

Modifying public pension benefits

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Ground Rules

- Overview of state laws around the country
- For guidance specific to your state, check relevant law

Legal status of pension benefits

- Previously: gratuity
- Now: generally viewed as contractual right

Gratuity

- Benefit that can be withdrawn or amended at any time – no rights therefore no protection
- Appearance of pension being a gift
- Why rejected
 - If state constitution bans state gifts to individuals, and pensions are gifts, then paying benefit would be unconstitutional. *Yeazell v. Copins*, 402 P.2d 541 (Ariz. 1965)

Contractual right

- Public employees have certain contractual rights in their pensions where pension part of terms of employment (60A Am. Jur. 2d 1175)
- Importance of contractual right: If impaired, can be enforced through court action
- Key issue: when does right go into effect? (more discussion below)

Sources of law

- State constitutions
- State statutes
- Cases in which implied contractual right exists

State constitutions

- Hawaii, Illinois, Louisiana, Michigan, New York – very specific language
- “[M]embership in any pension or retirement system of the state or civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired.” New York Constitution, Article V, Section 7 (1941)
- Difficult to change state constitutions

State statutes

- General Language: pension benefits are inviolable contract. Kentucky Revised Statutes 161.714
- Specific language: non-forfeitable right to receive pension benefits upon attainment of five years of service credit. New Jersey Statutes 43:3C-9.5
- Can tailor right as New Jersey has done

ImPLY existence of contract

- No specific language about contractual rights in pension benefits in some states' statutes or constitutions
- Courts imply contract based on Contracts Clause of U.S. Constitution (some states also have contracts clause) and other theories
- "No state shall . . . pass any . . . law impairing the obligations of contracts." (U.S. Const. art. I, 10)

Calabro v. City of Omaha

- City eliminated COLA and active and retired firefighters sued
- Nebraska Supreme Court held:
 - COLA constituted pension
 - Active and retired firefighters had a “vested, constitutionally [Contracts Clause of U.S. Constitution] protected contractual right when they accepted and commenced employment with the city.”
- 247 Neb. 955, 531 N.W.2d 541 (1995)

Betts v. Board of Administration

- Amendment to California pension law withdrew benefits that Betts earned as vested contractual right while employed (right arises as part of employment; cf. Contracts Clause in *Calabro*)
- Was contract substantially impaired by change?
- Yes, because no comparable new advantages offset the detriment Betts suffered
- California Supreme Court ruled that Betts' contractual right violated
- 21 Cal.3d 859, 582 P.2d 614, 148 Cal. Rptr. 158 (1978)

When does right go into effect?

- Upon hire (NY Const.)
- When participant fulfills service requirements (*Jones v. Cheney*, 489 S.W.2d 785 (Ark. 1973))
- Specified time period: upon attainment of five years of service credit member acquires non-forfeitable right to receive pension benefits (New Jersey Statutes 43:3C-9.5)

Another twist

- Even if pension benefits NOT changed, violation of contractual rights nevertheless found
- How? State took action that impaired funding of retirement system

Stone v. State

- Governor ordered state employers to forward pension contributions to state treasury instead of retirement system
- Order violated contractual rights of members to have retirement system funded in actuarially sound manner
- 191 N.C.App. 402, 664 S.E.2d 32 (2008), *review denied*, 363 N.C. 381, 680 S.W.2d 712 (2009)

Kaho'ohanohano v. State

- Act by legislature that retroactively reduced contribution to retirement system violated employees' constitution pension protection under Hawaii constitution, Article XVI, 2
- Act required the crediting of actuarial investment earnings in excess of 10% of actuarial investment yield rate toward contributions
- 114 Haw. 302, 162 P.3d 696 (2007)

New tiers for newly hired employees

- Tier: lower set of benefits than those for existing employees
- Example:
 - Increased age and service requirements for new employees in Nevada, New Mexico, and Rhode Island
 - Changes do not affect existing employees
- Different treatment of employees does not deny them equal protection of the law (*Jackson Firefighters Ass'n Local 87 v. City of Jackson*, MS, 736 F.2d 209 (5th Cir. 1984))

Developments: Colorado Senate Bill 10-001

- Modifications include:
 - Reduction of COLA from 3.5% yearly to a cap of 2% yearly and no COLA in 2010
 - Change in calculating highest average salary (HAS) for those not eligible to retire as of 1/1/2011
 - Modify Rule of 85 (age and service requirements for full service retirement) and substitution of Rule of 88 then Rule of 90 in future

Colorado: Who's affected by which benefit change?

| <i>Change</i> | <i>Who's affected</i> |
|------------------------------|--|
| COLA | Current and future retirees |
| Highest Average Salary (HAS) | Those NOT eligible to retire on 1/1/2011 (thus, most actives) |
| "Rule of" | Those NOT vested and those NOT eligible for retirement on 1/1/2011 (smaller group of actives than for HAS) |

Colorado legal action

- Lawsuit challenging changes as violating Contract Clause of U.S. and Colorado Constitutions because they diminish vested pension benefits
- *Justus v. State of Colorado*, District Court, Denver County, 2/26/10

Other developments

- COLA cut backs and other changes
 - South Dakota – 2010 COLA reduced to 2.1% and percentage of future COLAs tied to funding level
 - Minnesota – current COLA of 2.5% reduced or eliminated and future percentage tied to funding

Summary

- State constitutions hard to change
- Statutory contractual rights can be tailored
- Contractual rights may be violated by funding change
- New tiers of benefits for new employees
- Cutbacks that affect different classes of existing employees