANT FUNDED CLAIMANT'S DEFINED BENEFIT PENSION PLAN, DEFENDANT WAS PROPERLY AFFORDED 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.

In The Pennsylvania State University/The PMA Insurance Group v. Workers' Compensation Appeal Board (Hensal), 911 A.2d 224 (Pa. Cmwlth. 2006) and Department of Public Welfare/Western Center v. Workers' Compensation Appeal Board (Cato), 911 A.2d 241 (Pa. Cmwlth. 2008), the Commonwealth Court sanctioned the methodology utilized by both SERS and PSERS in applying the pension offset provision of Section 204(a) of the Act.

The methodology relies upon an actuarial assessment of the present value of the liability the sponsoring employer will bear while guaranteeing the payment of the injured employee's "defined benefit" payment annuity over the course of the employee's lifetime.

The position advanced by claimant in this case seeks a result that will effectively eliminate the Section 204(a) offset for injured employees eligible for "defined benefit" pension plan annuities.

The Amicus Curiae, SDIC, 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.

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 substance of claimant's Appeal, SDIC believes that it is important to first consider that the pertinent facts underlying this appellate proceeding are not in dispute.

There is no dispute that: (1) claimant's date of birth is August 4, 1944 (R. 14a); (2) claimant was an employee of defendant for 23.9099 years (R. 14a, R. 345a); (3) claimant joined SERS on November 29, 1978 (R. a32); (4) in doing so, he became a member of the SERS defined benefit plan as a "Class AA" employee (R. 46a); (5) during the course of his employment with defendant from 1993 through 2005,[10] claimant made contributions to the pension plan at a rate prescribed by statute, (R. 101a)[11]; (6) on the basis of a work injury occurring on July 24, 2001 claimant was awarded total disability benefits under Act at a rate of $439.40 per week; (7) he thereafter retired on September 21, 2002 (R. 35a, R.345a) and filed for a disability pension benefit (R. 52a); (8) on that basis, he was awarded a "maximum single life annuity" pension benefit of $1,888.97 per month[12] (R.

[10] Claimant originally retired on October 10, 1990. (R. 345a). He received a retirement pension from that date until September 7, 1993 when he returned to work for defendant. (R. 345a).
[11] There is no statutory funding requirement for sponsoring employers in the SERS System. The actuary determines employer funding. (R.101a).
[12] The SERS administrator originally calculated a maximum single life annuity of $1,995.52 per month. (R. 345a). When claimant's Purchase of Service of Debt was included in the calculation, the maximum single life annuity was reduced to $1,888.97 per month. (R. 345a).

345a) and (9) claimant has not challenged the calculation of his maximum single life annuity.[13]

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).[14]

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 sought to reduce employer indemnity liability through the establishment of "Impairment Ratings,"

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[13] The SERS 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 the Commonwealth Court.

[14] 77 P.S. §71.

"Compromise and Release" settlements and a series of "offsets[15]" designed to prohibit 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 authorized by Section 204(a), this Honorable Court explained 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).[16]

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[15] Offsets for pension payments were available to employers before the enactment of Act 57. In order to obtain the offset 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 benefits 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.

[16] As discussed by this Honorable 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 the individual Pennsylvania employer on the basis of its workers' compensation history or "experience" over the course of multiple years. The adjustment factor is calculated for the individual employer based on prior years' payroll and loss data – essentially comparing the loss data of the particular employer to the average loss data for all other employers in the state who share the same classification code. Most Experience Modification Factor calculations utilize loss data from three prior policy years. The typical window used for payroll and loss data looks back four years from 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

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

> 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[17]" obtained on the basis of an inability to work, resulting from the effects of a 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.

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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, 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.

[17] See Section 5704 of the Retirement Code.

3. The Regulatory Application of Section 204(a)

In accordance with its legal responsibility to "explain and enforce the provisions of this Act,"[18] the Bureau of Workers' Compensation issued a series of Regulations on January 17, 1998[19] administering the remedial changes brought about by Act 57.

In doing so, the Bureau promulgated Section 123.8 of the Act 57 Regulations confirming the application of Section 204(a) to both "defined benefit" 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).

[18] See Section 435(a)(b) of the Act.
[19] See 28 Pa. Bulletin 329 (No. 3, Sat., January 17, 1998).

Consistent with the foregoing, Section 123.10 of the Regulations recognizes that actuarial calculations must be utilized in order to determine the extent to which the employer funded the defined benefit plan[20]:

> (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 should carry significant weight in this proceeding, particularly when one considers that the actuarial methodology that has been advanced in cases such as this one has been developed by two state agencies well-qualified to so - SERS and PSERS.

Indeed, this Honorable Court has instructed that "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

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

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. 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 United States Supreme Court has declared that the statutory construction advanced by the agency responsible for explaining and enforcing the legislation 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).

The Commonwealth Court of Pennsylvania has recognized that as a state agency charged with the responsibility for applying and executing the SERS System, 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 per se, the fact is that the state agency responsible for administering the retirement System at issue in this case, as well as the agency responsible for administering a very similar system - PSERS - have independently concluded that the actuarial methodology sanctioned by the Commonwealth Court below is the appropriate method for

calculating the extent to which the employer funded claimant's "defined benefit" plan in this case.

It is respectfully submitted that the methodology referenced by the Bureau, and implemented by SERS and PSERS should be given great weight by this Honorable Court.

In order to fully appreciate why the actuarial methodology approved by the Commonwealth Court 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[21], 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, pursuant to an agreed upon "formula" stated explicitly in the plan document - the two most common formulas being the "unit benefit[22]" formula and the "flat benefit" formula.

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[21] Mr. Hustead is an actuary employed by the Hay Group. He and Brent M. Mowery developed the SERS methodology at issue in this case. He also signed the 2005 SERS Actuarial Report.
[22] 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 regard for individual compensation or length of employment. Fundamentals of Private Pensions, 8th Ed. at p. 245.

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[23]. The Handbook of Employee Benefits, 6th Ed. p. 1230.

In this case, the SERS benefit formula includes the employee's years of service multiplied by a statutory accrual rate of 2.5%, multiplied by the employee's final three-year average pay. (R. 98a).

In other words, the employee's monthly pension benefit rate – the maximum single life annuity - is fixed and unaffected by the pension plan's investment performance. (R. 96a).

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

That is so because the sponsoring employer – not the employee – bears the investment risk of the pension plan. (R. 95a-96a) That is, the employer is liabile for making appropriate contributions to the fund when the plan's investment returns fail to reach anticipated performance levels.

The SERS actuary, Mr. Mowery confirmed as follows:

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[23] As noted, the SERS benefit plan looks to 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"

> So the basic tenet of a defined benefit pension plan is that investment risk is borne by the sponsoring employer and participating employees do not derive any advantage or disadvantage from the outcome of the investments of the assets of the underlying plan. [24]

(R. 96a).

In a "defined benefit" scenario, "**the employer's cost is whatever is necessary to provide the benefit specified"** since, again, "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).

Because employer funding in a defined benefit plan looks to the distant future, "**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.

Mr. Mower explained that:

> I think you could appreciate that the projection [of plan liability] that is done each time an actuarial valuation of SERS takes place involves a prediction of benefits that are likely to be owed to plan participants in the future, not just a couple of years from now, but looking out in the case of a newly hired 20 years old active employee it is really **looking out into 60, 70 years into the future** when a young participant like that might potentially have worked a full career, retired and gone into pension pay status . .

(R. 105a-106a)(emphasis supplied).

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[24] In the context of a "defined contribution" plan the investment risk and reward are assumed by the individual employee. (R. 36a).

It has been observed, therefore, 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. The Handbook of Employee Benefits, 6th Ed. at p. 1232.

The role that actuarial assumptions[25] play in the employer's funding of a defined benefit plan – the question at issue in this case - cannot be understated. Pensions in the Public Sector, at p. 6.

Indeed, actuarial projections determine the defined benefit plan's "actuarial present values and resulting cost" by projecting future events through two types of actuarial assumptions: (1) "demographic assumptions" that predict rates of termination before retirement, rates of retirement, disability incidence and mortality, and (2) **"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 actuarial assumptions – including the economic assumption of investment rate of return - allow the actuary to fulfill it 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

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[25] The 2004 State Employees' Retirement System Actuarial Report defines "actuarial assumptions" as "Estimates of future experience with respect to rates of mortality, disability, turnover, retirement, investment income and salary growth. Decrement assumptions (rates of mortality, disability, turnover and retirement) are generally based on past experience, often modified for projected changes in conditions. Economic assumptions (salary increases and investment income) consist of an underlying rate in an inflation-free environment plus a provision for long-term average rate of inflation." (R. 274a).

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.

Accordingly, 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."

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

That is not what occurs in connection with a "defined contribution" plan where both the employee and employer **contribute to an individual account**, such as a 401K account, during the period of employment – and where the employee typically directs the investment, assumes the risk of account performance and receives benefits based upon 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 **future employer funding liability** in that context 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 to which the employer was obligated to fund the plan from the date of retirement into the future, in accordance with what is a universally accepted actuarial methodology.

The argument advanced by claimant in this case that a review of **past** contributions made by the sponsoring employer to the plan, in the aggregate, and of the plan's **past** investment performance, misapprehends the moment at which and the manner in which the sponsoring employer's liability is determined – the date of retirement, into the future.[26]

Before reviewing the details and the appropriateness of the methodology utilized by SERS and PSERS, it would seem fitting to first review the pertinent statutory features of the SERS System.[27]

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 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. (R. 79a).

The System is administered by an eleven-member "independent administrative board," which has the authority to make all decisions relating to the implementation of

[26] See Brief of Appellant at pp. 9-10.

[27] Much of this summary of SERS 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.

the Pennsylvania State Employees' Retirement Code, See 71 Pa. C.S.A. § 5101 *et seq*.[28] 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 plan in administering the investments and distributions of the 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.[29]

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; (R. 85a, R. 91a).

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

[28] Act of March 1, 1974, P.L. 125, No. 31.
[29] See Sections 5701-10 of the Retirement Code.

board with the assistance of the SERS actuary" See Public Pensions, "Governance in the Pennsylvania State Employees' System," at p. 320. (R. 102a-103a).

The role of the SERS actuary includes the following: (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 rate of investment return**[30], 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);[31] and (4) the actuary must approve in writing all computational procedures used in the calculations of contributions and benefits. 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 funding the SERS System:

> 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.**

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[30] From 1985 through 2008 the projected rate of investment return was 8.5% compounded annually since 1996. See SERS 2005 Actuarial Report, Hay Group, dated April 26, 2006 at p. 44. On April 29, 2009 the SERS Board announced that it would reduce its projected rate of investment return to 8% for the coming state fiscal years. See SERS Press Release dated April 29, 2009.

[31] 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).

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.

Each year the Board adopts a Five-Year Investment Plan, which 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.

In accordance with Section 5902(m) of the Retirement Code, the Board is obligated to issue a financial statement showing the financial condition of the fund on or before July 1 of each year.

6. The Assumed Rate of Investment Return

As noted above, the defined benefit plan at issue in this case is funded, in part, by the System's investment returns.

"The Fund's overall investment objective is to provide a total rate of return, over full economic cycles, which exceeds the return of a fully diversified market portfolio

within each class. The Board seeks to meet this objective within acceptable risk parameters through adherence to a policy of diversification of investments by type, industry, quality and geographic location." Commonwealth of Pennsylvania State Employees' Retirement System, 2008 Comprehensive Annual Financial Report at p. 29.

The SERS Board is governed by the "prudent investor" rule, which "requires the exercise of that degree of judgment, skill and care under the circumstances then prevailing which persons of prudence, discretion and intelligence, who are familiar with such matters, exercise in the management of their own affairs not in regard to speculation, but in regard to permanent disposition of the funds, considering the probable income to be derived there from, as well as the probable safety of their capital." Commonwealth of Pennsylvania State Employees' Retirement System, 2008 Comprehensive Annual Financial Report at p. 13.

In meeting its responsibilities the Board invests SERS funds in six major asset classes: (1) stock assets; (2) cash; (3) fixed income assets; (4) real estate assets; (5) venture capital and private equity investments and (6) inflation protection assets. Commmonwealth of Pennsylvania State Employees' Retirement System, 2008 Comprehensive Annual Financial Report at pp. 35-38, 41, 43, 44, 59.

The assumed rate of return from these investment classes is recommended by the plan's actuary and approved by the SERS Board and is calculated in conjunction with assumed rates of salary growth for members of the plan and the long-term average rate of inflation. SERS 16th Investigation of Actuarial Experience, dated March 15, 2006 at p. 6. (R. 306a); (R. 274a).

The assumed rate of investment return plays a central role in the administration of the plan because it allows the Board to make certain that future pension liabilities will be sufficiently funded by the sponsoring employers.

It does so by affording the Board the present value of the sponsoring employers' future liability.

The concept of present value of future liability is not foreign to the Act.

In fact, Section 316 of the Act provides that where an employer is obligated to "commute" the injured worker's entitlement to disability benefits into a lump sum payment, it shall make payment "**at its then value when discounted at five per centum interest,**" 77. P.S. § 604. (emphasis supplied).

The notion advanced by claimant that the assumed rate of investment return is an inappropriate measure of employer funding liability, misapprehends the fact that **that** is its very purpose - to assist the Board in properly calculating the funding liability of the System's sponsoring employers.[32]

What claimant does not appreciate is that the assumed rate of investment return is a standard tool utilized by the SERS Board to calculate the plan's future liability for all participating employees – not simply for those employees eligible to receive workers' compensation disability benefits.

In his treatise Fundamentals of Private Pensions, 8th Ed., Dan M. McGill of the Wharton School of the University of Pennsylvania confirms that in order to assure proper funding of a defined benefit plan, an assumed rate of investment return must be utilized so as to discount future employer liability for benefits to be paid to participating employees:

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[32] Again, the employer in a defined benefit plan bears the investment risk.

> To guide the funding policy of the employer, it is necessary to estimate the amount and timing of benefits that will eventually be paid under the terms of the plan. **Because the benefits will be paid over many years, and funds set aside for the payment of such benefits will earn interest [through return on investment]** until finally disbursed, it is necessary for proper financial planning to convert the anticipated benefit payments [the plan's liability] into a single sum value **through the discounting process**.

Fundamentals of Private Pensions, 8th Ed. at p. 595. (emphasis supplied)

Professor McGill further explains that the "present value of a series of future contingent payments is a function of the rate of investment return, or of interest at which the payments are discounted – the higher the interest assumption, the smaller the present value." Fundamentals of Private Pensions, 8th Ed. at p. 611.

The assumed rate of investment return has drawn much attention from the claimants' bar since it rarely tracks the plan's actual investment performance on a year-to-year basis.

Presumably, the claimants' bar feels frustration when the actuary assumes a return on investment rate of 8.5% while the plan's actual return on investment for a given year is, for example, 17.2%,[33] thereby supposedly reducing the sponsoring employer's contribution liability for that year.

While from a lay standpoint there is some visceral appeal to the notion that the return on investment figure used to calculate the extent of the employer's plan funding, should track the actual year-to-year performance of the plan, that presumption

[33] The SERS invested funds yielded 17.2% in 2007 and 16.4% in 2006. In 2008, the funds suffered a loss of 23.8%. See Commonwealth of Pennsylvania State Employees' Retirement System 2008 Comprehensive Annual Financial Report at p. 4.

misconstrues both the nature of employer liability and the purpose of the assumed return on investment.

Employer liability in a defined benefit plan does not look backward, but looks into the future, the length of which cannot be calculated with certainty. The plan must projected through the comprehensive actuarial process described above.

Moreover, because of the volatility of market performance in the short-term, a year-to-year assessment of market performance is not an acceptable method for defined benefit plan funding. Rather, in order to properly assess employer liability for the defined benefit plan – and to assure the viability of the System - the assumed rate of investment return must represent the expected rate of return **over the long term** and should not be altered to reflect fluctuations in the financial market that are transitory. Fundamentals of Private Pensions, 8th Ed. at 612.[34]

Indeed, if employer funding were based upon year-to-year tracking of the System's investment performance, the sponsoring employers and the System itself could

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[34] In 2008, because of the collapse of the global economy ad the global investment markets, the SERS Fund produce a 2008 return, net of fees, of -28.7%. See 2008 Commonwealth of Pennsylvania State Employees' Retirement System Comprehensive Annual Financial Report at pp. 4, 9). The ramifications of an isolated assessment of market performance would be devastating and unsustainable. The System's ten-year annualized investment rate was 10.1% for the year ending 2007 – a figure that exceeded the approved assumed rate of investment return. The 2008 performance of the System's investment portfolio reduced the System's ten year annualized investment return to 4.9%. The foregoing performance statistics not only reveal how variable rates of return are in the short-term, but underscore the harm that such a focused approach could cause both the sponsoring employer and the injured worker who might chooses to apply for his or her SERS pension during a down market. Indeed, if the actual 2008 rate of investment return were utilized in assessing employer liability the burden on the employer would be catastrophic. Moreover, if the actual 2008 rate of investment return were to be utilized in calculating a pension offset for an injured worker who chose to retire in 2009 – by calculating the employer's liability for funding on the basis of the System's 2008 performance – the injured worker would suffer the substantial consequences of the disproportional employer funding that would necessarily follow such a focused approach.

not be sustained since cost to the employer or the unfunded liability of the System would be overwhelming in a given year.[35]

7. 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.

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.

Moreover, the administration of a defined benefit plan has always required the use of economic actuarial assumptions such as the assumed rate of investment return, in order to sufficiently fund the plan's liability.

The methodology utilized by SERS and PSERS is appropriate because it is the only means available that calculates employer liability for annuity funding.

The methodology is as follows:

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[35] The general rule instructs that for a typical plan a change, upward or downward, in the assumed rate of investment return of 1% alters the long-run cost estimate by 25%. See Fundamentals of Private Pensions, 8th Ed. at p. 612. A cost fluctuation of 25% in a System as large as the SERS System would wreak havoc on sponsoring employers and employee participants.

(a) 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 or "maximum single life annuity;"

(b) The actuary then calculates the total value of the injured employee's annuity benefit – that is, the actuary determines how much money the plan must set aside today in order to assure the employee's future entitlement or the "present value funding benefit." In doing so, the actuary utilizes the assumed rate of investment return[36]approved by the SERS Board for maintaining sufficient funding of the plan;

(c) The actuary then calculates the present value of the known contributions made by the injured employee to the plan utilizing the assumed return on investment rate approved by the SERS Board;

(d) The actuary then subtracts the injured employee's present value funding of the plan from the present value of the employee's annuity; and

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

Claimant's presumption that the foregoing methodology exists only in the context of Pennsylvania Workers' Compensation administration is not accurate.

Rather, the methodology is utilized in other contexts where apportionment of funding between the employer and employee is required.

Professor McGill 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 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.

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[36] Again, on April 29, 2009 the SERS Board reduced the assumed investment return from 8.5% to 8%.

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[37].

Professor McGill explains 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).

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[37] 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 and therefore can provide logical guidance when reviewing the administration of the system.

"The law presumes that all benefits are financed by the employer, except those that can be attributed to employee contributions."

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.[38]

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, <u>using an interest rate</u> which would be used under the plan under Section 417(e)(3) (as of the determination date).**(emphasis supplied).

[38] Again, because SERS is a state system, ERISA and Section 411 of the Internal Revenue Code do not control or apply to its administration. 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.

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 claimants in cases such as this one have offered a series of lay grievances that again afford some visceral appeal they are, in reality, misguided "red herrings" that have no relevance to the standard administration of defined benefit plans.

Indeed, they can be dismissed rather quickly.

For example, the suggestion that employer contributions should 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.

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.

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 affirm the ruling of the Commonwealth Court below.

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 or via e-mail, as noted, upon the following:

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