

LEGAL SERVICES

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MEMORANDUM

December 22, 2011

SUBJECT: Requiring generic drug prescriptions for retired public employees
(Work Order No. 27-LS1148)

TO: Representative Bob Lynn
Attn: Patty Krueger

FROM: Dan Wayne
Legislative Counsel

You have asked what constitutes a diminishment of the state retiree health coverage, and whether a requirement for generic prescriptions would be considered a diminishment of the state's retiree health coverage.

1. What constitutes a diminishment of the state's retiree health coverage?

Article XII, sec. 7 of the Alaska constitution¹ protects public employees from cuts in accrued² pension benefits.

The constitutional promise is that earned pension benefits cannot be diminished, and the future right to a specified benefit is vested. *Hammond v. Hoffbeck*, 627 P.2d 1052 (Alaska 1981).³ This protects public employees from cuts in accrued pension benefits,

¹ Alaska Constitution article XII, sec. 7:

SECTION 7. Retirement Systems. Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired.

² The term "accrued rights" is synonymous with "vested" rights. *Bidwell v. Scheele*, 355 P.2d 584, 586 (Alaska 1960).

³ The reductions in benefits in the *Hammond v. Hoffbeck* case involved a reduction in occupational disability benefits for public safety employees, a requirement that an employee be totally unemployable in order to be eligible for an occupational disability pension rather than "incapacitated for service in the position held," and reducing occupational death benefits from one hundred per cent to forty per cent of monthly salary at the time of death.

including health benefits; however, *Hoffbeck* also recognized that there is a flexibility to this protection that is necessary to allow legitimate legislative response to changing economic and social conditions.⁴ The court found the following language in a California case to be "instructive":

An employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system. Such modifications must be reasonable, and it is for the courts to determine upon the facts of each case what constitutes a permissible change. To be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages.⁵

Following that discussion, the *Hoffbeck* court said:

We agree with this analysis and hold that the fact that rights in PERS vest on employment does not preclude modifications of the system; that fact does, however, require that any changes in the system that operate to a given employee's disadvantage must be offset by comparable new advantages to that employee.⁶

An important qualification is found in note 11 of *Hoffbeck*, which says:

We are not called upon to consider the problem, which has frequently arisen in other jurisdictions, presented by a pension fund that is insufficient to satisfy all employee claims brought under its provisions. We intimate no view as to the appropriate legal analysis of any legislative alteration in employee benefits systems made in response to such circumstances.

Six other states have constitutional protection for public employee retirement benefits that are similar to Alaska's: Hawaii,⁷ Michigan,⁸ New York,⁹ Illinois,¹⁰ Louisiana,¹¹ and

⁴ *Hammond v. Hoffbeck*, 627 P.2d 1052, 1057.

⁵ *Id.*, quoting *Allen v. City of Long Beach*, 287 P.2d 765, 767 (Cal. 1955) (citations omitted).

⁶ *Id.*

⁷ Article XVI, sec. 2 of the Hawaii constitution, provides:

Arizona.¹² Court decisions in the other states may leave more room for legislative changes to accrued public employee benefits than the Alaska Supreme Court's decision in *Hoffbeck*. For example, the Michigan Supreme Court has found that "the Legislature cannot diminish or impair accrued financial benefits but we think it may properly attach new conditions for earning financial benefits which have not yet accrued."¹³ The Michigan court found that raising the employee contribution rate was a "new condition,"

Membership in any employees' retirement system of the State or any political subdivision thereof shall be a contractual relationship, the accrued benefits of which shall not be diminished or impaired.

⁸ Michigan's constitution, art. IX, sec. 24 reads:

The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby. Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities.

"Accrued financial benefits," under Michigan's state constitution, means the right to receive a specified retirement allowance based on service performed. *Kosa v. State Treasurer*, 292 N.W.2d 452, 459 - 460 (Michigan 1980), quoting *Advisory Opinion re Constitutionality of 1972 PA 258*, 389 Mich. 659, 662 - 663 (Michigan 1973). They do not include health benefits. *Studier v. Michigan Public Schools Retirement Board*, 698 N.W.2d 350 (Michigan 2005).

⁹ New York's state constitution, section 7 of article V, construes membership in any pension or retirement system as a contractual relationship which "shall not be diminished or impaired." *Cook v. Binghamton*, 48 N.Y.2d 323, 331 (N.Y. 1979).

¹⁰ The Illinois constitution provides that "membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumental thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired." Ill. Const., art. XIII, sec. 5.

¹¹ The Louisiana constitution, article X, sec. 29, says that membership in a public retirement system creates a contractual relationship and "accrued benefits of members . . . shall not be diminished or impaired."

¹² The Arizona constitution, article XXIX, sec. 1, says "[m]embership in a public retirement system is a contractual relationship that is subject to article II, section 25, and public retirement system benefits shall not be diminished or impaired."

¹³ *Advisory Opinion re Constitutionality of 1972 PA 258*, 389 Mich. 659, 663 (Michigan 1973).

which was not "a diminishment or impairment of such accrued benefits unless the new conditions were unreasonable and hence subversive of the constitutional protection."¹⁴ A case in Hawaii involving a dispute over the date a firefighter was considered to have begun his retirement sparked a discussion about constitutional protection of public employee retirement systems. The Supreme Court of Hawaii found that, although benefits attributable to past services could not be reduced, the legislature could make general changes in the retirement system.¹⁵

After *Hoffbeck*, the next discussion of art. XII, sec. 7, by the Alaska Supreme Court occurred in 2003 where the court considered challenges to a number of changes the state had made to PERS and TRS retiree health care plans in 1999 and 2000.¹⁶ Some changes provided greater benefits to the affected employees, but others were disadvantageous to them.¹⁷ Reductions in benefits included increasing the deductible amount, eliminating a provision that waived the annual deductible once \$50,000 in claims were paid, eliminating the lifetime coinsurance of 100 percent once \$50,000 in claims were paid, changing the rates of co-insurance, and increasing the costs of drugs not purchased through the mail-order service.¹⁸ A suit by retirees alleged that the changes amounted to an impermissible diminishment of accrued benefits under article XII, sec. 7, Constitution of the State of Alaska.¹⁹ The Alaska Supreme Court found that health insurance benefits are "accrued benefits" as that term is used in article XII, sec. 7. The court noted that handbooks published by the state for employees and retirees promise coverage, not merely payment of a particular premium, and said "[t]he natural and ordinary meaning of 'benefits' in a health insurance context refers to the coverage provided rather than the cost of the insurance."²⁰

¹⁴ *Advisory Opinion re Constitutionality of 1972 PA 258*, 389 Mich. 659, 663 - 664 (Michigan 1973).

¹⁵ *Chun v. Employee's Retirement Sys.*, 607 P.2d 415, 421 (Hawaii 1980). However, see *Kaho'ohanohano v. State*, 162 P.3d 696 (Hawaii 2007), in which the Supreme Court of Hawaii also extended constitutional protection to the "sources of funds" for accrued benefits, limiting the use of funds designated for payment of retirement benefits and potentially prohibiting their use for purposes other than paying retirement benefits.

¹⁶ *Duncan v. Retired Public Employees of Alaska, Inc.*, 71 P.3d 882 (Alaska 2003).

¹⁷ *Duncan*, 71 P.3d at 885.

¹⁸ *Id.*, n. 7.

¹⁹ *Id.*

²⁰ *Duncan*, 71 P.3d at 888 - 889.

In *Duncan*, the court also held, based on *Hammond v. Hoffbeck*, that the prohibition on diminishment did not mean that retirement benefits are unchangeable; it determined that benefits can be modified so long as the modifications are reasonable, and one condition of reasonableness is that disadvantageous changes must be offset by comparable new beneficial changes.²¹ The court clarified that, for the purpose of applying this test, the effect of changes to health insurance benefits are evaluated differently than the effect of changes to pension benefits; a change to a pension benefit may be evaluated based on its effect on a single employee, but a change to a health insurance benefit is evaluated based on its effect on the group of covered employees as a whole.²²

Although the constitutional right to pension and health benefits under an Alaska state retirement system vests (accrues) immediately upon the employee's enrollment in the system, under *Duncan*, a health benefit can be modified as long as the modification is reasonable and any change that results in a disadvantage to the covered employees (collectively, not just to a single employee) are offset by a comparable new advantage.²³ This interpretation of the state constitution leaves room for the state to change PERS and TRS retiree health benefits to require that prescribed drugs be generic in circumstances where prescription of a generic drug is otherwise reasonable and legally permissible.

2. "Would a requirement for generic prescriptions be considered a diminishment of the state's retiree health coverage?"

Retirees and benefit providers may consider a change that increases the generic drug prescription requirement in the health insurance coverage the state provides to retirees to be a diminishment; however, depending on factors discussed above in the answer to your first question, the Alaska Supreme Court may not consider the change an unconstitutional diminishment of retiree health care benefits.

Interestingly, there are already requirements that state retirees, in some instances, receive generic drug prescriptions. According to page 35 of the current version (May 2003) of the retiree health insurance care booklet published by the State of Alaska, retirees who elect to obtain certain prescriptions from a mail order pharmacy under the plan "will receive the generic equivalent when available and permissible by law." Also, retirees in the state plan are required to enroll for Medicare benefits as soon as they are eligible;

²¹ *Id.*

²² *Duncan*, 71 P.3d at 889 - 892.

²³ *Id.*

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although Medicare does not require prescription of generic drugs in every instance, some Medicare provider plans require at least some prescription of generic drugs.²⁴

If I may be of further assistance, please advise.

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Attachment

²⁴ See attached chart, "2012 Medicare Part D Plans for Alaska," published on the Internet at the website for the Alaska Department of Health and Social Services, by the Medicare Information Office in the Division of Senior and Disability Services.