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The constitutionality of Illinois public pension reform

by Donald R. Tyer

Illinois legislators have postponed the inevitable battle on pension reform for public employees until the General Assembly's fall veto-session. Even though a bipartisan sponsored reform package made it out of a House committee in May, it could not garner sufficient support on the floor to encourage its sponsors to attempt to push it through the General Assembly.

One fact everyone agrees on is that the Illinois public pension systems are critically underfunded, which some have estimated at \$85 billion. Early last year, Governor Quinn signed into law a reform measure for public pensions decreasing the pension benefits of all public employees hired *after* the law took effect last year. Governor Quinn claims the law will save Illinois billions of dollars, but the projected savings will not be realized until many years down the road. The question now facing the General Assembly is whether the "Pension Clause" contained in the Illinois Constitution bars reforms that would decrease the benefits of *current* public employees.

Current retirees and public employees who will be retiring in the near future will place a tremendous strain on Illinois' already underfunded pension systems. In an effort to ease this burden, the recently-tabled reform proposal planned to create a three-tiered pension benefit plan for some current public employees in the statewide pension systems. The reform proposal does not include fire or police pension funds, at this point. The first tier would preserve existing pension benefits by requiring higher employee contributions which would increase every three years. The second tier would offer reduced pension benefits for current employees, while the third tier would allow employees to opt in to a 401(k) type retirement plan with the state matching employee contributions.

All three options have the net effect of reducing benefits for employees who are currently contributing to the various state pension systems, and this, critics argue, is a

violation of the Pension Clause in the Illinois Constitution.

The Pension Clause of the 1970 Illinois Constitution provides:

Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired. (1970 Illinois Constitution, Article XIII, Section 5)

The Pension Clause establishes that a contractual relationship exists between a public employee who contributes to a public pension fund and the fund itself. Throughout the history of public pension systems in the United States, states have adopted a variety of protections for pension plan participants ranging from codifying the contractual nature of the relationship in the state constitution (as in Illinois) to using legal concepts such as promissory estoppel to define the rights and benefits of each employee (as in Minnesota).

Even though states choose different approaches to afford protections to public workers, funding problems are forcing legislators to explore ways to alter benefits. In some states pension reform has already been challenged in the court system. Recent pension reform court rulings in Minnesota and Colorado may be viewed as bellwethers to other states grappling with the same problems.

The Minnesota and Colorado pension reform cases involved reducing the cost of living adjustment (COLA) that pensioners in those states automatically received. In both cases, courts dismissed the lawsuits in favor of the state legislatures, allowing the reform measures to proceed.

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In Minnesota, the court found that the retirees did not prove beyond a reasonable doubt that changes to pension benefits were unconstitutional. In Colorado, the court held that reducing pension benefits to strengthen the overall pension fund was not a violation of any constitutional protections. (*Swanson v. State of Minnesota*, No. 62-CV-10-5285 (Second Judicial District, Ramsey County, Minn., amended complaint filed July 2, 2010) and *Justus v. State of Colorado*, 2010 CV1589 (Denver, Colo. Dist. Ct. Sept. 13, 2010)) These two decisions are not binding precedent for other state courts facing similar pension reform lawsuits now or in the future. To proponents of pension reform, however, these decisions bolster their argument to pursue the reduction of current benefits even when those benefits are constitutionally protected.

Note that South Dakota is currently awaiting a decision in its COLA reduction lawsuit, and the governor of New Jersey signed legislation on June 28, 2011, suspending COLA increases for New Jersey's public pensioners as part of a package of comprehensive pension reforms. (*Tice v. South Dakota*, 10-225 (Hughes, S.D.Cir.Ct. 2010), New Jersey Laws, Chapt. 78, P.L. 2011)

Public employee unions are the most vocal in the anti-reform movement. They argue that the Illinois Constitution's Pension Clause is an iron-clad protection for public pension benefits and was drafted specifically for that very purpose. Eric Madiar, chief legal counsel to Illinois Senate President John Cullerton, also argued against pension reform in a comprehensive legal analysis of the issues and history surrounding the Pension Clause. (Eric Madiar, 2011, *Is Welching on Public Pension Promises An Option of Illinois? An Analysis of Article XIII, Section 5 of the Illinois Constitution.*)

In his analysis, Madiar pointed to the Pension Clause debates that took place during the 1970 Illinois Constitutional Convention as a starting point for his interpretation of the Pension Clause language that prohibits Illinois from reducing benefits at all. In 1970, the Pension Clause sponsors argued that the Illinois Constitution needed a codified protection for public employees, similar to a provision in the New York Constitution that declared the contractual nature of pension benefits and foreclosed the possibility of the state reducing or eliminating those benefits entirely.

According to Madiar's brief, after the Pension Clause was sent to committee for editing prior to submission to the voters, the Pension Laws Commission attempted to change the language by adding a contingency clause that would give power to the General Assembly to "enact reasonable modifications in employee rates of contribution, minimum service requirements and other provisions pertaining to the fiscal soundness of the retirement systems . . ." This change (submitted by the Commission twice) was rejected prior to sending the Constitution in its final form to the voters. Anti-reformers point to this fact as evidence that the drafters of the Pension Clause clearly sought to prohibit the state from reducing or diminishing an employee's benefits.

When the text of the Pension Clause was eventually sent to Illinois voters, it included an official explanation from the Convention. The explanation stated that under the Clause, "provisions of state and local governmental pension and retirement systems shall not have their benefits reduced" and that membership in these systems "shall be a valid contractual relationship." Finally, the explanation stated that the clause was "self-explanatory."

Anti-reformers argue that Illinois case law supports the proposition that public pension benefits may not be reduced by the state. The Illinois Supreme Court first analyzed the issue of reducing pension benefits in the 1974 decision, *Peters v. City of Springfield*, 57 Ill2d 142 (1974). In *Peters* the firefighters sued to enjoin the city from lowering the mandatory retirement age, arguing that if the retirement age was lowered from 63 to 60, their overall pension payment would be reduced as they would not receive the extra three years' increase in their salaries. The court held that the Pension Clause, like its counterpart in New York, created a contractual relationship that protected the employees' rights from being diminished or impaired, even though it upheld the ordinance lowering the retirement age. Anti-reformers point out that the Illinois Supreme Court interpreted the Pension Clause to be a protection against state or local governments diminishing benefits, but the *Peters* decision was hardly a resounding proclamation that benefit terms could never be touched.

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In the 1979 case, *Kraus v. Board of Trustees of the Police Pension Fund of the Village of Niles*, 72 Ill.App.3d 833 (1st Dist. 1979), the First District appellate court reviewed a case involving the reduction of benefits to current public employees. In *Kraus*, a police officer on disability challenged changes made to the Illinois Pension Code while he was on disability and before he became eligible to collect his pension. The changes to the Code became the basis for the pension board's decision to award Kraus a lower pension than he expected. In reviewing the case, the court conducted an exhaustive analysis of the Illinois Constitutional debates, the New York court decisions, as well as the *Peters* decision, and concluded that any *direct* legislative action to reduce benefits due to a pension member is unconstitutional. The court distinguished the *Peters* decision, finding that lowering the mandatory retirement age only indirectly affected pension benefits and thus did not trigger the protections of the Pension Clause. Importantly, the court also held that pension benefits were a contractual right that could be modified under established contract principles such as an exchange for valuable consideration.

In 1985, the Illinois Supreme Court revisited the Pension Clause in *Felt v. Board of Trustees of the Judges Retirement System*, 107 Ill.2d 158 (1985). In *Felt*, several judges sued the Judges Retirement System after it applied an amendment in the Illinois Pension Code that changed the formula to determine pension benefits. The new formula used an average of the last year's salary rather than the salary on the last day of service to determine the annuity benefit. The plaintiffs argued that the Pension Clause protected their interest in having their benefits calculated by the rules in effect on their first day of service and that any change should only apply to new judges.

The court agreed, holding that the judges had a contract with their pension system and changing the formula amounted to an unconstitutional reduction of the benefits they were vested in from the day they joined the system. The court rejected the argument that the state could make these changes under its police power, characterizing the proposed change as a substantial impairment of benefits and not at all defensible as an exercise of the state's police powers.

Anti-reformers use the *Felt* decision to illustrate their fundamental point: the Illinois Constitution codifies the relationship between public employees and the pension system as contractual with benefits that cannot be taken

away without consideration. The question is what would constitute the kind of valuable consideration that would make benefit reductions constitutional. Pension reformers have an answer for that question.

The bi-partisan pension reform proposal that has been tabled until this fall would ultimately diminish pension benefits for some current public workers. The proposal seeks to change the annuity amounts that these workers would receive when they retire, based on the new three-tier system previously explained above.

Reformers agree that the Pension Clause clearly establishes that a contractual relationship exists between public employees and the pension system. However, reformers argue that the term "benefits" of membership in the system that shall not be diminished or impaired in the Pension Clause means the benefit is simply an employee's right to receive an annuity upon retirement, but does not guarantee the amount of the annuity or the formula for calculating the annuity. While reformers acknowledge that the Pension Clause protects those benefits already earned, they cite their interpretation of the Convention debates, case law and common sense in support of pension reforms that reduce the benefits that employees may earn in the future, especially in consideration of not lowering salaries, eliminating positions, or allowing pension funds to collapse.

Reformers argue that during the convention debates, delegates mainly grappled with two important issues involving the Pension Clause. The first issue was whether the Pension Clause required state government to fully fund its public pensions. Delegates were concerned that they were adding a provision to the Constitution that would hamstring the state by forcing it to fully fund pensions that were woefully underfunded even prior to the convention. The second issue was whether eliminating COLA increases to annuitants would be considered a reduction in pension benefits.

Delegates Lyons and Kinney, co-sponsors of the Pension Clause, explained to the delegates that their proposed language was meant to establish contractual protection for pension rights and to "provide security to people . . . in the event that sweeping home rule powers are given to local governments." Kinney went on to explain that the lan-

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guage of the clause was meant to guarantee that “people will have the rights that were in force at the time they entered into the agreement to become an employee” - that if their benefits were \$100 a month when they started in 1970, then they should not be less than \$100 a month in 1990.

Though this statement appears to support the premise that the Illinois Constitution prohibits decreasing future benefits, reformers point out that Kinney made this statement (and others like it) in the context of explaining to delegates that the Pension Clause did *not* require the state to provide cost of living increases. Reformers argue that Delegate Kinney was the only sponsor to articulate any viewpoint about changing prospective benefits, and if the other sponsors agreed with her, they could have made that clear during the debates.

At best, reformers argue, the delegates’ debates about the Pension Clause indicate there was uncertainty about the scope of its restrictions, a view shared by the Illinois Supreme Court in the *Peters* decision. Thus, the court held that the purpose of the Pension Clause was only to “prevent retroactive diminution of previously ‘earned’ benefits.” The *Peters* holding, though over thirty years old, has never been expressly overruled and is the cornerstone of the argument that the Illinois Constitution would not be violated if future pension benefits were somehow altered or diminished.

In the *Felt* decision, reformers argue the Illinois Supreme Court applied a balancing test in weighing the legislation changing the formula for calculating the judges’ pension benefits, with the need to remedy a chronically under-

funded system. The court opined that the pension system’s woes were not the fault of too many judges retiring early and that changing the retirement formula would not fix the problem. Reformers point out the court did not expressly overrule its decision in *Peters*, and the *Felt* holding indicates the court could look at the present pension crisis, weigh it against the proposed changes to the system, and find that these changes are, in fact, a permissible exercise of the state’s police power unlike the circumstances in *Felt*.

Pension reformers interpret the Pension Clause and pertinent case law in a light that favors their most basic argument, which supports enacting legislation that begins the process of repairing the pension system, couching it in terms of modifying state employees’ contracts in consideration for not firing those employees or significantly reducing salaries, then let the courts determine whether this legislation is proper in light of the Illinois Constitution.

What becomes clear, after considering both viewpoints, is that the language of the Pension Clause is open to interpretation, and Illinois courts have not clearly delineated the limits of its protections for pensioners. As seen in the recent Colorado and Minnesota decisions, courts may begin to look for methods to square the need for reform with the language of each state’s constitution and the established protections of contract law. If pension reform is successfully adopted in Illinois, it will undoubtedly be promptly challenged in the court system. The courts will be called upon to determine whether the state can impose these changes as a contract modification or whether it is just a convenient argument for making an unconstitutional modification to its employees’ benefits. ■

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