

Public Sector Pensions: The Legal Issues

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The Basics

- Private versus public pensions
- Pensions versus other post-retirement benefits
- Evolution of state law

Non-Pension Retirement Benefits (OPEBs)

- Legal assumption: OPEBs may be modified absent clear evidence that the right to such benefits has been vested

Overview of Current Approaches

- Constitutional protection
 - For both past and future accruals, as of the first day of employment
 - Only for accrued benefits
- Common law contractual protection
 - For both past and future accruals, as of the first day of employment
 - Once vested or eligible for retirement
 - Only for accrued benefits
 - For both past and future accruals
 - Once retired
- Common law property interest prior to retirement

Legal Risk Hierarchy

- Benefits being paid to retirees
- Benefits that have already been earned by participants not yet retired
- Future benefit accruals
- New Hires

Open Issues

- To what extent does plan underfunding/state fiscal crisis allow otherwise impermissible changes?
- Where do COLAs fit in?
- Are future accruals protected?

Exercising Police Power

- Regardless of the strength of a state's legal protection, the state *always* retains the ability to amend pension benefits where reasonable and necessary to achieve an important public purpose
- Many unknowns remain:
 - What level of fiscal distress is required
 - What makes the change the “least drastic” available?
 - What alternatives, if any, must be pursued first?

COLAs

- Are they properly considered part of the participant's accrued benefit?
- When does a right to a COLA vest?

Future Accruals

- States differ significantly in their protection of future accruals
- Need to define what the “contract” protects
- Salary analogy
- Almost always seen as a less substantial change than those that affect benefits already earned

The Current Litigation Scorecard

- **Arizona:** Trial court held state could not increase employee contribution rate (Final decision)
- **Colorado:** Trial court held state was permitted to reduce COLAs for current retirees
- **Florida:** Trial court held new employee contributions and prospective COLA elimination were impermissible
- **Minnesota:** Trial court held state could reduce COLAs for current retirees. (Final decision)
- **New Hampshire Judges:** Supreme court held plan could not be amended to change benefit formula from one tied to current salary of position to one based on final salary.
- **New Hampshire HB2:** Trial court held employee contribution rate could not be increased for vested participants
- **Rhode Island:** Vested participants in state retirement plan enjoy contractual rights to benefits

The Minnesota Ruling

- Lawsuit challenged reduction of COLA for current retirees
 - COLAs had been set at 2.5%, were reduced to 2%, 1.5%, or 1% depending on plan
 - Part of broader pension reforms
- Court held:
 - No contract existed with respect to specific COLAs
 - Even if there was a contract, the change was not “substantial”
 - Even if it was substantial, the change was permissible because it was reasonable and necessary to serve an important public purpose

The Minnesota Ruling

- Fact that the plans were *not* on the brink of default was not dispositive
 - “The speed and depth of the financial decline posed a credible risk of default that required a response.”
- Court hesitant to interfere with legislative judgment
 - State had passed a “comprehensive package of amendments that spread the burden and sacrifice of stabilizing the Plans across all members, the State, and the taxpayers.”

What about Rhode Island?

- Fundamental pension reform passed November 2011, will go into effect July 1, 2012
 - Preserves accrued benefits through June 30, 2012*
 - For most employees, moves to a hybrid plan for accruals beginning July 1st
 - Raises retirement ages
 - Suspends COLAs until Rhode Island's plans, *in the aggregate*, are at least 80% funded

What Can a State Legislature Do?

- Make the contractual issue clear, at least for employees hired on or after the effective date of the legislation
- For reforms that affect current employees:
 - Study all possible solutions
 - Have a good understanding of existing legal precedent
- Going forward:
 - Consider funding and governance reforms

For Further Information

- *Public Pension Plan Reform: The Legal Framework*
 - http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1573864
- *Statutes as Contracts? The “California Rule” and its Impact on Public Pension Reform*
 - http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1933887
- *A Legal Guide to State Pension Reform*
 - http://www.educationsector.org/sites/default/files/publications/PensionLegalGuide_RELEASE.pdf