

26 May 2015

Practice Group(s):
Private Equity

Illinois Supreme Court Holds Public Pension Cutbacks Unconstitutional

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The national debate on public pension plans shifted to the State of Illinois this month. On the heels of the Oregon Supreme Court's decision in *Moro v. State of Oregon* (see K&L Gates Client Alert: [Changing the Rules in the Middle of the Game](#)), the Illinois Supreme Court struck down state legislation cutting pension benefits for active and retired employees. In *In re Pension Reform Litigation*, a unanimous Illinois Supreme Court held that legislation eliminating some cost of living adjustment ("COLA") benefits and cutting other benefits on its face violated the pension protection clause of the Illinois Constitution.¹

In contrast to the Oregon Supreme Court decision, the Illinois court held that the state constitutional protections attach when the employee first begins employment, and formulas in place at the time may not be diminished or impaired for the individual. Using particularly strong language, the Illinois Supreme Court also rejected the State's argument that an inviolable pension promise violates the State's sovereignty: the pension protection clause "is in no sense a surrender of any attribute of sovereignty. Rather, it is a statement by the people of Illinois...that the authority of the legislature does not include the power to diminish or impair the benefits of membership in a public retirement system."² And "[c]risis," the court concluded, "is not an excuse to abandon the rule of law."³

Funding Shortage and Benefits Cutbacks

Illinois established five state-funded retirement systems for public employees over the years 1939 to 1947. These systems provide traditional defined benefit pension plans for their members. These systems are subject to the pension protection clause of the Illinois Constitution, which provides: "Membership in any pension or retirement system of the State...shall be an *enforceable contractual relationship*, the benefits of which shall not be *diminished or impaired*."⁴ In response to underfunding issues, Illinois adopted this clause when the new state constitution was enacted in 1970. Despite this guarantee, the State of Illinois chronically underfunded its pension systems. From 1970 until 2013, the funded status of the retirement systems remained about the same—41percent.⁵

In response to the funding crisis, the state legislature passed legislation designed to reduce annuity benefits for "Tier 1" public pension plan members in four of the five state-funded plans.⁶ The 2013 law, Public Act 98-599, made the following changes: (1) delayed when members under the age of 46 were eligible to begin receiving their retirement benefits, (2)

¹ *In re Pension Reform Litig.*, 2015 IL 118585.

² *Id.* at 31.

³ *Id.* at 35.

⁴ Ill. Const. 1970, art. XIII, § 5 (emphasis added).

⁵ *In re Pension Reform Litig.*, at 9.

⁶ Tier 1 benefits are for members who belonged to the systems prior to January 1, 2011. The law deliberately excluded the Judges Retirement System from its application.

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capped the maximum salary that could be considered when calculating the amount of a member's retirement annuity, (3) reduced the fixed 3 percent annual annuity COLA to a variable and limited amount, (4) completely eliminated at least one, and up to five, annual COLA increases, and (5) altered how the base annuity amount was determined, effectively making members' base pensions smaller for members of two systems.⁷

Court Finds Cutbacks Violate Illinois Constitution

Almost immediately after the legislation passed, current public employees and retirees filed suit to challenge the law. Upholding the lower court decision, the Illinois Supreme Court found the new law violated the pension protection clause of the Illinois Constitution. Pointing to Illinois case law, the court found the benefits protected by the clause attach once an individual first embarks upon employment: "Accordingly, once an individual begins work and becomes a member of a public retirement system, any subsequent changes to the Pension Code that would diminish the benefits conferred by membership in the retirement system cannot be applied to that individual."⁸ The court also noted Arizona had a similar clause in their constitution, and the Arizona Supreme Court recently struck down legislative changes that diminished benefit payments.⁹

Court Rejects Police Power Justification

The State argued that pension rights should be analyzed under a constitutional "contracts clause" analysis. Under this analysis, the State argued, the legislature may modify or invalidate contracts through the exercise of its police powers. The court initially noted that it had not considered this argument in its most recent decision on the pension protection clause. The court proceeded to reject this argument, holding that neither the legislature nor the executive branch may disregard the provisions of the state constitution unless justification for this departure is found within the law itself. In the court's words, "[e]xigent circumstances are not enough."

The Court rejected the police powers argument on two grounds. First, the court noted that legislation impairing contracts has only rarely been upheld under the Contracts Clause. This is particularly true when the state seeks to impair a contract to which it is a party. Because the state's financial self-interest is at stake, courts do not give the deference that might otherwise be afforded in determining whether the impairment is reasonable and necessary to serve an important public purpose.

Second, the court reasoned that the pension protection clause is an independent source of protection for public pension benefits. The new constitution adopted in 1970 "not only created a new right of constitutional dimension, conferring enforceable contractual status on the benefits of membership in public retirement systems, [it] also defined the scope of the protection afforded such benefits."¹⁰ Given the plain meaning and the legislative history of the pension protection clause, the court concluded that it had no possible basis for interpreting the clause to allow the legislature to override its protections.

Finally, the court emphasized that the pension protection clause is in no sense a surrender of the State's sovereign authority. "Rather, it is a statement by the people of Illinois...that the

⁷ Ill. Public Act 98-599; see *In re Pension Reform Litig.*, at 12.

⁸ *Di Falco v. Board of Trustees*, 122 Ill. 2d 22, 26 (1988).

⁹ *In re Pension Reform Litig.*, at 21 (citing *Fields v. Elected Officials' Ret. Plan*, 320 P.3d 1160, 1165-68 (Ariz. 2014)).

¹⁰ *Id.* at 29.

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authority of the legislature does not include the power to diminish or impair benefits of membership in a public retirement system.”¹¹ Because the sovereignty of government in this country ultimately resides in the people, they can, within limits established by the federal constitution, delegate, withhold, or place limitations on the powers of government “as they choose.”¹²

Conclusion

This Illinois decision seemingly forecloses state legislation that impairs pension rights for existing employees. The state legislature might consider calls to amend the state constitution or to authorize municipal bankruptcy filings by cities and other municipalities. Outside of Illinois, states with pension protection clauses in their constitutions may look to this case when they encounter challenges to similar legislation.

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¹¹ *Id.* at 31.

¹² *Id.* at 31 (citing *Hawthorn v. People*, 109 Ill 302, 306 (1883)).