

FIRST CIRCUIT COURT
STATE OF HAWAII

FILED

August 23, 2016

9:00 o'clock A.m.

U. Meade-Viernes

Clerk, Fifth Division

IN THE CIRCUIT COURT OF THE FIRST CIRCUIT
STATE OF HAWAII

BOARD OF TRUSTEES OF THE
EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII,

Plaintiff,

vs.

STATE OF HAWAII; HAWAII HEALTH
SYSTEMS CORPORATION; and DOES
1-100,

Defendants.

Civil No. 16-1-1543-08 (JHC)
(Declaratory Judgment)

ORDER GRANTING PLAINTIFF BOARD
OF TRUSTEES OF THE EMPLOYEES'
RETIREMENT SYSTEM OF THE STATE
OF HAWAII'S MOTION FOR
TEMPORARY RESTRAINING ORDER

Hearing:

Judge: Jeannette H. Castagnetti

Date: August 22, 2016

Time: 1:30 p.m.

ORDER GRANTING PLAINTIFF BOARD OF TRUSTEES OF THE EMPLOYEES'
RETIREMENT SYSTEM OF THE STATE OF HAWAII'S
MOTION FOR TEMPORARY RESTRAINING ORDER

Before the Court is Plaintiff Board of Trustees of the Employees' Retirement System of the State of Hawaii's Motion for Temporary Restraining Order, pursuant to Hawaii Rules of Civil Procedure Rule 65(b), filed on August 16, 2016, in which Plaintiff seeks an immediate stay of the implementation of 2016 Hawaii Laws 2nd Sp. Sess. Act 1 (S.B. 2077) (hereafter "Act 1") pending a written determination from the Internal Revenue Service as to the tax effects of Act 1 in the wake of the privatization or

closure of certain Hawai'i health systems corporation facilities. Defendant State of Hawai'i filed its Memorandum in Opposition on August 18, 2016.

The Court heard Plaintiff's motion on August 22, 2016. David M. Louie, Esq. and Joseph A. Stewart, Esq. appeared for Plaintiff Board of Trustees of the Employees' Retirement System of the State of Hawai'i ("Plaintiff" or "ERS"); Deputy Attorney General James C. Paige appeared for Defendant State of Hawai'i; and Anne E. Lopez, Esq. appeared for Hawaii Health Systems Corporation ("HHSC"), which joined in Defendant State of Hawai'i's opposition.

As further background, Act 1 authorizes certain HHSC public employees facing position abolishment, reduction-in-force, or workforce restructuring to select either (1) severance benefits or (2) a special retirement benefit in lieu of exercising any reduction-in-force rights. Treasury Regulation section 1.401(k)-1(a)(2)(i) characterizes this selection as a "cash or deferred arrangement" or CODA. Act 1 further requires the State to pay a monthly contribution for employees separated from service as a result of House Bill 1075, or "Act 103," of the Session Laws of Hawai'i 2015.

Act 103 "provides more detailed authority for establishing public-private partnerships in the Maui regional system to use one or more of the system's facilities more cost-effectively by discontinuing the system's provision of health care services at one or more of those facilities and transferring the right and responsibility to manage, operate and provide health care services in those facilities to one or more private entities or their nonprofit management entities."

"The test for granting or denying temporary injunctive relief is three-fold: (1) whether the plaintiff is likely to prevail on the merits; (2) whether the balance of

irreparable damage favors the issuance of a temporary injunction; and (3) whether the public interest supports granting an injunction."¹ "[T]he more the balance of irreparable damage favors issuance of the injunction, the less the party seeking the injunction has to show the likelihood of success on the merits."²

Addressing the first factor in support of a temporary injunction, Plaintiff argues that it is likely to prevail on the merits. When Plaintiff applied for a determination letter with regard to the ERS Plan in early 2014, the IRS established that the Plan met the tax qualification requirements of section 401(a) of the Internal Revenue Code ("Code"). Plaintiff asserts that an unintended consequence of Act 1 is that it would cause the ERS to lose its tax qualified status and substantially impair the benefits to ERS members, including the loss of income tax deferral and loss of tax deferred rollover of benefits to other retirement vehicles, such as an IRA. Further, according to the Internal Revenue Manual, section 4.72.2.3.3, a CODA is not permitted to be part of a defined government benefit plan such as the ERS. The potential inclusion of a CODA would cause the ERS to be disqualified for failure to meet the tax qualification rules of section 401(a) of the Code.³

¹ *Nuuanu Valley Ass'n v. City & Cty. of Honolulu*, 119 Hawai'i 90, 106, 194 P.3d 531, 547 (2008) (quoting *Office of Hawaiian Affairs v. Hous. & Cmty. Dev. Corp. of Hawaii*, 117 Hawai'i 174, 211, 177 P.3d 884, 922 (2008); see also *Life of the Land v. Ariyoshi*, 59 Haw. 156, 158, 577 P.2d 1116, 1118 (1978) (same)).

² *Office of Hawaiian Affairs*, 117 Hawai'i at 211-12, 177 P.3d at 922 (citation and quotation marks omitted).

³ See Internal Revenue Manual, § 4.72.2.3.3 (06-10-2015) ("a CODA that is part of a defined benefit plan would disqualify the entire plan because defined benefit plans are not permitted to contain CODAs").

Such tax disqualification and impairment of benefits, Plaintiff argues, is unconstitutional under article XVI, section 2, also known as the Non-Impairment Clause, of the Hawai'i State Constitution, which provides, in pertinent part, that "[m]embership in any employees' retirement system of the State . . . shall be a contractual relationship, the accrued benefits of which shall not be diminished or impaired."⁴ The Supreme Court in *Kaho'ohanohano v. State*, 114 Hawai'i 302, 162 P.3d 696 (2007), observed that "the proceedings of the 1950 Constitutional Convention demonstrate that article XVI, section 2 was introduced to ensure that the State and local governments would provide a sound retirement system for their employees and that an ERS member's constitutional right that the accrued benefits shall not be diminished or impaired is inextricably tied to protecting the source of such benefits."⁵ In other words, the "ERS funds must be secure in order to ensure that the ERS will be able to fulfill its obligations to its members into the future."⁶

The intent of the Non-Impairment Clause "was in part to provide the legislature with the flexibility to 'reduce benefits as to . . . persons already in the system [insofar] as their future services were concerned,' but '[i]t could not, however, reduce the benefits attributable to past services.'"⁷ Accordingly, the Hawai'i Supreme Court held that it would be "inconsistent with the delegates' statements and the Committee of the

⁴ Haw. Const. Art. XVI, § 2.

⁵ *Kaho'ohanohano*, 114 Hawai'i at 339-41, 162 P.3d at 733-35.

⁶ *Id.*, 114 Hawai'i at 342, 162 P.3d at 736.

⁷ *Everson v. State*, 122 Hawai'i 402, 408-09, 228 P.3d 282, 288-89 (2010) (quoting *Kaho'ohanohano*, 114 Hawai'i at 342, 162 P.3d at 736 (citation omitted)).

Whole report to conclude that the delegates intended to afford legislative flexibility to the extent that the legislature could ultimately *diminish or impair the benefits already accrued and contractually guaranteed.*⁸ In addition to protecting the *source* of benefits, the Hawai'i Supreme Court subsequently established, in *Everson v. State*, 122 Haw. 402, 405, 228 P.3d 282, 285 (2010) that the Non-Impairment Clause protects *accrued* benefits (emphasis provided). Thus, Plaintiff contends, there is authority to support a broad interpretation of article XVI, section 2 of the Hawai'i State Constitution to preclude *any* impairment to the ERS fund.

Moreover, Plaintiff maintains that Hawai'i Revised Statutes (HRS) section 88.22-5 requires that the ERS be administered in accordance with the relevant tax qualification requirements of the Code, including section 401(a). Plaintiff contends that the benefit of tax deferral is part of the benefits which accrue to members from participation in the ERS. In amending HRS section 88.22-5 as part of House Bill 808, or "Act 123," passed in 2013, the legislature noted that its purpose was to "preserve the tax qualified status of the [ERS] under section 401(a) of the [Code] . . . for the benefit of all members in the System."⁹ In addition, the legislature noted the harmful federal tax consequences if the ERS were to lose its tax-exempt status in that members would "no longer have favorable pre-tax treatment and would instead be entirely subject to federal income tax at the time of contribution . . . [and] . . . taxed on the value of their total accrued retirement benefits at the time they vest rather than when they receive their retirement benefits." Thus, in order to maintain tax-qualified status, the ERS must meet

⁸ *Kaho'ohanohano*, 114 Hawai'i at 342, 162 P.3d at 736 (emphasis in original).

⁹ S. Stand. Comm. Rep. No. 1271.

the applicable Code requirements.¹⁰ Based on the foregoing, Plaintiff argues that it is likely to prevail on the merits.

As to whether the balance of irreparable damage favors the issuance of a temporary injunction, Plaintiff emphasizes that the ERS and its members will be irreparably harmed if Act 1 is implemented and the ERS plan is disqualified. “[A]n injury is irreparable, within the law of injunctions, where it is of such a character that a fair and reasonable redress may not be had in a court of law, so that to refuse the injunction would be a denial of justice; where, in other words, from the nature of the act, or from the circumstances surrounding the person injured, or from the financial condition of the person committing it, it cannot be readily, adequately, and completely compensated for with money. The term ‘irreparable damage’ does not have reference to the amount of damage caused, but rather to the difficulty of measuring the amount of damages inflicted.”¹¹ “[T]he greater the probability of the party seeking the injunction is likely to prevail on the merits, the less he has to show that the balance of irreparable damage favors issuance of the injunction.”¹²

Plaintiff asserts that, as stated, (1) disqualification resulting from implementation of Act 1 would deprive ERS members of the ability to defer tax obligations, a central benefit of retirement plans such as the ERS, (2) the loss of other

¹⁰ *Id.*, No. 1011.

¹¹ *The 7's Enters. v. Rosario*, 111 Hawai'i 484, 496 n.17, 143 P.3d 23, 35 (2006) (quoting *Klausmeyer v. Makaha Valley Farms, Ltd.*, 41 Haw. 287, 339-40 (1956)).

¹² *Stop Rail Now v. De Costa*, 120 Hawai'i 238, 244, 203 P.3d 658, 664 (App. 2008) (quoting *Penn v. Transp. Lease Haw., Ltd.*, 2 Haw. App. 272, 276, 630 P.2d 646, 650 (1981)).

benefits, such as the ability to rollover benefits, in addition to increased administrative expenses would result in substantial impairment to members' accrued benefits, and (3) inclusion of a CODA would violate the requirements for a qualified defined benefit plan and result in the disqualification of the ERS, as well as an operational failure. Returning the ERS to qualified status would thus entail removing the unconstitutional provisions of the ERS plan, for which a stay is also necessary to address. Plaintiff, thus, concludes that the balance of irreparable damage favors issuance of a temporary injunction.

Lastly, in arguing that the public interest supports granting an injunction, Plaintiff reiterates that the Hawai'i Supreme Court in *Kaho'ohanohano* recognized that there is a public interest in ensuring that there is no violation of the Non-Impairment Clause by increasing the ERS' unfunded liability,¹³ and that preserving the ERS' tax-exempt status is vital to protecting the source of accrued benefits and serves an important public interest.

In opposing the motion for temporary injunctive relief, Defendant State of Hawai'i argues with respect to the first factor that not until the IRS examines the tax consequences of Act 1 will the Court be able to conclude that Plaintiff is likely to succeed on the merits of its constitutionality claim. Further, "with the exception of statutes that classify on the basis of suspect categories, . . . every enactment of the legislature is presumptively constitutional."¹⁴ Hence, "all doubts must be resolved in

¹³ See *Kaho'ohanohano*, 114 Hawai'i at 333, 162 P.3d at 727.

¹⁴ *State ex rel. Anzai v. City & County of Honolulu*, 99 Hawai'i 508, 515, 57 P.3d 433, 440 (2002) (internal quotation marks and citation omitted).

favor of the act.”¹⁵ Without an IRS ruling, Defendant argues, Act 1 is presumptively constitutional.

With respect to the second factor of irreparable injury, Defendant essentially argues that Plaintiff’s request is untimely and premature. Such an emergent request could have been avoided by seeking an IRS ruling much earlier, such as during Act 1’s legislative process.¹⁶ Further, the earliest that any employee election can occur is *after* the transfer of the hospitals to private entities as contemplated under Act 103; thus, there is no irreparable injury at this juncture.

Finally, Defendant argues that it is in the public interest for legislation to be properly implemented because it is the duty of the executive branch to faithfully execute the laws of the State, which necessarily entails a determination that implementation of Act 1 is consistent with state and federal constitutions.

This Court finds that, under the circumstances, and upon consideration of the arguments set forth, Plaintiff has sufficiently shown that (1) the ERS is likely to prevail on the merits, (2) the balance of irreparable damage favors the issuance of a temporary injunction, and (3) the public interest supports granting an injunction. As stated, Plaintiff’s purpose in moving for a temporary injunction is to seek a letter ruling from the IRS as to ERS’ tax qualification status in light of Act 1, as well as the potential

¹⁵ *State ex rel. Amemiya v. Anderson*, 56 Haw. 574, 545 P.2d 1175, 1181 (1976) (internal quotation marks and citations omitted).

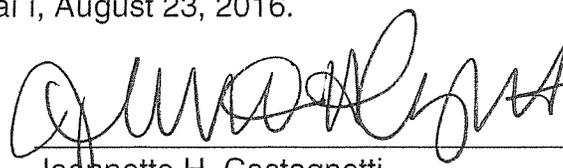
¹⁶ In response, Plaintiff argued at the August 22 hearing that it could not seek an earlier determination from the IRS because the Tax Exempt and Government Entities Division does not issue letter rulings on proposed legislation. See Internal Revenue Bulletin, January 4, 2016, Rev. Proc. 2016-4, § 6 (“Employee Plan Rulings and Agreements does not issue letter rulings on a matter involving the federal tax consequences of any *proposed* federal, state, local, municipal, or foreign legislation”) (emphasis added)).

unintended federal tax consequences of the implementation of the Act. Importantly, Plaintiff's request for relief is limited in scope and does not include or involve issues relating to the transfer of the Maui hospitals pursuant to Act 103. Plaintiff only seeks to stay the implementation of Act 1 pending a written determination by the IRS as to the election or cash or deferred arrangement provided for in Act 1.

Lastly, the Court acknowledges and agrees with Defendant State of Hawai'i's request that the Court impose a date certain by which Plaintiff is to submit its request to the IRS. Time is of the essence for Plaintiff to submit its request to the IRS as it is presently unknown when the IRS will respond to the request for a letter ruling as to Act 1. The Court also recognizes that the ERS must follow the Code as to both form and operation. If an election is made under Act 1 before the Court rules on Plaintiff's motion for preliminary injunction, an operational failure could result, thus jeopardizing ERS' tax qualification status under section 401(a) of the Code. Therefore, the Court finds good cause to extend the temporary restraining order until the Court rules on Plaintiff's motion for a preliminary injunction.

Accordingly, for the reasons stated, the Court ORDERS, ADJUDGES AND DECREES that Plaintiff's Motion for Temporary Restraining Order is GRANTED. The court further ORDERS that Plaintiff shall submit its written request to the IRS on or before August 31, 2016. Plaintiff's motion for preliminary injunction shall be heard on September 29, 2016 at 1:30 p.m.

DATED: Honolulu, Hawai'i, August 23, 2016.



Jeannette H. Castagnetti
Judge of the above-entitled Court



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Board of Trustees of the Employees' Retirement System of the State of Hawai'i, vs. State of Hawaii, Hawaii Health Systems Corporation, Civil No. 16-1-1543-08 JHC; In the Circuit Court of the First Circuit, State of Hawaii; Order Granting Plaintiff Board of Trustees of the Employees' Retirement System of The State of Hawai'i's Motion for Temporary Restraining Order