

Legal Issues in Public Pension Reform



AMY MONAHAN
UNIVERSITY OF MINNESOTA LAW SCHOOL

Evolution



- From gratuity to something more protective

Overview of Current Approaches



- **Constitutional protection**
 - As of the first day of employment
 - Only for accrued benefits
- **Common law contractual protection**
 - As of the first day of employment
 - Once vested or eligible for retirement
 - Once retired
- **Common law property interest prior to retirement**

Practical Frameworks



- No detrimental changes for current employees
- No detrimental changes for vested members/those eligible to retire
- No detrimental changes for retirees

Legal Risk Hierarchy



- Benefits that have already been earned
- Future benefit accruals
- New Hires

Open Issues



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

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?

Future Accruals



- Should future accruals ever be considered part of the contract?
 - Clear that other conditions of employment, such as tenure, salary, and other benefits can be prospectively altered
- Even future accruals are protected, a change to future accruals is considered less substantial than a change to benefits already accrued

COLAs



- Are they properly considered part of the participant's accrued benefit?
- When does a right to a COLA vest?
- Does a participant have a reasonable expectation to receive a particular COLA?

Minnesota COLA Ruling



- MN most recently embraced a “promissory estoppel” approach to public pensions
 - Contract implied if state made promise, employee reasonably relied on the promise, and justice requires enforcement of the promise
- In 2009, MN enacted a guaranteed minimum COLA and in 2010 repealed that provision and replaced it with lower COLA amounts until 90% funding achieved

Minnesota COLA Ruling



- District court held:
 - No reasonable expectation of a particular COLA
 - No contract based on statutory language
 - Even if there was a contract, change was justified based on state's police power
 - ✦ Broad-based reform that imposed burden on all affected parties was reasonable and necessary to serve an important public purpose

Minnesota COLA 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.”
- “The Legislature appropriately and responsibly took a multitude of steps, not in the state’s self-interest, but in the collective interests of all members.”
- Deference to legislative judgment

Colorado COLA Ruling



- The Colorado Supreme Court had previously adopted the California Rule (which protects pension as of first day of employment, including future accruals and COLAs)
- In 2001, law passed adopting a 3.5% COLA
- In 2010, CO legislature passed broad pension reform that, among other things, capped COLAs at 2%

Colorado COLA Ruling



- District court held:
 - No contractual right to the *specific* COLA formula in place at retirement
 - ✦ Formula had been changed often and was always made applicable to current retirees
 - No “clear and unmistakable” right to an unchangeable COLA for the rest of their lives.
 - ✦ Retirees in fact signed documents acknowledging that COLA was subject to change
 - ✦ Absence of clear statutory language

Take Aways from Recent Rulings



- Comprehensive reform plans that affect wide range of stakeholders
- Multiple options considered
- Not in the state's self-interest
- Temporary