



CYPEN & CYPEN
NEWSLETTER
SPECIAL SUPPLEMENT
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Never Forget September 11, 2001

and

Always Remember May 2, 2011

**ILLINOIS SUPREME COURT AFFIRMS
UNCONSTITUTIONALITY OF PENSION**

AMENDMENTS

The issue presented in this consolidated appeal is whether Public Act 98-641, which amends the Illinois Pension Code as it pertains to certain pension funds for employees of the city of Chicago, violates the pension protection clause of the Illinois Constitution. ([See C & C Newsletter for July 30, 2015, Item 1.](#))

On cross-motions for summary judgment, the circuit court of Cook County declared the Act to be unconstitutional in its entirety, and permanently enjoined its enforcement because it diminished pension benefits in violation of the pension protection clause. The Illinois Supreme Court affirmed.

Illinois has established various public pension systems, including four pensions for public employees of the city of Chicago. These pension funds include the Municipal Employees', Officers', and Officials' Annuity and Benefit Fund (MEABF); the Laborers' and Retirement Board Employees' Annuity and Benefit Fund (LABF); the Firemen's Annuity and Benefit Fund (FABF); and the Policemen's Annuity and Benefit Fund (PABF). At issue are the City pensions impacted by the Act, which include MEABF and LABF. Participants in the MEABF include most civil servant employees of the City, as well as non-teacher employees of the Chicago public school system. Participants in the LABF include primarily labor service workers.

These funds operate in a similar way to the state-funded retirement systems, in many respects. The City pension funds are all subject to the pension protection clause of the Illinois Constitution, which provides:

Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.

Also, the City pension funds provide traditional defined benefit plans under which members receive specified annuities upon retirement, generally based upon the member's salary, years of service and age at retirement.

As with the state-funded pensions, prior to the enactment of the Act, for employees hired prior to January 1, 2011, annuity payments under the funds were subject to 3% automatic annual increases beginning after the member's first full year of retirement, and compounded annually. For employees hired after January 1, 2011, the annuity adjustments were tied to the Consumer Price Index.

Benefits under MEABF and LABF are funded from three sources: contributions from the City, contributions from the employees and investment returns. Prior to the Act, employees contributed 8.5% of salary toward their pension on an annual basis. The City contributed

an amount based on a fixed multiplier, 1 or 1.25 times the annual employee contributions, which was historically paid largely from property tax proceeds.

Public pensions, including the City pensions, have been historically inadequate to cover benefits owed to members. The specific concerns over funding deficiencies in the City pension funds have been well documented. Concerns over the ongoing funding deficiencies led to adoption of the pension protection clause in 1970.

Despite warnings that the funding mechanism was not sufficient to cover projected future benefits, and adoption of the pension protection clause, the method of funding remained static with respect to MEABF and LABF. The Pension Code continued to set City contribution levels at a fixed multiple of employee contributions. This contribution level had no relationship to the obligations that the funds were accruing. Annual actuarial valuations of the funds continued to show that the actuarially required contributions needed to fund the benefits were not being met.

The 2007 Comprehensive Annual Financial Report for MEABF disclosed that an employer contribution multiple of 2.97 was needed adequately to finance the plan. The same report revealed that the statutory employer contributions had been less than the annual required contribution for the past five years, and were again expected to be less than the ARC for 2008.

It was undisputed that if the funds remained in the same trajectory, they would continue to pay out more in benefits than they received in contributions and investment returns, leading to a path of insolvency. It is now projected that without reforms, MEABF and LABF, respectively, will be insolvent in 10 years and 13 years.

Against this backdrop, as with the state-funded pensions, the State Legislature amended the Pension Code to require, starting in 2015, the City to contribute amounts sufficient to enable Chicago police and firefighter pension funds to reach 90% actuarial funding by 2040. No such legislation was passed with respect to MEABF and LABF at that time. Instead, in 2014, the Legislature ultimately enacted the Act, the legislation at issue in this case.

The Act was intended to address an immediate funding crisis that threatens the solvency and sustainability of the public pension systems serving employees in the City of Chicago. The Legislature expressly found that the financial crisis could not be addressed by increased funding alone, without also increasing employee contribution rates and reducing the annual adjustments for current and future retirees.

Under the Act, the City's funding contribution progressively increased, leading to actuarially-based payments beginning in 2021 to bring the funds to 90% funding levels by 2055. However, for the first five years, from 2016-2020, the City would continue to contribute under the

current multiplier framework, with an increased rate each year.

Further, if the City fails timely to pay the required contributions, the funds may certify the delinquent amounts to the Comptroller. The Comptroller, beginning in 2016, must deduct and deposit into the funds the certified amounts or a portion of those amounts specified from the grants of state funds to the City. The Act also increased the requirement of employee contributions for members of the funds. Instead of contributing 8.5% of salary, the Act increased member contributions by .5% each year from 2015 to 2019, when the contribution reaches 11% of salary. Contribution then remains fixed at 11%, unless the funds reach a 90% funding ratio, at which point member contributions would decrease to 9.75%, so long as the fund maintains a 90% ratio. If the funds fall below that mark, employee contributions are increased again to 11% of their salaries.

The Act also includes a comprehensive set of provisions designed to reduce annuity benefits to members of MEABF and LABF. The Act replaces former provisions under which retirees receive flat 3% annual increases with a new system that limits the amount of annual increases. The increase is now equal to the lesser of three percent or half the annual unadjusted percentage increase in the CPI.

Furthermore, the Act removes the compounding component, and instead of an annual increase, eliminates the increases entirely in specific years, and postpones the time when a retiree begins receiving the initial increase.

Two separate lawsuits challenging constitutionality the Act were filed in the circuit court of Cook County.

Both complaints sought a declaration that the Act is unconstitutional in violation of the pension protection clause because it diminishes pension benefits, and sought to enjoin its enforcement. The City and the State were permitted to intervene in both cases to defend constitutionality of the Act.

Defendants argued that the Act did not diminish or impair benefits because it results in a “net benefit” for the funds’ participants, and will save the funds from an otherwise inevitable insolvency. The City additionally maintained that any payment of benefits owed prior to the Act was not the obligation of any city government, but, rather, was the obligation solely of the funds themselves, and that under the Pension Code participants’ benefits were limited to sums on hand in the funds. Therefore, under the Act, the pension funds will be saved from insolvency and put on a path to full actuarial funding, making the funds’ participants “better off” than without the Act. Moreover, defendants argued that the modification of benefits under the Act was permissible as the product of a bargained-for exchange between the City and the labor unions.

On July 24, 2015, the circuit court declared the Act unconstitutional. The court found that the Act diminished pension benefits in violation of

the pension protection clause. The court rejected the “net benefit” argument as contrary to the pension protection clause, its purpose and the Supreme Court’s interpretation of it. The court reasoned that the argument rested as a misapprehension of the scope of the protections in the pension protection clause, disregarded settled distinctions between pension benefits and funding choices, and failed to account for the fact that the so-called “net benefits” are subject to legislative repeal at any time.

The court additionally rejected defendants’ assertion that the Act was a valid bargained-for exchange, finding that the unions were not acting as agents in collective bargaining process, could not have represented the retired members while at the same time acting as representatives of the active employees, and nothing in the process that led to the enactment of the Act barred the individual plaintiffs from asserting their constitutional rights or operated as a waiver of those rights. Finally, the court held that the unconstitutional provisions of the Act could not be severed, and that the Act was therefore unenforceable in its entirety.

The sole question of law presented for the Court’s review is whether Public Act 98-641 violates the pension protection clause set forth in the Illinois Constitution. The Act provides membership in any pension or retirement system of the State, any unit of local government or school district, or agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.

The Supreme Court has previously considered the object and purpose of this clause, and reaffirmed the scope of its protections, consistent with earlier holdings from the court and the appellate court since the pension protection clause was adopted in 1970.

As the Court has previously explained, under the clause, a public employee's membership in a pension system is an enforceable contractual relationship, and the employee has a constitutionally protected right to the benefits of that contractual relationship. Those constitutional protections attach at the time an individual begins employment and becomes a member of the public pension system. Thus, under its rule and plain and unambiguous language, the clause prohibits the Legislature from unilaterally reducing or eliminating the pension benefits conferred by membership in the pension system.

Now begins the fun.

Jones v. Municipal Employees' Annuity and Benefit Fund of Chicago,
Docket Nos. 119618, 119620, 119638, 119639 and 119644 (Ill., March
24, 2016),

<http://www.illinoiscourts.gov/Opinions/SupremeCourt/2016/119618.pdf>.