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?
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In 2009, MN enacted a guaranteed minimum COLA and in 2010 repealed that provision and replaced it with lower COLA amounts until 90% funding achieved
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
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