No. 18P25

No. TENTH JUDICIAL DISTRICT

SUPREME COURT OF NORTH CAROLINA

****

MICHAEL HUGHES, on behalf of himself and others similarly situated, Plaintiff-Appellee, v. BOARD OF TRUSTEES TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM, a North Carolina body politic and corporate; TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM OF NORTH CAROLINA; CONSOLIDATED JUDICIAL RETIREMENT SYSTEM OF NORTH CAROLINA; LEGISLATIVE RETIREMENT SYSTEM OF NORTH CAROLINA; STATE TREASURER Dale R. Folwell, ex officio CHAIR OF THE BOARD OF TRUSTEES TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM (in his official capacity); and STATE OF NORTH CAROLINA, Defendants-Appellants.	)	From Wake County COA24-263 22-CVS-4566

****

PETITION FOR DISCRETIONARY REVIEW

****

INDEX

TABLE OF AUTHORITIES

Cases

Statutes

No. TENTH JUDICIAL DISTRICT

SUPREME COURT OF NORTH CAROLINA
****

MICHAEL HUGHES, on behalf of himself and others similarly situated, Plaintiff-Appellee, v. BOARD OF TRUSTEES TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM, a North Carolina body politic and corporate; TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM OF NORTH CAROLINA; CONSOLIDATED JUDICIAL RETIREMENT SYSTEM OF NORTH CAROLINA; LEGISLATIVE RETIREMENT SYSTEM OF NORTH CAROLINA; STATE TREASURER Dale R. Folwell, ex officio CHAIR OF THE BOARD OF TRUSTEES TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM (in his official capacity); and STATE OF NORTH CAROLINA, Defendants-Appellants.	)	From Wake County COA24-263 22-CVS-4566

****

PETITION FOR DISCRETIONARY REVIEW

****

TO THE HONORABLE SUPREME COURT OF NORTH CAROLINA:

Pursuant to N.C. Gen. Stat. § 7A-31 and Appellate Rule 15, Plaintiff-Appellant Michael Hughes, on behalf of himself and others similarly situated, respectfully petitions for discretionary review of the Court of Appeals' decision issued in this case, over a dissent, on 19 November 2024.

INTRODUCTION

Under the plain language of N.C. Gen. Stat. § 135-5(o), if active North Carolina state employees receive a cost-of-living adjustment (a "COLA") to their pay in any given year, and *if* in that same year retired state employees receive a COLA, then the adjustments must be "comparable." And § 135-5(o) outlines the specific criteria for ensuring that such adjustments are "comparable." Unfortunately, the COLAs provided to retirees in recent years were not "comparable" to the COLAs provided to active employees in those years.

Retired state employee Michael Hughes filed a putative class action on behalf of present and future retired state employees, seeking to remedy that clear violation of the law and to uphold the settled contractual right of state retirees to their retirement benefits. Defendants—who jointly oversee the three state retirement systems at issue—moved to dismiss the case based on sovereign immunity. The trial court denied that motion.

The majority of a panel of the Court of Appeals reversed. The majority's

opinion characterized Hughes' claim as seeking, on behalf of retirees, "a proactive and absolute right to cost of living increases accorded to active employees" of the State, and then the opinion noted that retirees have no vested right to receive a COLA under § 135-5(o). *But that is not Hughes' claim*. His actual claim mirrors the plain text of § 135-5(o), which provides this:

- Retirees are not guaranteed to receive a COLA (i.e., there is no vested right to them); but
- Retirees can receive a COLA if and only if active employees receive a COLA; and
- *If* retirees receive a COLA, *then* it must be "comparable" to the COLA given to active employees; and
- The statute specifically defines "comparable" in a way that ensures that active employees and retirees have the same "net disposable income" given their different tax situations.

Put even more simply, Hughes is not claiming that retirees must receive a COLA—he is claiming that *if* retirees receive a COLA, *then* it must be "comparable" to the COLA given to the active employees. And he is claiming that retirees are owed compensation for the incomparable COLAs they have received in recent years.

Surprisingly, the majority opinion's own explication of § 135-5(o) is correct and is exactly what Hughes is arguing. The majority opinion ultimately concludes that "[t]hese two sentences [of § 135-5(o)] read together plainly provide retirees 'may receive' cost-of-living increases, and, if and when

appropriated, they shall be comparable to those of active employees under the statutory formulas." *That is exactly what Hughes is contending, and exactly what failed to happen here: COLAs were in fact appropriated for retirees, but they were not "comparable."* Hughes agrees with the majority opinion's interpretation of the statute, so it's unclear to him why the majority reversed the trial court instead of affirming. In dissent, Judge Hampson recognized what Hughes' actual claim was and that it simply mirrored the text of the statute.

This Court should grant the petition for three reasons. First, the subject matter of the appeal has significant public interest. The state employee retirement systems serve hundreds of thousands of current members, and they will serve more as active employees retire—all putative class members. The COLAs previously given to the retirees are not "comparable" to those given to the active employees, which violates the law. In fact, the recent COLAs given to state retirees are less than the rate of inflation, meaning that the real value of the retirement benefits are decreasing. Thus, all present and future retired state employees have a direct interest in this case.

Second, the appeal involves a legal principle of major significance to the jurisprudence of the State. Specifically, this case involves interpreting a key statute governing the retirement benefits for state employees, and whether the "comparability" requirement will be read out of the statute or whether the

plain text enacted by the General Assembly will be enforced.

Third, the majority opinion conflicts with decisions from this Court. This Court has long recognized that the State waives sovereign immunity when it enters into an employment contract with a state employee, *see, e.g.*, *Smith v. State,* 289 N.C. 303, 320, 222 S.E.2d 412, 423–24 (1976), and that the terms of that contract are based on the understandings and expectations of the employees created by, most commonly, the statutes governing state employee benefits, *see, e.g.*, *Lake v. State Health Plan for Teachers & State Employees*, 380 N.C. 502, 521, 869 S.E.2d 292, 308 (2022). All those cases involved state employee benefit statutes that are materially similar to the statute here, as far as sovereign immunity is concerned.

Thus, this case is just like the previous cases providing legal relief to state employees entitled to the benefits they were promised and relied upon when they chose to become public servants. Those promises by the State-as-employer deserve no less enforcement than similar promises by private employers, and the majority's opinion conflicts with those earlier decisions from this Court.

STATEMENT OF RELEVANT FACTS

I. Retirees, like Hughes, fail to receive "comparable" COLAs.

The Teachers and State Employees' Retirement System ("TSERS"), Consolidated Judicial Retirement System ("CJRS"), and the Legislative

Retirement System ("LRS") are pension plans administered by the Department of State Treasurer. (R p 5 ¶¶ 8–11). Collectively, these retirement systems are referred to as the "Retirement Systems."

When an active member of the Retirement Systems ("Active Member") retires and becomes a "Retiree," they are entitled to a lifetime of monthly retirement benefits. (R p 6 ¶¶ 15–18). Retirees rely on these monthly benefits to fund all aspects of their living expenses.

Plaintiff Michael Hughes began working for the North Carolina Department of Administration in 1994, as a mechanical engineer. (R p 8 ¶ 28). He spent nearly 20 years inspecting public buildings for safety violations. After retiring in 2012, he began receiving $1,823.53 in monthly retirement benefits, totaling $21,882.36 per year. (R p 8 ¶ 31). Since Hughes retired in 2012, he and other Retirees of the Retirement Systems have received several small COLAs. (R p 8 ¶¶ 32–33). Active Employees, by contrast, have consistently received much larger COLAs. (R p 7 ¶ 26).

After more than 11 years of retirement, Hughes had received cost-of-living adjustments totaling $6,084.30 per year by the end of 2023. To simply keep up with inflation through the end of 2023, Hughes would have needed approximately $7,809.02 per year by the end of 2023 in total adjustments.[1]

---

[1] *See, e.g.*, www.bls.gov/data/inflation_calculator.htm (last visited January 9, 2024) (U.S. Bureau of Labor Statistics inflation calculator).

This means that, after considering the small COLAs that Hughes and the other Retirees received and adjusting for inflation, the value today of each dollar that Hughes or other Retirees received in 2012 is now worth less than a dollar. Their benefits, in real dollars, are decreasing.

N.C. Gen. Stat. § 135-5(o) governs increases and cost-of-living adjustments to Retirees' benefits. (R p 7 ¶¶ 21–23). The third paragraph of § 135-5(o) allows for certain "increase[s] in retirement allowances" based on the Consumer Price Index (CPI), but only "if the additional liabilities on account of such increase do not require an increase in the total employer rate of contributions." (*Id.*).

In addition to that, the last paragraph of § 135-5(o) governs "cost-of-living increases in retirement allowances," and it mandates that, if and when Retirees are provided COLAs, they must be "comparable" to the COLAs provided to Active Employees when considering the same relative impact "upon the net disposable income of each group." (R p 7 ¶¶ 22–23). Specifically, that last paragraph of § 135-5(o) provides this:

> Notwithstanding the above paragraphs, retired members and beneficiaries *may receive* cost-of-living increases in retirement allowances if active members of the system receive across-the-board cost-of-living salary increases. Such increases in post-retirement allowances *shall be comparable to cost-of-living salary increases for active members* in light of the differences between the statutory payroll deductions for State retirement contributions, Social Security taxes, State income withholding taxes, and federal

> income withholding taxes required of each group. The increases for retired members shall include the cost-of-living increases provided in this section. The cost-of-living increases allowed retired and active members of the system shall be comparable when each group receives an increase that has the same relative impact upon the net disposable income of each group.

N.C. Gen. Stat. § 135-5(o) (emphasis added). The comparability requirement ensures that the COLAs for Retirees and Active Employees yield roughly the same after-tax benefit for each group, with its recognition that there are some "differences" between how each group is taxed.

That is the paragraph directly at issue in this case. Hughes alleges that, under the plain language of this paragraph, Retirees may receive COLAs if Active Employees receive COLAs, and *if* Retirees do receive COLAs, *then* they must be "comparable" to the Active Employees' COLAs.

An Active Employee with the same starting salary in 2012 as Hughes' total beginning retirement benefit in 2012 would have received, from 2012 through the end of 2023 and in the years that Hughes received COLAs, COLAs totaling $24,614.69 per year. The $6,084.30 per year in COLAs that Hughes alleges he received through the end of 2023 is far from "comparable" to that. Thus, Hughes alleges that if Defendants had abided by the mandate in N.C.G.S. § 135-5(o), the COLAs to his base retirement benefit would have been about four times higher per year by the end of 2023. This is similarly true for other Retirees.

II. Hughes sues to enforce § 135-5(o), and the Superior Court denies two motions to dismiss.

Hughes filed this action in April of 2022 to recover the retirement benefits that were due to him. (R pp 3–14). Defendants—who jointly oversee the Retirement Systems—moved to dismiss. (R pp 25–26). Defendants made several arguments in that motion, including that because the General Assembly is vested with the power to make political decisions, including decisions about changes to state employees' retirement benefits, the General Assembly's choice to not follow the "comparable" requirement for Retirees is a political choice that cannot be challenged. (R p 29; RS pp 1–10).

The Superior Court, Judge Stephan Futrell presiding, denied the motion to dismiss in its entirety. (R pp 31–32). Defendants then filed an answer (R pp 33–42), and discovery proceeded, including depositions and significant productions of documents.

Then, more than a year after their first motion to dismiss was denied, Defendants filed another motion to dismiss and a motion for judgment on the pleadings. (R pp 43–45). In those motions, Defendants raised four arguments: (1) Defendants are shielded by sovereign immunity; (2) there is no private right of action for Hughes' statutory claim under N.C.G.S. § 135-5(n); (3) this case presents a nonjusticiable political question; and (4) Hughes does not have standing to sue the legislative-system and judicial-system defendants, even

though this is a class action and the claims are legally identical, because he was not a participant in those systems. (R pp 43–45; RS pp 12–25).

The Superior Court, Judge Graham Shirley presiding, denied both motions in December of 2023. (R pp 49-50). However, apparently concerned about the standing issue, the trial court ordered Hughes to add a judicial-system plaintiff and legislative-system plaintiff within 90 days, a requirement that has been stayed by this appeal. (R p 50).[2]

III. A panel of the Court of Appeals reverses, over a dissent.

Defendants timely appealed (R pp 61–64), raising only the issue of sovereign immunity. A panel of the Court of Appeals reversed.

First, the majority's opinion noted that the State waives sovereign immunity when it enters into an employment contract with a state employee. Slip op. at 10–12.

Second, the majority characterized Hughes' argument as "seek[ing] a proactive and absolute contractual right to cost of living increases accorded to active employees." Slip op. at 12. Basically, the majority asserted that Hughes was claiming that § 135-5(o) mandates that Retirees receive COLAs if Active

---

[2] Although that requirement was stayed by the Defendants' appeal, counsel for Hughes has since been retained by two judicial-system plaintiffs: the Hon. Burley Mitchell, Jr. (a retired Chief Justice of this Court) and the Hon. Sanford Steelman, Jr. (a retired Judge of the Court of Appeals). Mr. Mitchell and Mr. Steelman will be added to the pleadings as plaintiffs if this Court reverses the Court of Appeals and the case is remanded.

Employees receive COLAs. And the majority concluded that there was no such right in § 135-5(o) because that statute provides that Retirees "may" receive a COLA if Active Employees do, and "may" means something "discretionary" and not "mandatory;" in that same vein, the majority noted that the next sentence of § 135-5(o), which requires comparability, does not mandate that Retirees receive a COLA. Slip op. at 18. In sum, the majority concluded, § 135-5(o) does not "create a pro-active vested right to COLAs for retirees or active employees." Slip op. at 22.

The majority held that Hughes' claim for breach of contract and his related claim for a declaratory judgment should have been dismissed. The majority did not take issue with Hughes' allegation that § 135-5(o) was a provision in the contract between himself and the State, based on his expectations and understandings stemming from the benefits statutes; rather, the majority concluded that his contract claim failed because § 135-5(o) did not require that Retirees receive COLAs if Active Employees receive COLAs (which was not his actual claim, of course).[3]

In dissent, Judge Hampson explained the error that requires

[3] The majority also held that § 135-5(n) provides a statute of limitations and not a private right of action that waives sovereign immunity (slip op. at 20), which Hughes had conceded in his opening brief because his cause of action arises from the contract, not directly from the statute. That issue does not resolve or affect this petition.

discretionary review by this Court:

> Contrary to the majority's assertion, Plaintiff is not "seek[ing] a proactive and absolute contractual right to cost of living increases." Indeed, Plaintiff agrees there is no guaranteed right to such cost-of-living increases under this provision. Rather, Plaintiff contends more narrowly that this statutory provision requires that *if* retired members and beneficiaries receive a cost-of-living increase under this provision, that increase must be "comparable" to the cost-of-living increase provided as across-the-board cost-of-living salary increases to active members. This is consistent with the plain language of the statute, which provides [quoting § 135-5(o)].

Dissenting slip op. at 3 (emphasis in original). Based on that conclusion, the dissent would have held that there was no sovereign immunity. Dissenting slip op. at 5.

Hughes moved for en banc review, which the Court of Appeals denied, although four judges voted to grant the motion. *See* Order 31 December 2024.

REASONS WHY THE PETITION FOR DISCRETIONARY REVIEW SHOULD BE GRANTED

I. The Subject Matter of the Appeal Has Significant Public Interest.

The subject matter of the appeal has significant public interest, *see* N.C. Gen. Stat. § 7A-31(c)(1), because it directly affects the hundreds of thousands of current and future participants in the State's retirement systems. Those participants deserve a final ruling on this serious claim, one way or another, from this State's highest court.

II. The Appeal Involves a Legal Principle of Major Significance to the Jurisprudence of the State.

The appeal involves a legal principle of major significance to the jurisprudence of the State: how to interpret a key statute governing the retirement benefits for state employees, and whether the "comparability" requirement in that statute will be read out of the statute and ignored or whether the plain text enacted by the General Assembly will be enforced. *See* N.C. Gen. Stat. § 7A-31(c)(1).

The General Assembly required that COLAs for Retirees "*shall be comparable to cost-of-living salary increases for active members*…." If the Court of Appeals opinion is allowed to stand, then that provision becomes meaningless. Whether or not to ignore that clear statutory mandate is an important issue of law, one that may affect how other courts deal with statutory mandates like the one in § 135-5(o) or how they deal with similar claims by State employees based on statutory employment benefits.

III. The Court of Appeals Decision Conflicts With This Court's Decisions.

A. This Court has made clear that claims like the breach of contract claim here are not barred by sovereign immunity.

This Court has held and consistently reaffirmed that "[a] public employee has a right to expect that the retirement rights bargained for in exchange for his loyalty and continued services, and continually promised [to]

him over many years, will not be removed or diminished." *Bailey v. State*, 348 N.C. 130, 141, 500 S.E.2d 54, 60 (1998). In fact, the Court has reaffirmed that principle in at least five separate cases, described below in chronological order:

1. *Simpson v. N.C. Local Government Employees' Retirement System* (1987)

In *Simpson*, two firefighters who were vested members of the North Carolina Local Government Employees' Retirement System challenged a law modifying how disability retirement benefits were calculated. *Simpson v. N.C. Local Gov't Emps.' Ret. Sys.*, 88 N.C. App. 218, 224, 363 S.E.2d 90, 94 (1987), *aff'd*, 323 N.C. 362, 372 S.E.2d 559 (1988). As a result of the General Assembly's actions, the firefighters would "receive, upon disablement after vesting, a smaller retirement allowance under the modified statute than under prior law." *Id.* at 220, 363 S.E.2d at 92. The firefighters claimed that the decrease "constitute[d] an impairment of contractual rights" in violation of the Contracts Clause of the United States Constitution. *Id.* at 221, 363 S.E.2d at 92. The Court of Appeals agreed, and this Court affirmed *per curiam*.

The Court of Appeals held that the relationship between plaintiffs and the Retirement System "is one of contract." *Id.* at 223, 363 S.E.2d at 92. In support of that holding, the court reasoned that "[a] public employee has a right to expect that the retirement rights bargained for in exchange for his loyalty and continued services…will not be removed or diminished." *Id.* at 223–24, 363

S.E.2d at 94 (emphasis added). The court rejected the State's argument that the General Assembly's inclusion of a right-to-amend clause in the statute defeated the firefighters' claim. *Id.* at 221, 363 S.E.2d at 92–93.

Simpson also held that the challenged law substantially impaired the firefighters' vested rights under the contract "inasmuch as plaintiffs stand to suffer significant reductions in their retirement allowances as a result of the legislative amendment under challenge." *Id.* at 225, 363 S.E.2d at 94. But the court concluded that a genuine issue of material fact remained: whether the State had demonstrated that the legislative changes to the retirement plan were "reasonable *and necessary* to serve an important state interest." *Id.* at 226, 363 S.E.2d at 95 (emphasis in original). Accordingly, the court held that summary judgment for the State had been "improvidently entered" and remanded the case to the trial court for further proceedings. *Id.*

2. *Faulkenbury v. Teachers' & State Employees' Retirement System of N.C.* (1997)

In *Faulkenbury*, this Court considered whether a statute "which reduced plaintiffs' disability retirement payments" violated the Contracts Clause. *Faulkenbury v. Teachers' & State Employees' Retirement System of North Carolina*, 345 N.C. 683, 690, 483 S.E.2d 422, 426–27 (1997). Noting that the case was "almost on all fours with" *Simpson*, the Court held "that the relation between the employees and the governmental units was

contractual." *Id.* "At the time the plaintiffs' rights to pensions became vested, the law provided that they would have disability retirement benefits calculated in a certain way," and thus the benefits "were rights [the plaintiffs] had earned and that may not be taken from them by legislative action." *Id.*[4]

After declining to overrule *Simpson*, the Court considered and rejected various arguments purporting to explain why the plaintiffs lacked a contractual right to disability benefits calculated in the manner provided at the time their benefits vested. The Court expressly rejected the argument that "the statutes upon which the plaintiffs rely ... only state a policy which the General Assembly may change." *Id.* Instead, the Court held that these statutes "provided what the plaintiffs' compensation in the way of retirement benefits would be" at the time the plaintiffs "started working for the state," and thus the statutory calculation became part of their employment contracts. *Id.*

Faulkenbury reached this conclusion notwithstanding its recognition that "nothing in the statutes" indicated that the General Assembly "intended to offer the benefits as a part of a contract." *Id.* at 691, 483 S.E.2d at 427. Instead of restricting its analysis to the four corners of the statute, the Court considered how a reasonable person offered employment with the State would

[4] Hughes cited *Faulkenbury* in his Complaint, in his brief in the trial court, at the motion to dismiss hearings, and in the Court of Appeals. (R p 13; RS pp. 39–41; 24 August 2022 T. p. 39; 9 November 2023 T. p. 21).

interpret what the benefits provided by the statute represented:

> [W]hen the General Assembly enacted laws which provided for certain benefits to those persons who were to be employed by the state and local governments and who fulfilled certain conditions, this could reasonably be considered by those persons as offers by the state or local government to guarantee the benefits if those persons fulfilled the conditions. When they did so, the contract was formed.

Id. The Court concluded that it was reasonable for a prospective employee to believe the statutes providing retirement disability benefits were part of the compensation package promised, even though these statutes provided that the General Assembly "reserved the right to amend the retirement plans for state and local government employees." *Id.*

Regarding whether the plaintiffs' contracts were substantially impaired, the Court reasoned that even if other changes to the plaintiffs' overall retirement benefits meant they were "receiving more than any reasonable expectation they had for disability benefits," they were "entitled to what they bargained for when they accepted employment with the state and local governments" and "should not be required to accept a reduction in benefits for other benefits they have received." *Id.* at 693, 483 S.E.2d at 429.

3. ***Bailey v. State*** **(1998)**

In *Bailey*, a class of state and local government employees challenged a state law capping the amount of retirement benefits that were exempted from

state taxation. 348 N.C. at 139, 500 S.E.2d at 54. Prior to that law, benefits paid to retirees under any state or local retirement system were entirely tax-exempt. *Id.* This Court recognized that every member of the class had "'vested' in the retirement system" before the law took effect, meaning they had met "the requirement that employees work a predetermined amount of time in public service before [becoming] eligible for retirement benefits." *Id.* at 138, 500 S.E.2d at 58.

Once again, the Court declined to overrule *Simpson*. *Id.* at 142, 500 S.E.2d at 61 ("[T]he contractual relationship approach taken by the Court of Appeals in *Simpson* and our subsequent decisions is the proper one."). Instead, the Court reaffirmed "the principle that where a party in entering an obligation relies on the State, he or she obtains vested rights that cannot be diminished by subsequent state action." *Id.*

With respect to whether a contract existed regarding the tax exemption, the Court framed the question as "whether the tax exemption was a condition or term included in the retirement contract." *Id.* at 146, 500 S.E.2d at 63. The Court held that the trial court's finding of fact that "[a] reasonable person would have concluded from the totality of the circumstances and communications made to plaintiff class members that the tax exemption was a term of the retirement benefits offered in exchange for public service to state and local governments" was dispositive and supported by the evidence

produced at trial. "Based on this finding and the supporting evidence," the Court determined that, "in exchange for the inducement to and retention in employment, the State agreed to exempt from state taxation benefits derived from employees' retirement plans." *Id.* at 150, *Id.* at 146, 500 S.E.2d at 65.

The Court in *Bailey* also held that the plaintiffs had shown that their contract rights were substantially impaired and that the impairment was not reasonable and necessary. *Id*. at 151–52, 500 S.E.2d at 66–67. First, the Court concluded that the imposition of a $4,000 annual exemption cap—which would produce "losses to retirees in expected income ... in excess of $100 million"—was a substantial impairment of the employees' contractual right to tax-exempt retirement benefits. *Id.* at 151, 500 S.E.2d at 66. Second, the Court rejected the State's effort to justify the $4,000 cap as a "reasonable and necessary" means to equalize the tax treatment of state and federal retirement benefits, as required by a recent United States Supreme Court decision. *Id.* at 152, 500 S.E.2d at 66–67. The Court held that the cap "was not *necessary* to achieve the state interest asserted" because the State could have equalized the tax treatment of state and federal retirement benefits in "numerous ways … without impairing the contractual [rights] of plaintiffs." *Id.* (emphasis added).

4. *North Carolina Association of Educators (NCAE) v. State* (2016)

In *NCAE*, North Carolina public school teachers claimed that the

General Assembly violated the law when it eliminated North Carolina's career status system, "creat[ing] a new system of employment" and "retroactively revok[ing] the career status of teachers who had already earned that designation." *North Carolina Association of Educators (NCAE) v. State*, 368 N.C. 777, 779, 786 S.E.2d 255, 258 (2016). Under the career status system, teachers employed for a statutorily-fixed number of years became eligible to enter into a "career teacher" contract with the local school board, after which the teacher would "no longer [be] subject to an annual appointment process and could only be dismissed for ... grounds specified [by] statute." *Id.* This Court concluded that the law eliminating career status was unconstitutional "to the extent that the Act retroactively applies to teachers who had attained career status" as of the date the statute took effect. *Id.*

First, the Court concluded that there was a contractual right in career status, even though the statute at issue did not explicitly provide for one. The Court explained that "[l]aws which subsist at the time and place of the making of a contract ... enter into and form a part of it, as if they were expressly referred to or incorporated in its terms." *Id.* at 789, 786 S.E.2d at 264 (quoting *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 429–30 (1934)). Therefore, when teachers entered into contracts with local school boards, the "statutory system that was in the background of the contract between the teacher and the board set out the mechanism through which the teachers could

obtain career status." *Id.* Thus, the Court concluded, "vesting [of the right] stems not from the Career Status Law, but from the teacher's entry into an individual contract with the local school system." *Id.*

The Court then concluded that repealing the Career Status Law effected "a substantial impairment of the bargained-for benefit promised to the teachers who have already achieved career status." *Id.* at 790, 786 S.E.2d at 265. Addressing whether the impairment was "reasonable and necessary," the Court explained that the burden shifted back to the State to "justify an otherwise unconstitutional impairment of contract" in light of "the interest the State argues is furthered." *Id.* at 791, 786 S.E.2d at 265. Although the Court agreed with the State that "maintaining the quality of the public school system is an important purpose ... [and] that alleviating difficulties in dismissing ineffective teachers might be a legitimate end justifying changes to the Career Status Law, no evidence indicates that such a problem existed." *Id.* at 791, 786 S.E.2d at 266. Furthermore, the Court could not discern how retroactively repealing career status for all teachers who had already earned it was a "reasonable" way of advancing the State's asserted interest in light of "several alternatives ... that would allow school boards more flexibility in dismissing low-quality teachers." *Id.* at 792, 786 S.E.2d at 266. Accordingly, the Court held that the repeal of the Career Status Law was unconstitutional as applied to teachers who had entered into contracts with school boards that had granted

them career status protections. *Id.*

5. *Lake v. State Health Plan for Teachers & State Employees* (2022)

In *Lake*, state retirees alleged that the State violated the law when it eliminated the option to remain enrolled in a premium-free preferred provider organization (PPO) health insurance plan. *See generally Lake v. State Health Plan for Teachers & State Employees*, 380 N.C. 502, 521, 869 S.E.2d 292, 308, *cert. denied*, 143 S. Ct. 111 (2022). This Court, relying on each of the four cases outlined above, ultimately concluded that: (1) the retirees had a contractual right to remain enrolled in a premium-free PPO plan; and (2) there were disputed facts about whether the state substantially impaired the contracts (for example, what the value of the new insurance plan was) and whether the impairment was reasonable and necessary. *Id.*

The Court rejected the defendants' argument that the right-to-amend provision in the statute at issue (in which the General Assembly specifically reserved the right to change the insurance coverages) precluded a finding that the contractual rights could be impaired. 380 N.C. at 527, 869 S.E.2d at 312. The Court also held that, when it comes to the "reasonable and necessary" defense: (1) the burden was on the State to establish that; (2) the existence of the problem the State supposedly seeks to fix requires evidence; (3) the State's desire to save money is not, standing alone, enough, because contracts are

contracts even if parties don't want to perform them when the bill comes due; (4) the fact that certain economic trends have caused an increase in cost in maintaining a benefit is not enough; and (5) the State cannot impose drastic measures when a more moderate course would suffice. *Id.*

6. Under these decisions, the breach of contract claim here is not barred by sovereign immunity.

These five decisions make clear that Hughes has sufficiently alleged a claim for which Defendants have no sovereign immunity, and that the Court of Appeals opinion conflicts with established precedent from this Court. *See* N.C. Gen. Stat. § 7A-31(c)(3).

First, the law is clear that the State and its agencies waive sovereign immunity when they enter into contracts with private parties, who are then permitted to sue the State for any breach of that contract and related claims. This Court made that plain in *Smith,* 289 N.C. 303, 222 S.E.2d 412, where it articulated five obvious reasons for this principle, concluding that "whenever the State of North Carolina, through its authorized officers and agencies, enters into a valid contract, the State implicitly consents to be sued for damages on the contract in the event it breaches the contract." *Id.* at 320, 222 S.E.2d at 423–24.

None of the five decisions outlined above expressly addressed sovereign immunity, which is both unsurprising and almost the point. That defense was

never raised likely because it is obviously futile. Just like the plaintiffs in *Smith* and those five cases, Hughes has alleged a claim for breach of contract. Based on his contract claim under § 135-5(o), sovereign immunity has been waived. If sovereign immunity existed in the situation here, then none of the five decisions discussed above would exist.[5]

Second, and as the dissent in this case recognized, the issue of how to interpret the contract at issue—that is, how to interpret § 135-5(o)—is really a merits issue going not to whether there is sovereign immunity over the contract claim, but whether the contract claim succeeds. *See Can Am S., LLC v. State*, 234 N.C. App. 119, 127, 759 S.E.2d 304, 310 (2014) (holding that the "defendants cite to no authority, and we find none, for the proposition that waiver of sovereign immunity is contingent on breach of contract" and that "[t]his Court has consistently held that we are not to consider the merits of a claim when addressing the applicability of sovereign immunity as a potential defense to liability"). In other words, there is no sovereign immunity over Hughes' claim even if § 135-5(o) does not mean what Hughes says it means.

---

[5] The Court of Appeals has applied those five decisions, many times, highlighting the importance of the issues raised here. *See, e.g.*, *Dieckhaus v. Univ. of N.C*, 287 N.C. App. 396, 421, 883 S.E.2d 106, 125 (2023). As in the five Supreme Court decisions, in none of these decisions were the defendants held to have sovereign immunity for the contract claim. Indeed, *Dieckhaus* rejected the claim of sovereign immunity because the plaintiffs had pleaded the existence of a contract, regardless of whether the contract ultimately were found to have been breached. 287 N.C. App. at 410, 883 S.E.2d at 118.

Nonetheless, Hughes believes that § 135-5(o) is clear on its face, and so this Court can and should simply enforce the plain text of that statute.

B. The majority's opinion misunderstands the central claim and fails to apply the plain text of the statute, as the dissent recognized.

The majority opinion misunderstands the central claim here: it's not that Retirees must always receive a COLA if the Active Employees do, it's simply that *if* the Retirees receive a COLA, *then* it must be "comparable" to the one received by the Active Employees. That is exactly what the plain text of § 135-5(o) provides, and even the majority opinion does not contend otherwise. Rather, the majority opinion raises up and then strikes down an argument that Hughes never made—a straw man.

Indeed, the majority opinion's own explication of § 135-5(o) is correct and is exactly what Hughes is arguing. The majority opinion says this:

> The plain language of this sentence stating retired members "may receive increases in retirement allowance" is discretionary and are not mandatory. N.C. Gen. Stat.§ 135-5(o). The second sentence, explaining the prior sentence states the increases "shall be comparable to cost-of-living salary increases for active members" provides the amount of the increases, *if any,* appropriated by the General Assembly. These two sentences read together plainly provide retirees "may receive" cost-of-living increases, and, if and when appropriated, they shall be comparable to those of active employees under the statutory formulas.

Slip op. at 18 (emphasis in original). That is exactly what Hughes is

contending, and exactly what failed to happen here: COLAs were in fact appropriated for Retirees, but they were not "comparable." Based on its *own explication* of § 135-5(o), the majority opinion should have affirmed, not reversed.

Furthermore, there is no meaningful difference between *Bailey* and this case: if the retirement benefits statute can confer on Retirees a vested right in their underlying retirement benefits (*Bailey*), then it also can confer on them a vested right in a COLA (this case)—if the statutory language is clear enough that it does so, and it is here. The language is as clear about the COLAs here as it was about the underlying benefits in *Bailey*.

In response to Hughes' motion for en banc review, the Defendants argued that Hughes never alleged what was always his central claim, both below and on appeal: that *if* retirees receive a COLA, *then* it must be "comparable" to the COLA given to the active employees. That assertion is simply untrue.

First, the Complaint alleges that clearly, including by using the words "comparable" or "comparability" 15 times, alleging that Defendants "failed to give State Retirees comparable cost-of-living adjustments to those of active State Employees as required by statute," and alleging that "Defendants have violated the mandate of N.C.G.S. § 135-5(o) by the inadequate amount of increase they have requested for cost-of-living adjustments for State Retirees." (R p 4 ¶ 1, p 10 ¶ 56).

It is true that, as Judge Hampson recognized in dissent, the Complaint alleged that Defendants violated N.C.G.S. § 135-5(o) *both* by "the inadequate number of times" COLAs were given to Retirees *and* "the inadequate amount of increase[s]" of the COLAs for Retirees. (Dissenting op. at 3 n.2; *see* R p 12 ¶¶ 55–56). But, as the dissent also recognized, "merely alleging alternate theories does not subject Plaintiff's Complaint to a sovereign immunity defense. Indeed, taken as a whole, Plaintiff's Complaint is more fairly read as challenging Defendants' compliance with the comparability." (*Id.*) That is correct.

Second, the nature of Hughes' claim was clear to everyone in the courts below. For example, the very first line of Hughes' trial court brief in opposition to the motions at issue was this: "This case is relatively straightforward. Under N.C.G.S. § 135-5(o), *if* active North Carolina state employees receive a cost-of-living adjustment (a 'COLA') in any given year, then any COLA for retired state employees—*if one is given*—must be 'comparable.'" (R Supp. p 29 (emphasis added)). And Hughes argued exactly that at both trial court hearings, and the presiding judges understood the claim:

> MR. LEE [counsel for Hughes]: Exactly. They don't have to give retirees an increase when they give active employees an increase. But if they do give retirees an increase, it has to be comparable.
>
> THE COURT: So you're saying that once they choose to, they have to abide by those conditions described in

> the remaining sentences, but you're not saying they have to give every year.
>
> MR. LEE: Exactly. …

(24 August 2022 T pp 29–30). Defendants never claimed in the trial court that they did not understand that this was Hughes' central claim or that it was not sufficiently alleged in the complaint.

Third, Hughes made the nature of his claim clear in his brief to the Court of Appeals:

> Defendants argue, as they did during both rounds of motions below, that § 135-5(o) is "permissive" and says only that Retirees "may" be granted a COLA, so that the General Assembly "is not required" to grant one. (Br. at 21–22). Hughes agrees, as he did below. But that misses the point. The point is that *if* a COLA is given to Retirees, *then* it must be "comparable" with the one necessarily given to the Active Employees. Indeed, Defendants actually admit as much at one point in their brief: "When a cost-of-living increase is made to State retirees' pensions under the last paragraph of § 135-5(o), it needs only to be 'comparable' to the across-the-board cost-of-living salary increases granted to active members of the system (i.e., current employees) in light of several factors." (Br. at 22). Hughes agrees with that assertion 100%, and this case is simply about enforcing that clear requirement.

Br. at 32.

In their reply brief to the Court of Appeals, Defendants asserted—for the first time—that Hughes could not make this claim because the Complaint failed to allege it. Reply Br. at 3–5. First, that assertion is just untrue, as noted

above. Second, Defendants waived that argument by never making it in the trial court. *See, e.g.*, *Piraino Bros., LLC v. Atl. Fin. Grp., Inc.*, 211 N.C. App. 343, 348, 712 S.E.2d 328, 332 (2011).

Defendants' response to the en banc motion is useful in one regard: it agrees with Hughes that the Court of Appeals' majority opinion did not actually address the central claim that, under § 135-5(o), *if* retirees receive a COLA, *then* it must be "comparable" in amount to the COLA given to the active employees. (*See* Defendants' Br. p 5 line 16 through p 6 line 17 and p 7 line 17 through p 8 line 5). That concession by Defendants simplifies the issues. Now, at a minimum, this Court should grant the petition and direct the Court of Appeals to address the claim clearly made. *See, e.g.*, *Janu Inc. v. Mega Hosp., LLC*, 385 N.C. 608, 894 S.E.2d 743 (2023) (granting PDR for limited purpose of vacating portions of Court of Appeals opinion and remanding for consideration of an issue not addressed). But because the merits issue is a pure legal question, this Court can and should grant the petition, rule on the merits, and reverse the Court of Appeals' majority opinion with instructions to remand the matter to the trial court for further proceedings.

Defendants have cited several out of state cases about COLAs, a few of which the majority opinion cited. Slip op. at 18–20. None of those decisions are controlling or applied North Carolina law, of course, and North Carolina has the five cases on point discussed above. Furthermore, none of those cases are

on point because none of them involved the issue of sovereign immunity—rather, they involved whether the plaintiffs could prevail on their claims on the merits, which is not at issue here. Moreover, none of those cases involved a contractual claim based on a clear statutory requirement like § 135-5(o)—which has not been amended or repealed. Indeed, § 135-5(o) appears to be a unique animal.

Furthermore, there are out-of-state decisions on the other side of the coin that Defendants and the majority opinion do not cite; they are as inapt as those cited by Defendants and the majority opinion, but they reach the opposite result. *See, e.g.*, *Fields v. Elected Officials' Ret. Plan*, 320 P.3d 1160 (Ariz. 2014) (holding that a statutory decrease in a COLA-like adjustment for retirees violated a clause in the state constitution that was tantamount to the contracts clause, thereby violating the settled expectations of state employees, including retired judges, noting that case law around the country supports the idea that retirement "benefits," including those protected by constitution and by statute, clearly include COLAs and COLA-like adjustments to those benefits); *In re Pension Reform Litig.*, 32 N.E.3d 1, 16–29 (Ill. 2015) (Illinois Supreme Court citing *Fields* and holding similarly); *Kleinfeldt v. New York City Emps.' Ret. Sys.*, 324 N.E.2d 865, 868–69 (N.Y. 1975) (holding that New York state constitution protected contractual "benefits" rights of state employees, and that statutorily-enacted decrease to retirement benefit formula affected those

"benefits" and violated employees' contractual expectations).

Finally, although Defendants did not explicitly raise the political question doctrine on appeal, and although the majority opinion did not address that doctrine, some of Defendants' arguments in their briefs below could be read to suggest that that doctrine applies—for example, when they argued that the General Assembly has the sole and unbridled power to change the benefits at issue or to appropriate funds to pay them.

As an initial matter, a dismissal based on the political question doctrine is not immediately appealable. *See, e.g.*, *Craig v. Town of Huntersville*, 288 N.C. App. 271, 884 S.E.2d 796 (2023) (table). Anyhow, the five cases discussed above make clear that the issues here are not subject to the political question doctrine. Even though those cases never specifically used the term "political question," they squarely addressed the idea behind the doctrine—that the legislature has the sole and unbridled power to change the benefits at issue—and then squarely rejected that idea. In fact, this Court rejected that idea even when the statutes *specifically provided* that the General Assembly had the ability to change the rules for State employee benefits. *Simpson*, 88 N.C. App. at 221, 363 S.E.2d at 92–93; *Faulkenbury*, 345 N.C. at 691, 483 S.E.2d at 427; *Lake*, 380 N.C. at 527, 869 S.E.2d at 312.

The five cases show that Defendants are not immune or shielded by the political question doctrine simply because the General Assembly is involved in

appropriations necessary for Defendants to comply with their contractual obligations. If Defendants breach their contractual obligations, then they are liable, even if they breach them because the General Assembly did not appropriate money. The General Assembly ultimately may not appropriate money to pay any judgment, and it might not be able to be forced to do so, but that's a separate issue from liability for breach of contract.

ISSUES TO BE BRIEFED

1. Did the State waive sovereign immunity for a contract claim by a retired state employee that Defendants violated § 135-5(o)?

2. Does § 135-5(o) require that, *if* retirees receive COLAs, *then* they must be comparable to the COLAs received by the active employees?

CONCLUSION

Hughes' contract claim is simple: if Retirees receive a COLA, then it must be "comparable" to the COLA provided to Active Employees. The majority's opinion doesn't actually disagree with that claim, which is not subject to sovereign immunity. But more importantly for purposes of this petition: (1) that claim has significant public interest, especially to the hundreds of thousands of State employees; (2) that claim involves a legal principle of major significance; and (3) the majority's opinion conflicts with clear precedent from this Court. The Court should grant the petition.

This 9th day of January, 2025.

MILBERG COLEMAN BRYSON
PHILLIPS GROSSMAN PLLC

/s/ Mark R. Sigmon
Mark R. Sigmon, N.C. Bar No. 37762
5 W. Hargett St., Suite 1001
Raleigh, NC 27601
Phone: (919) 451-6311
Fax: (919) 882-9057
msigmon@milberg.com

N.C. R. App. P. 33(b) Certification: I certify that all of the attorneys listed below have authorized me to list their names on this document as if they had personally signed it.

Matthew E. Lee, N.C. Bar No. 35405
Jeremy R. Williams,
N.C. Bar No. 48162
MILBERG COLEMAN BRYSON
PHILLIPS GROSSMAN, PLLC
900 W. Morgan Street
Raleigh, North Carolina 27603
Phone: (919) 600-5000
Fax: (919) 600-5035
mlee@milberg.com
jwilliams@milberg.com

Edward H. Maginnis,
N.C. Bar No. 39317
Karl S. Gwaltney,
N.C. Bar No. 45118
MAGINNIS HOWARD
7706 Six Forks Road, Suite 101
Raleigh, North Carolina 27615
Phone: (919) 960-1545
Fax: (919) 882-8763

emaginnis@maginnishoward.com
kgwantley@maginnishoward.com

Counsel for Plaintiff-Appellee Michael Hughes

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing brief was served by email to the following:

Mary W. Scruggs
Special Deputy Attorney General
mscruggs@ncdoj.gov

Olga Vysotskaya de Brito
Special Deputy Attorney General
ovysotskaya@ncdoj.gov

P.O. Box 629
Raleigh, NC 27602
Telephone: (9l9) 716-6806
Facsimile: (919) 716-6755

Counsel for Defendants

This 9th day of January, 2025.

MILBERG COLEMAN BRYSON
PHILLIPS GROSSMAN PLLC

/s/ Mark R. Sigmon
Mark R. Sigmon, State Bar No. 37762
5 W. Hargett St., Suite 1001
Raleigh, NC 27601
Phone: (919) 451-6311
Fax: (919) 882-9057
msigmon@milberg.com