VOL. 28, NO. 3 AUTUMN 2015

BENEFITS LAW JOURNAL

State-Level Developments

Illinois Supreme Court Affirms Constitutional Protection of Public Pensions

David R. Godofsky and Emily Hootkins

As states and municipalities deal with their structural budget problems, the burden of underfunded public pension plans takes on ever greater importance. Pension plans for public employees do not have the protections afforded by the federal Employee Retirement Income Security Act (ERISA) to benefits earned in single-employer pension plans. However, in many states, state constitutional rules protect the pension benefits of public workers.

Politicians like to promise benefits now and leave the hard work of paying for them later. Eventually, budget realities intrude, and often the result is that states, municipalities, and other government entities attempt to "reform"—that is, reduce—the pensions promised to their workers. In some cases, such reforms involve only future workers, while current employees are grandfathered into the benefit structures already in place. In other cases, current employees are affected, but only with respect to benefits that have not yet been

David R. Godofsky is a partner with Alston & Bird LLP and leader of the firm's Employee Benefits and Executive Compensation practice group. In addition to being an attorney, Mr. Godofsky is a Fellow of the Society of Actuaries. Emily C. Hootkins is an associate with Alston & Bird LLP and a member of the firm's ERISA Litigation practice group and the Employee Benefits and Executive Compensation practice group.

earned. In a few instances, public employers have attempted to reduce pensions that are computed based on service already rendered by the employees, or the future cost-of-living adjustments to such pensions.

In *In re Pension Reform Litigation*,[1] the Supreme Court of Illinois decisively rejected a new theory that the state of Illinois advanced as the basis for reducing public employee pension benefits. The state argued that the state's "reserved sovereign power" (referred to herein as the "police power") trumped Article XIII, Section 5, of the state constitution (the pension protection clause), which 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."

Background

Illinois has five state-funded retirement systems (collectively, the retirement systems):

- General Assembly Retirement System (GRS);
- State Employees' Retirement System (SERS);
- Teachers' Retirement System of the State of Illinois (TRS);
- State Universities Retirement System (SURS); and
- Judges Retirement System (JRS).

The five retirement systems provide retirement annuities to eligible employees. Employees who first began contributing to the retirement systems before January 1, 2011, are eligible for Tier 1 annuity benefits, while employees who first contributed on or after January 1, 2011, are eligible for the lower Tier 2 annuity benefits.

Employees in SERS may retire with full benefits as early as age 60. With 30 years of service, the retirement benefit would be approximately 50 percent of final average compensation, with automatic cost of living adjustments (COLAs) of 3 percent per year. With longer service, the benefit could be as high as 75 percent of final average compensation, with 3 percent annual COLAs.

The five retirement systems are funded by a combination of employee and employer contributions. For decades, the retirement

systems have been chronically underfunded. In its decision, the court noted that projections of crisis and insolvency go back to 1917. By 1969, the retirement systems were 41.8 percent funded, according to the court. In 2013, the retirement systems were still only 41.1 percent funded.

As described in the court's opinion, the Illinois General Assembly struggled with budgetary problems but it was unable to reach a consensus on solving its fiscal problems, absent reductions in the benefits of the retirement systems to current employees. Perhaps knowing that any pension reform legislation would have to survive judicial scrutiny, the General Assembly, in 2013, enacted Public Act 98-599, reducing the future pension benefits of current workers in four of the five retirement systems, leaving the benefits for judges intact, despite the fact that JRS was only 29.8 percent funded.

Public Act 98-599 cuts back future pensions for current employees by *inter alia*: delaying the retirement age by up to five years for employees currently under age 46; capping the amount of salary that is considered in calculating final average compensation; changing the fixed 3 percent annual COLA to a variable COLA; and eliminating from one to five annual COLAs.

Holding

It has long been the law in Illinois that the pension protection clause was held to protect public sector pensions against unilateral[2] reduction for current employees, even with respect to benefits not yet earned.[3] The state's principal argument in favor of Public Act 98-599 was that a budgetary crisis necessitated the modifications to the pension benefits, thus trumping the protections afforded by the pension protection clause. The state argued that its exercise of the police power was reasonable and necessary in light of the dramatic squeeze on the state's finances due to the recent recession, the poor condition of the economy, and the deterioration of the state's credit rating.

In a 7–0 opinion, the court forcefully rejected that defense. The court noted that the underfunding of the five retirement systems was the result of decades of fiscal decisions by the General Assembly. The court had a seemingly visceral reaction to allowing the General Assembly to use a self-created crisis to reduce pension benefits. The court noted that if it were allowed to reduce pensions in an emergency, the General Assembly could create the emergency conditions necessary to do so. State governments always want more money and always have uses for more money. Economic cycles are such that pensions would not be safe if a fiscal crisis were sufficient to override the pension protection clause.

Constitutional protections are inherently based on distrust of the elected branches of government. However, the court recited a history of public pensions in Illinois suggesting a particularly deep distrust for the legislature in this area. After going through a litany of poor funding and policy decisions leading to not only the pension crisis but fiscal mismanagement in general, the court said that, "Public Act 98-599 is merely the latest assault in this ongoing political battle against public pension rights." If this type of exception is allowed with respect to constitutional protections, "[n]o rights or property would be safe from the State."

Policy Implications

In re Pension Reform Litigation goes beyond self-created crises and forecloses unilateral reductions to public worker pensions in Illinois, arguably even in cases of unforeseeable emergency. As states struggle with pension obligations, this issue could arise elsewhere. Several states have explicit pension protection clauses in their constitutions, including Alaska, Arizona, Hawaii, Louisiana, Michigan, New Mexico, and New York, although the scope of protection varies considerably from one state to another.[4] In several other states, the state's contracts clause has been held to provide some level of protection to public worker pensions.

For those states that, like Illinois, protect benefits not yet earned, the lack of an emergency exception creates an interesting paradox. Public employees generally do not have a right to the future employment that is necessary to obtain the currently unearned benefit. Similarly, most public sector pensions are a percentage of salary and—with limited exceptions, typically for judges and certain elected officials—there is no protection against reductions in pay. Thus, the inability to reduce future (as yet unearned) benefits means that state governments are more likely to resort to layoffs or salary reductions. For those unlucky employees who lose their jobs or suffer reductions in salaries, those pension protections are ephemeral; they will never earn or receive the protected benefits.

Protections for unearned pensions also have other implications. Pension formulas can go up but not down. Economic conditions are not the only cyclical phenomena. Political cycles occur as well, and public employees not only show up to vote in disproportionate numbers but they also tend to be highly motivated to vote based on issues relating to their own compensation and benefits. In states that protect pension formulas from an employee's first day in the system, one legislative session can bind future legislatures for a generation.

Notes

1. *In re Pension Reform Litig.*, 32 N.E.3d 1 (Ill. 2015).

2. The Illinois courts have repeatedly stated that the Pension Protection Clause protects against unilateral reductions in retirement benefits. *Buddell v. Bd. of Trs., State Univ. Ret. Sys.*, 514 N.E.2d 184 (Ill. 1987). In a case currently before the Illinois Supreme Court, the Chicago Transit Authority and its Retirement Plan have argued that modifications may be made to retiree medical benefits pursuant to collective bargaining, as those modifications are not unilateral (*Matthews v. Ret. Plan for Chi. Transit Auth. Emps.*, Nos. 117638, 117713, and 117728 (Ill.)).

3. *Buddell*, 514 N.E.2d 184.

4. This list may not be exhaustive as a 50-state survey is beyond the scope of this article. Some states protect only benefits that have been accrued or only benefits for employees who are vested or eligible to retire. Other states protect even unearned future benefits for current workers.