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How Much Can States Change Existing Retirement Policy?

**In Defense of State Judicial Decisions Protecting Public Employees'
Pensions**

Douglas L. Greenfield
Susan G. Lahne
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In Defense of State Judicial Decisions Protecting Public Employees' Pensions

Most state courts treat the pensions provided to public employees as contracts and protect the terms under which these public pensions are provided, usually set out in state statutes and codes, against subsequent reduction through later-enacted state laws.¹ In several states, courts have held that a public employee's protected contract rights are established when the employee commences employment, thus giving the employee the right to continue to accrue benefits, under the same terms, throughout his or her employment. Although the extent and nature of the protection afforded public pensions varies across these states, public employees' contractual rights are recognized in the vast majority of states. As a consequence, governments in these jurisdictions at a minimum must satisfy a substantial burden to alter unilaterally the pension benefits formula applicable to current employees in ways that reduce the benefits that such employees will receive when they retire.

One advocate of public pension reform, Professor Amy Monahan, has challenged the legal analysis on which a significant number of these state courts have relied in protecting public pensions.² She argues that these state courts have erred by failing to use a strict enough standard in determining that their state's public pension plans created contractual rights and should,

¹ This paper addresses solely rights created by state or local legislation setting public pension terms for public employees of states and their agencies and instrumentalities. In many cases, such employees may also have rights concerning their pension benefits that derive from collective bargaining agreements or memoranda of understanding between their state employers and unions that represent them. The existence and nature of such agreements, and the rights given by such agreements, would, of course, be additional facts and circumstances that would be taken into account by courts, arbitrators, or other tribunals adjudicating disputes over these employees' pension rights.

² See A. Monahan, *Statutes as Contracts? The "California Rule" and its Impact on Public Pension Reform*, 97 Iowa L. Rev. 1029 (2012) (arguing that there is no legal basis for state court decisions holding that pension benefits "not yet earned" are contractually protected and that courts in various states, including California, have "improperly infringed on legislative power"); see also A. Monahan, *Public Pension Plan Reform: The Legal Framework*, U. of Minn. Law School Legal Studies and Research Paper No. 10-13, <http://ssrn.com/abstract=1573864> (2010). Cf. Buck, Stuart, *Legal Obstacles to State Pension Reform*, <http://dx.doi.org/10.2139/ssrn.1917563>, (August 26, 2011) (advocating for "reform" of state public pension systems on similar economic and policy grounds).

instead, have required overt (“unmistakable”) proof of legislative intent to be contractually bound and to bind future legislatures.

Professor Monahan’s assertion that state courts are now or ever were required to adopt the analysis that she suggests is unsupported. There is no reason, and Professor Monahan offers none, why state courts may find state legislation has created enforceable contract rights only by identifying an express “legislative intent” in the statutory language, particularly when these courts are considering the nature of their states’ employment contracts with public employees. As explained below, the state courts’ long-standing precedents protecting public employees’ pension contract rights against unilateral reductions are valid exercises of state judicial authority.

The Source of Legal Protection of Public Pensions: The vast majority of state courts, relying on either state law or the Contract Clause of the U.S. Constitution, treat pensions provided to public employees as enforceable contracts protected from later unilateral reduction, even if imposed through legislative enactments.³ State courts relying on state law refer to provisions in state constitutions that either specifically protect public pensions or, more generally, protect contracts against impairment.⁴ A handful of state courts eschew the contract analysis and protect public pensions under a property rights theory, relying on appropriate provisions of the state or federal constitutions (*e.g.*, the Due Process Clause of the Fifth and Fourteenth Amendment of the U.S. Constitution, the Takings Clause of the Fifth Amendment, or the state constitutional analogues of these protections).⁵ Courts in one state have applied a promissory estoppel theory in limiting subsequent modifications to the terms of public pension obligations,⁶ and a few states provide no protection for public employees’ pensions, following the

³ See E. Madiar, *Public Pension Benefits Under Siege: Does State Law Facilitate or Block Recent Efforts to Cut the Pension Benefits of Public Servants?*, ABA Journal of Labor & Employment Law, V. 27, no. 2 179, 181-185 (2012) (summarizing and categorizing state courts’ varying treatments of public pensions).

⁴ See generally, D. Simko, *Of Public Pensions, State Constitutional Contract Protection, and Fiscal Constraint*, 69 Temp. L. Rev. 1059 (1996) (collecting cases).

⁵ See, *e.g.*, *Pineman v. Oechslin*, 488 A.2d 803 (Conn. 1983); *Spiller v. State*, 627 A.2d 513 (Me. 1993); *Pierce v. State*, 910 P.2d 288 (N.M. 1995); *Ass’n of State Prosecutors v. Milwaukee Cnty.*, 544 N.W.2d 888 (Wis. 1996).

⁶ See *Christensen v. Minneapolis Mun. Emps. Ret. Bd.*, 331 N.W.2d 740 (Minn. 1983).

largely abandoned concept, prevalent early in the 20th century, that public pensions are pure gratuities.⁷

State courts that rely on a contract theory, and not on express constitutional provisions specifically guaranteeing the payment of public pensions to government employees, have reached different conclusions regarding the scope and nature of their public employees' protected rights to their pensions.⁸ Their differences concern their views of when a public employee's contractual rights arise, what the contractual rights cover, and whether (and on what basis) the government employer may later make unilateral changes. With regard to when protected contractual rights arise, some state courts have ruled that public employees' pensions are protected only after the employee has satisfied requirements related to age and/or service that, if not satisfied, could have resulted in forfeiture of the pension; that is, by satisfying age and service requirements to qualify for retirement or by completing a certain number of years of service.⁹ Other jurisdictions have ruled that public employees' contractual pension rights arise earlier, when they first begin employment or have worked long enough to have developed a reliance interest in the current pension program.¹⁰ Among the states in which

⁷ See, e.g., *Ballard v. Bd. of Trs. of Police Pension Fund of Evansville*, 324 N.E.2d 813 (Ind. 1975); *Kunin v. Feofanov*, 69 F.3d 59 (5th Cir. 1995) (applying and interpreting Texas law).

⁸ Compare, e.g., *Police Pension & Relief Bd. of Denver v. McPhail*, 139 Colo. 330 (1959) (holding that amendment reducing pension could not be constitutionally applied to retired employees who had satisfied all pension system requirements before enactment of amendment) with *Betts v. Bd. of Admin.*, 21 Cal.3d 859 (1978) (holding that amendment reducing pension could not be constitutionally applied to former employee who had terminated employment but had not yet retired at time of enactment).

⁹ See, e.g., *Jones v. Cheney*, 489 S.W.2d 785 (Ark. 1973). Other states have adopted similar rules based on express provisions in the state constitution. See, e.g., *Kaho'ohanohano v. State*, 162 P.3d 696 (Haw. 2007); *Smith v. Bd. of Trs. of La. State Employees' Ret. Sys.*, 851 So. 2d 1100 (La. 2003); *Ass'n of Prof'l & Technical Emps. v. City of Detroit*, 398 N.W.2d 436 (Mich. Ct. App. 1986).

¹⁰ See, e.g., *Betts v. Bd. of Admin.*, 21 Cal. 3d 859 (1978); *Police Pension & Relief Bd. of Denver v. McPhail*, 139 Colo. 330 (1959); *Singer v. City of Topeka*, 607 P.2d 467 (Kan. 1980); *Opinion of the Justices*, 303 N.E.2d 320 (Mass. 1973); *Calabro v. City of Omaha*, 531 N.W.2d 541 (Neb. 1995); *Oregon State Police Officers Ass'n v. State*, 918 P.2d 765 (Or. 1996); *Bakenhus v. City of Seattle*, 296 P.2d 536 (Wash. 1956); *Booth v. Simms*, 456 S.E.2d 167 (W. Va. 1995). Other states have adopted similar rules based on express provisions in the state constitution. See, e.g., *Municipality of Anchorage v. Gallion*, 944 P.2d 436 (Alaska 1997); *Kraus v. Bd. of Trs. of Police Pension Fund of Niles*, 390 N.E.2d 1281 (Ill. App. Ct. 1979); *Birnbaum v. N.Y. State Teachers' Ret. Sys.*, 152 N.E.2d 241 (N.Y. 1958).

contract rights are recognized under either of these analyses, courts have reached varying conclusions regarding what the protected contractual rights cover and the extent to which government employers may subsequently modify even protected pensions.¹¹ In jurisdictions that find that contractual rights arise only after public employees satisfy “vesting” age and service requirements, courts have frequently protected only the portion of the employee’s pension derived from past service.¹² In these cases, the government is generally permitted to make unilateral amendments to the pension terms that apply to future pension accruals credited through future service.

In jurisdictions that find that a public employee’s pension contract rights arise at an earlier point, either when the employee first was hired or joined the pension plan, or at some point during the employee’s public service, courts have generally held that, once these rights come into effect, the employee is protected with respect to both past service and future service.¹³ In these jurisdictions, thus, public employees are considered to have a contractual right to continuance, throughout their employment, of substantially the same pension terms as in effect when their protected pension rights came into effect, and this protection covers both the pension credited to them when the rights first arose and the additional pension that may be credited to them for future service throughout their public service career. In many of these jurisdictions, a public employee is considered to have protected rights as of the first day of employment. However, as mentioned earlier, even the jurisdictions that recognize contractual rights beginning on the first day of employment vary substantially in their views on the nature of the rights and the extent to which subsequent legislation may nonetheless adopt unilateral modifications of the protected pension terms.¹⁴

Where recognized as contractual, public employees’ pension rights are protected generally under state constitutions (in a number of states) and under

¹¹ See *Howell v. Anne Arundel Cnty.*, 14 F. Supp. 2d 752 (D. Md. 1998). (reduction in rate of increase of future pension benefits which had not vested did not constitute substantial impairment of contractual rights under pension program)

¹² See *id.*

¹³ See, e.g., *Allen v. Bd. of Admin. of Pub. Employees’ Ret. Sys.*, 34 Cal. 3d 114 (1983); *Sonoma County Org. of Pub. Emps. v. Cnty. of Sonoma*, 23 Cal. 3d 296 (1979). See also cases cited *supra* at fn. 10.

¹⁴ Compare, e.g., *Allen v. City of Long Beach*, 287 P.2d 765, 765 (Cal. 1955) (permitting reasonable unilateral reductions in protected pension to retirees or employees who have qualified for retirement) with *Thurston v. Judges’ Ret. Plan*, 876 P.2d 545, 547-48 (Ariz. 1994) (no unilateral modifications to existing protected pension obligations permitted).

federal constitutional law, specifically the Contract Clause, against unilateral reduction or elimination by state government.¹⁵ When determining whether subsequent legislation impairs recognized contractual rights, virtually all jurisdictions employ some variation of the analysis adopted by the U.S. Supreme Court in *U.S. Trust v. New Jersey*,¹⁶ which balances the harm caused by a legislative impairment of contracts against the competing public interests supporting the legislative action. This balancing analysis has been summarized as follows:

Analysis of the parties' arguments under the federal Contracts Clause requires this court to determine: first, whether there is a contractual relationship between plaintiffs and the state; second, if so, the nature of the contractual promises that allegedly have been impaired; third, whether a state law (here a constitutional provision) impairs any of those contractual promises and, if so, whether the impairment is "substantial" and, fourth, if so, whether the state law creating the substantial impairment is justified by a significant and legitimate public purpose and whether the method used by the state to advance that public purpose constitutes an unnecessarily broad repudiation of its contractual obligation to private persons.¹⁷

Under this test, once a contract is found to exist, the balancing factors are interrelated; the more substantial and severe the impairment, the greater the government's burden to justify the impairment. Also, government actions taken to relieve the government of its own contractual obligations are viewed more stringently than governmental actions that affect only private contracts.¹⁸

¹⁵ U.S. Const. art. I, § 10 ("no State shall . . . pass any . . . Law impairing the Obligations of Contracts"). The Contract Clause has been understood throughout its history to apply to municipalities and other subdivisions of a state in the same way as it applies to states. See *Atlantic Coast Line R.R. Co. v. Goldsboro*, 232 U.S. 548 (1914).

¹⁶ See *U.S. Trust v. New Jersey*, 431 U.S. 1 (1977).

¹⁷ *Oregon State Police Officers Ass'n v. State*, 918 P.2d at 771, 779 (applying this analysis to find that the state pension program created constitutionally protected contract rights in which state employees became "vested" upon acceptance of employment; subsequent amendments reducing pension terms held to "substantially impair" contractual obligations and to be "not justified by any significant and legitimate public purpose").

¹⁸ In the *U.S. Trust* case, the Supreme Court directed that "complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake. A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as

Thus, the balancing test is applied with more bite when government seeks to alter a contract to which the government itself is a party, as courts reason that self-interest is more likely to be the motivation than public policy when the government is acting to eliminate or reduce its own financial obligations, rather than those of third parties.

Courts applying this type of balancing analysis to amendments that alter public employees' existing contractually protected pension benefits have almost unanimously treated these efforts as imposing "substantial" impairments,¹⁹ and courts also have typically found governments' justifications based on even real fiscal crises or emergencies insufficient.²⁰ Most states therefore cannot readily reduce their existing pension obligations to their employees in an effort to solve a fiscal crisis, and until recently few even tried.²¹

an important public purpose, the Contract Clause would provide no protection at all." See *U.S. Trust* at 26.

¹⁹ See, e.g., *Valdez v. Cory*, 139 Cal. App. 3d 773 (Cal. Ct. App. 1983) (holding that changes in pension funding method constituted substantial impairment).

²⁰ See, e.g., *Calabro*, 531 N.W.2d at 552 (holding that elimination of pension cost of living adjustment constituted unconstitutional impairment under state constitution despite showing of serious fiscal problems for city).

²¹ Recently, governments' efforts have been mounted to modify public pension obligations, such as through the new city charter changes in the California cities of San Jose and Long Beach. See generally *American Fed'n of State, Cnty. & Mun. Emps. Local 101 v. San Jose*, No. 1-12-cv-227864 (Cal. Super. Ct. filed July 5, 2012); *City of San Jose v. San Jose Police Officers Ass'n*, No. 5:12-cv-02904-LHK (N.D. Cal. filed June 5, 2012); *San Diego Mun. Emps. Ass'n v. Super. Ct.*, 206 Cal. App. 4th 1447 (2012); *City of San Diego v. Super. Ct.*, No. 37-2010-00091207-CU-WM-CTL (Cal. App. 4th 2011); Kristen De Pena, State Pension Litigation Update (July 3, 2012), available at <http://www.statebudgetsolutions.org/publications/detail/state-pension-litigation-update>. These are being challenged with varying results. See, e.g., *Justus v. Pub. Employees' Ret. Ass'n of Colo.*, No. 2010 cv 1589 (Dist. Ct. Colo. June 29, 2011); *Williams v. Scott*, No. 2011 CA 1584 (Cir. Ct (2d) Fla. Mar. 6, 2012); *Professional Firefighters of New Hampshire v. The State of New Hampshire*, No. 217-2011-CV-385 (N.H. Super. Ct. Jan. 6, 2011); *Rhode Island Council 94 v. Carcieri*, No. PC 10-2859 (R.I. Super. Ct. Sept. 13, 2011); *Rhode Island Public Employees' Retiree Coalition v. Chafee*, CA. Nos. 12-3166, 3167, 3168 (R.I. Sup. Ct.) (complaint filed June 22, 2012); *Swanson v. State of Minn.*, No. 62-CV-10-05285 (Minn. Dist. Ct. June 29, 2011); *Barnes v. Arizona State Retirement System*, CV 2011-011638 (Ariz. Sup. Ct. Maricopa Cnty. Feb. 1, 2012); *Orange County v. Association of Orange County Deputy Sheriffs*, No. BC389758 (L.A. Cnty. Super. Ct. Jan. 26, 2011).

Criticism of the “California Rule:” Professor Monahan takes issue with the state courts that have found that public employees’ protected pension rights arise when they begin employment. She, as have many others, calls this approach the “California Rule,” in reference to certain early California cases that have been cited with approval subsequently by other courts.²² She specifically chastises the courts in twelve other states (Alaska, Colorado, Idaho, Kansas, Massachusetts, Nebraska, Nevada, Oklahoma, Oregon, Pennsylvania, Vermont, and Washington) for having “adopted the California Rule without much discussion.”²³ Professor Monahan challenges the decisions that she asserts have adopted the “California Rule” on the three following bases:

- First, she asserts that these decisions are not based on a finding of “clear and unambiguous evidence” that the legislature intended to create a contract binding itself and future legislatures when it established a pension program for the governmental employees.²⁴ By “fail[ing] to discern legislative intent,” she argues, these courts have created a “separation of powers issue” and have failed to give weight to the “federal courts’ presumption that statutes do not create contracts,” which, according to Professor Monahan, “reflects concern over this potential infringement [of legislative power].” State courts, she asserts, should “abide by the standards articulated by federal courts in deciding impairment challenges brought under the Contract Clause, under which, federal courts do not consider “laws as contracts when the obligation is not clearly and unequivocally expressed” so as not to “limit drastically the essential powers of the legislative body.”²⁵ Professor Monahan claims, in other words, that these decisions are faulty because the state courts, in determining whether the public pension law created contract rights, and if so, the nature of those rights, did not follow the analysis that federal courts typically use to determine whether a modification of a

²² In lumping together a wide variety of different judicial decisions under the “California Rule” label, Professor Monahan follows a wide-spread practice to simplify these courts’ diverse analyses, which – as is proper in judicial decision-making – are based on the different facts and circumstances presented in each case. As described *infra* at 2-6, these decisions are not uniform in their approaches to finding, under state law, when protected contract rights arise and the nature of those rights.

²³ See Monahan, 97 Iowa L. Rev. at 1046-62, 1071.

²⁴ Monahan, 97 Iowa L. Rev. at 1032, 1076-79 (citing *Nat’l R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co.*, 470 U.S. 451, 465-66 (1985), which in turn cites *Dodge v. Bd. of Educ.*, 302 U.S. 74, 79 (1937)).

²⁵ *Id.* at 1076.

law should be found to violate the Contract Clause of the U.S. Constitution.

- Second, she asserts that the courts' findings that public employees' pension rights attach on beginning employment is suspect because it provides protection inconsistent with the level of protection afforded other aspects of public employee compensation arrangements.²⁶ She argues that public employees, hired on an at-will basis, should not be treated as having contractually protected rights to continuance of the pension terms in effect at hiring for future years of employment because the employee has no right to protection, for those future years of employment, with respect to other aspects of the compensation arrangement.
- Finally, she asserts that recognizing this protected contract right "creates economic inefficiencies because it artificially eliminates one option that otherwise would be available for curbing the government's labor costs even if the affected employees preferred such reductions to cuts in other forms of compensation."²⁷ In effect, she argues, the protection is "somewhat illusory" because the government may find other ways to cut the employees' compensation.²⁸

Professor Monahan's analysis proceeds from the premise that state courts are limited, when deciding whether a pension program established and maintained by state government for its own employees creates enforceable contractual rights, and the nature of those rights, to considering whether the enacting legislation displays "clear and unambiguous evidence that the legislature intended to create a contract."²⁹ Professor Monahan suggests that the state courts have erred by failing to require proof under this high standard and that their decisions are therefore somehow suspect. She believes that legislatures within states that recognize these pension rights should enact laws designed expressly to provide test cases for reviewing the basis of the long-standing state precedents and that courts, faced with legal challenges to modifications of the public pension programs, would realize the error of their ways, abandon these long-standing precedents, and adopt the federal standard of proof requiring unmistakable proof of legislative intent.

²⁶ *Id.* at 1076-79.

²⁷ *Id.* at 1079.

²⁸ *Id.*

²⁹ *Id.* at 1076.

As explained below, these premises and conclusions are not well founded.

Defense of the decisions finding protected rights under a “California Rule” approach: It is elemental that state courts have the judicial authority to determine, in each case properly before them, whether a contract exists and its terms as a matter of state law. In the cases that Professor Monahan criticizes, the state courts have done just that. Contrary to her assertion, they have not acted *ultra vires* or trampled on their state legislature’s prerogatives, even if their decisions finding protected contractual rights in their public pension programs have not relied on finding an express “legislative intent” in the statutory language.

Professor Monahan’s critique of these state courts’ decisions is based on her conflation of the analysis that federal courts employ, when faced with the need to determine as a matter of federal law whether legislation creates contract rights protected against impairment under the Contract Clause of the U.S. Constitution,³⁰ with the state courts’ independent approaches to discerning, under state law, the existence and nature of contracts, especially employment contracts between state governments and their employees.³¹ These are two separate types of analysis, founded on different goals. Federal courts are inherently reluctant to derive contractual obligations from federal or state legislation, on one hand in the belief that such legislative acts, particularly at the federal level, are typically intended to establish a “scheme of public regulation,” not to create contractual obligations protected against subsequent government modification,³² and on the other hand out of a respect

³⁰ This federal analysis is referred to in some circles as the “unmistakability” doctrine. See *State ex rel. Horvath v. State Teachers Ret. Bd.*, 697 N.E.2d 644, 653-654 (Ohio 1998) (citing cases referring to doctrine); E. Madiar, *Public Pension Benefits Under Siege: Does State Law Facilitate or Block Recent Efforts to Cut the Pension Benefits of Public Servants*, ABA Journal of Labor & Employment Law, V. 27, no. 2 179, 186-187 (2012).

³¹ Professor Monahan acknowledges that federal courts, in deciding impairment challenges under the Contract Clause, defer to state courts’ determinations regarding whether a contract is created under state law by state legislation, see Monahan, 97 Iowa L. Rev. at 1045, but she ignores this separation of powers distinction in her critique, failing to give any credence to the substantial differences that flow from the different roles of state and federal courts in evaluating state public employee pension programs.

³² See, e.g., *National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry.*, 470 U.S. at 456-66 (holding that Rail Passenger Service Act of 1970, establishing Amtrak and permitting railroads to contract with Amtrak for relief from common carrier obligations, did not create constitutionally protected contract rights because,

for state sovereignty.³³ As a result, federal courts typically impose a high burden on litigants seeking to show that legislation has created contractually protected rights, especially rights between private-sector parties. In contrast, state courts are not so constrained in their review and evaluation of their own states' laws, particularly when they are reviewing laws governing their state government's employment relationships and they are deciding whether a contract exists and the terms of such a contract.³⁴ Professor Monahan offers no explanation for why the stricter, more hedged, federal analysis would be more appropriate for making state law determinations than the state-law approaches already well established in long-standing state law precedents.

Thus, Professor Monahan's assumption that a state court would be bound to follow the legislature's pronouncements on its intent about its obligations with respect to employment contracts between the government and its employees is misplaced. Although a legislature may issue pronouncements, as part of its pension legislation or in connection with legislation amending its pension programs, concerning its intentions about the nature of the employment contracts into which its executive branches, agencies, or instrumentalities may enter, a state court adjudicating a dispute between a public employee and his or her government employer over the employment agreement in effect between them would not be bound by such a pronouncement. Rather, the adjudicating court would take into account all of the relevant facts and circumstances in determining the terms of the contract,

"absent 'an adequate expression of an actual intent' of the State to bind itself, . . . this Court simply will not lightly construe that which is undoubtedly a scheme of public regulation to be, in addition, a private contract to which the State is a party" [citation omitted]).

³³ See, e.g., *Dodge v. Bd. of Ed. of Chicago*, 302 U.S. at 79 (giving "great weight to the views of the highest court of the State touching these matters" to find, *in agreement with the views of the state supreme court*, that state legislation awarding public school teachers annuities did not give them contractual protection against impairment by subsequent legislation reducing those annuities). Professor Monahan acknowledges that federal courts are very reluctant, even when making decisions under the Contract Clause, to reach conclusions about whether specific state legislation is contractual in nature that are contrary to the decisions of that state's courts. See Monahan, 97 Iowa L. Rev. at 1045.

³⁴ See, e.g., *Booth v. Sims*, 456 S.E.2d at 181-86 (after reticulated review of history of state trooper pension system, rejecting under state constitution prospective and retroactive reductions to state troopers' pensions where state had failed to satisfy its funding obligations over time and troopers had more than 50 years' service and therefore "substantial detrimental reliance on the existing pension system").

but the legislature's statements could not bind the court in its independent exercise of its judicial authority.³⁵

In point of fact, the state courts typically have determined whether enforceable contract rights have been created with respect to state pension statutes or codes by evaluating the surrounding circumstances, including the express legislative language, the reasonable expectations of the parties, and the actions both have taken in performance of the contract, as well as the express statutory language.³⁶ Admittedly, the focus in many cases has been on the expectations of the employees. Those considerations were, and continue to be, valid.³⁷ But even if the focus is shifted to discerning the intentions of the government in entering into these employment agreements, there are obvious sound reasons for the courts' conclusions that these government employers had decided to bind themselves contractually with respect to their pension obligations to their public employees.

It is reasonable to conclude that government employers desire and intent to treat their complex, articulated pension programs *in toto* as an important aspect of their contractual obligations to each of their employees covered under

³⁵ Professor Monahan acknowledges that, even under the Contract Clause, a federal court's determinations on the existence and nature of a contract require consideration of the surrounding circumstances, as well as the express statutory language. *Id.* at 1041.

³⁶ See, e.g., *Booth v. Sims*, 456 S.E.2d at 172-77, 183 (reviewing history of state troopers' pension system in detail; noting "the legislature had not sufficiently increased the contributions of the troopers and the Division to meet the State's eventual pension debt" and "both legislatures and executives in the past made then current promises to be fulfilled in the future by other legislatures and executives"); *Opinion of the Justices*, 303 N.E.2d at 327-28; Madiar, ABA Journal on Labor & Employment Law at n. 109 (collecting cases).

³⁷ The court's explanation, in *Booth v. Sims*, 456 S.E.2d at 183-84, of its reasons for rejecting legislative attempts to reduce state troopers' pensions serves as a good example:

It is a recurrent problem of government that today's elected officials curry favor with constituents by promising benefits that must be delivered by tomorrow's elected officials. Unfortunately, the state troopers, secretaries, school service personnel, teachers, highway workers, maintenance employees, assistant prosecuting attorneys and other ordinary state and local workers are not sophisticated politicians who expect their government to lie to them. When, therefore, today's legislature and today's governor make those workers promises, those workers believe the promises and organize their lives in the expectation that their government and their employer will treat them honorably.

the program.³⁸ Pension plans, unlike other forms of compensation, are designed as complex systems intended to be funded consistently over time and to produce life-long replacement income to be provided over time to employees after retirement.³⁹ Stability is an important facet of all pension plans, and this is particularly true of government pension programs, which tend to be larger, more long-term, and more complex in terms and scope than private-sector plans. Because fulfilling pension promises made to employees at the beginning of an employment relationship requires such a long-term commitment from both the government employer and the employee, it behooves each of the parties to have a common understanding of their long-term obligations. Commitments as to retirement age, accrual rates, cost of living adjustments, employee and employer contribution requirements, and vesting periods are all essential elements of the economic arrangement between the parties and also may be essential to the success of the pension program. That other forms of the employees' compensation, or the job itself, are not also subject to the same level of long-term commitment does not diminish the need for both parties to lock in the pension arrangement in order for it to succeed at all. And although there is a tendency to view the benefits of protecting these pension commitments only from the employees' vantage point, the government employer also benefits by fixing its long-term costs and the expectations of its employees, managers, creditors, and taxpayers. Finally, it bears noting that the government employer also benefits by obtaining and retaining the services of more qualified and more committed employees who make decisions based on their desire to preserve and enhance their own long-term retirement security.

The wide-spread, long-standing acceptance by both legislative and executive branches of state government of their courts' determinations regarding the contractual intent underlying the state pension programs provides equally strong support for the correctness of these state courts' recognition of the contractual nature of the pension programs. Although governments have not uncommonly adopted new multi-tiered benefit obligations that offer less costly benefits to new hires than to current

³⁸ See Madiar, ABA Journal of Labor & Employment Law at 194, n. 111 (citing *Lauderdale v. Eugene Water & Elec. Bd.*, 177 P.3d 13, 19-21 (Or. Ct. App. 2008)).

³⁹ In this regard, the reduction of the governments' promises, as part of these employment agreements, to maintain these long-term, complex funding and payment programs, to promises of "deferred compensation," see Monahan, 97 Iowa L. Rev. at 1043, understates the actual nature of the states' substantial undertaking. The state courts have obviously understood that more than merely future compensation payments is involved in the commitment that governments took on as enforceable contractual pension obligations.

employees, it is virtually unheard of for a government to declare to new hires that the current government pension program is only a temporary feature, available to the new employees only until the government employer exercises its unilateral and unfettered right to reduce or eliminate the pension benefits at any time in the future. If the courts had initially mistaken the legislative intent underlying these pension programs, and governments had not intended that they create binding contractual rights, governmental entities surely would instead have taken concrete steps, all these many decades, to correct the courts' errors and to establish that they intended to have the freedom to revise such arrangements at will, as well as to ensure that newly hired employees understood the precariousness of the current pension arrangements.

Accordingly, there is nothing suspect or flimsy about these state courts' findings that their legislatures enacted public employee pension legislation intended to bind government employers contractually regarding the terms of the pension system on a prospective basis. These courts had substantial grounds for concluding that the contractual protections attached when employees began their public service and prevented substantial modification of the pension program throughout their careers. There is no *legal* basis for impugning the validity of these courts' analyses of the contracts formed between the government employers and their employees, based on the existing legislation and the surrounding circumstances. Indeed, a better characterization of Professor Monahan's criticism is that these courts should be faulted for not *inferring* a negative intention – that is, an intent to not bind the government contractually – based on the absence of express legislative language.

In addition, as Professor Monahan acknowledges, courts have ample basis for finding that an implied contract in fact was formed between a government employer and its employees regarding the promised pension benefits and that the implied contract extended to continuing, for the duration of the employee's employment, the terms of the pension system in effect when the contract was formed.⁴⁰ A court's conclusions in this regard on the scope and nature of the contractual rights thus provided to its governmental employees with regard to their pensions would be consistent with the government employer's typical hiring conduct in describing the state pension

⁴⁰ Professor Monahan admits that “[t]here is good authority for the position that [already earned] accrued benefits are protected by an implied-in-fact contract,” *see id.* at 1082, and she provides no reason why such an implied contract could not be determined, by the state courts, to cover prospective accruals as well.

program to prospective employees not as a contingent arrangement, but as a permanent aspect of a complex, long-term compensation scheme.

Further, the economic incongruities that Professor Monahan fears are overstated. Governments in financial crisis need not look to reducing their labor costs as the only source of relief, as creditors and taxpayers also may be asked to share in the burden.⁴¹ As noted earlier, each state has its own standards for determining whether, and to what extent, unilateral legislative modifications of existing contract rights may be made, and this is particularly true with respect to government pension promises to public employees.⁴² Finally, in the last resort, a municipality (although not a state) could avail itself of bankruptcy.⁴³ With other means available to governments to handle their fiscal needs, courts need not abandon their long-standing precedents regarding the nature of the public-sector employment relationships in their jurisdictions – particularly as the legal analysis underlying these long-standing precedents remains sound.

At bottom, the concerns of governmental pension reformers, like Professor Monahan, appear to be premised on fears over the widening distance between the structures of the labor market in the private and public sectors. The private sector business model in current times calls for high employee turnover and low fixed costs, so that such businesses may react to market conditions nimbly. The private sector retirement systems and the federal law regulating them now attempt to reflect this reality.⁴⁴ But the government sector has not heretofore and need not now mirror the private sector model. Most government functions require large stable workforces that will provide continuity for the foreseeable future. The employees of governments are also

⁴¹ See E. McNichol and I. Lav, *A Common-Sense Strategy for Fixing State Pension Problems in Tough Economic Times*, Center for Budget and Policy Priorities, <http://cbpp.org/cms/index.cfm?fa=view&id=3492> (May 12, 2011).

⁴² In this regard, it is worth noting the inequity inherent in cutting pensions promised to state and local public servants based on alleged underfunding that was substantially caused, in many cases, by funding “holidays” that government employers awarded themselves.

⁴³ See 11 U.S.C. § 901 *et seq.*; *United States v. Bekins*, 304 U.S. 27 (1938) (upholding the constitutionality of chapter 9 of the Bankruptcy Code).

⁴⁴ The Employee Retirement Income Security Act of 1974 (“ERISA”), which established federal standards for private-sector pension plans, and which Professor Monahan suggests as the best model for states to follow, see Monahan, 97 Iowa L. Rev. at 1079, generally protects private-sector employees’ pension only to the extent of “accrued benefits” (a defined term excluding various additional benefits that may be included in a pension plan) and only to the extent that such benefits are “vested.” See 29 U.S.C. § 1054(g); 26 U.S.C. § 411(d)(6).

taxpayers to the same governments and consumers of the government services that they themselves provide. A government contractually-based pension program, designed to be a permanent feature of the employment relationship and intended to provide definitely determinable replacement income to the government's long-term workforce in retirement, is both sustainable and desirable on both economic and policy grounds.

Conclusion: Professor Monahan's invitation to state courts that protect public pensions from the first day of employment to revisit the analytical foundation of their decisions appears at base to be driven by policy goals, rather than the discovery of any flaw in the legal theories underlying these courts' decisions. State courts are not bound by the federal standards that apply under the Contract Clause, including the strict standards of proof requiring express "unmistakable" evidence of legislative intent, in determining whether state legislation governing public pensions creates a contract and the terms of such contract. More specifically, state courts have the authority and the responsibility to determine the nature of the contractual obligations existing between state government employers and their employees, including those related to public pension programs. Even if a court were to re-examine the public pension programs within its jurisdiction and to conclude that the legislature that first created those laws did not "clearly and unmistakably" manifest its express intent to enter into a binding contract for itself and future legislatures – a result that even Professor Monahan would not favor on policy grounds⁴⁵ – the court would nonetheless have more than adequate basis on which to decide that those pension laws created enforceable contract rights, based on surrounding circumstances as well as the court's inherent power to find the existence of an "implied-in-fact" contract.⁴⁶

Ultimately, Professor Monahan's attempt to denigrate the validity of decades of judicial precedents about the binding nature of legislation establishing pension commitments to government employees and to motivate state courts to overturn long-settled premises about these commitments would impose its own, unjustifiable costs. The states and their instrumentalities have promised pension benefits to their employees; those employees have relied on those long-standing promises; and as a result the citizens of the states have

⁴⁵ See Monahan, 97 Iowa L. Rev. at 1083 (stating that, at a minimum, "earned benefits are entitled to a high standard of legal protection" and "can be changed only under a legitimate exercise of a state's police power – a difficult hurdle to clear").

⁴⁶ See *id.* at 1082-83 (noting that the outcome of a re-examination of legislative intent is not predictable and that "[t]here is good authority for the position that [already earned] accrued benefits are protected by an implied-in-fact contract").

benefited from the services provided by those employees. There is no sound public policy reason to conclude that these promises – based on the reasonable expectations of the contracting parties – should not be fully protected by the laws prohibiting or limiting the impairment of contracts.