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*

• *Statutes as Contracts? The “California Rule” and its Impact on Public Pension Reform*

• *A Legal Guide to State Pension Reform*