SUMMARY — THE PROPOSED "CONSIDERATION"-BASED PLAN IS UNCONSTITUTIONAL BECAUSE IT OFFERS NO CONSIDERATION IN EXCHANGE FOR REDUCING PENSION BENEFITS

Some plans put forth to "reform" the Pension Code purport to offer "consideration" in exchange for reductions in pension benefits for active employee Tier I members of state-funded pension systems. One purported "consideration"-based plan that the We Are One Illinois coalition understands is being considered would negatively impact how future pay raises are used to compute a pension system member's pension upon retirement. That plan would require each Tier I active employee to select between two options:

Option 1: Future pay increases do not count in calculating the member's initial pension amount upon retirement; in exchange the member would receive the current 3% annual annuity adjustment, compounded; or

Option 2: Future pay increases count in calculating the member's initial pension amount upon retirement; in exchange the member would receive an annual annuity adjustment that is less than the current compounded adjustment.

This so-called "consideration model"-based plan suffers from fatal contractual and constitutional flaws. Put simply, there is no "consideration" for the pension diminishments it would impose.

If enacted, the plan would be nothing more than another legislative fiat that reduces pension benefits already conferred by membership in a state-funded pension system—the very type of unilateral pension reduction legislation that the Illinois Supreme Court has ruled is unlawful. The plan would force an employee to choose between giving up one of the components that comprise the constitutionally-protected formula by which a member's pension is calculated without any new benefit—the so-called "consideration"—in return. Whichever option a first responder, teacher, nurse, or other public servant of Illinois selects under the plan, the end result would be a substantial reduction in the pension benefit to which that member presently is entitled. The plan thus violates the Illinois Constitution's Pension Protection Clause.

Should the General Assembly enact, and Governor Rauner sign into law, legislation based on this so-called "consideration model"-based plan, the We Are One Illinois coalition will commence litigation to invalidate the legislation as unconstitutional and to highlight that the General Assembly has once again overstepped the scope of its legislative power. As the Illinois Supreme Court observed a year ago, "the magnitude of the difficulty facing our elected representatives … is not an excuse to abandon the rule of law. It is a summons to defend it." *In re Pension Reform Litigation*, 32 N.E.3d 1, 28 (Ill. 2015) (hereinafter referred to as "Pension Litigation")). Our elected representatives would be well-served to heed that summons. Enactment of this type of plan would do nothing more than yet again postpone to a future day the work needed to create a lawful and appropriate funding solution for the State's pension obligations.

THE PLAN IGNORES WELL-SETTLED CONSTITUTIONAL LAW

The Illinois Supreme Court has opined several times on the scope of protection afforded by the Pension Protection Clause. This particular type of "consideration" model ignores those teachings. It thus bears repeating what the Supreme Court only recently reaffirmed—that the Pension Protection Clause provides absolute protection to Illinois public servants.

The Pension Protection Clause provides that "[m]embership in any pension or retirement system of the State, any unit of local government … or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired." Ill. Const. 1970, art. XIII, § 5. The Supreme Court explained that under the Clause "members of pension plans subject to its provisions have a legally enforceable right to receive the benefits they have been promised." *Pension Litigation*, 32 N.E.3d at 16. Further, the Supreme Court confirmed that "[t]he protections afforded to such benefits by [the Clause] attach once an individual first embarks upon employment in a position covered by a public retirement system, not when the employee ultimately retirees." *Id.* "Accordingly, once an individual begins work and becomes a member of a public retirement system, any subsequent changes to the Pension Code that would diminish the benefits conferred by membership in the retirement system cannot be applied to that individual." *Id.*; *see also Jones v. Municipal Employees' Annuity and Benefit Fund of Chicago*, 2016 IL 119618, ¶ 29 (March 24, 2016 Ill. S.Ct.) ("[U]nder its plain and unambiguous language, the clause prohibits the General Assembly from unilaterally reducing or eliminating the pension benefits conferred by membership in the pension system.") (citing *Pension Litigation*, 32 N.E.3d at 16 and n. 12)).

The Pension Protection Clause's protection of public pension system members extends to the statutory formula in the Pension Code that a pension system uses to determine its members' pension payments. *Pension Litigation*, 32 N.E.3d at 18. In short, a pension system member has a constitutionally-protected right to have the member's annuity calculated pursuant to the formula in the Pension Code as of the time the member began employment and any beneficial modifications to the formula made during the course of the member's employment. *Id.*

As explained below, the current Pension Code accounts for salary increases that a member receives during the member's public service tenure in computation of the member's initial pension annuity and, subsequently, adjusts that amount each year by 3%, compounded. As a result, no matter the moniker bestowed on it, the so-called "consideration model" described above does not pass contractual or constitutional muster.

THE PLAN IGNORES THE PENSION CODE

The pension annuity that a member of a state-funded pension system receives over the course of the member's retirement is specified by a formula set forth in Illinois' Pension Code. The plan overlooks the existing formula relevant to each system.

Each system operates in approximately the same way in computing a member's initial pension amount upon retirement. Three main factors comprise that amount: (1) final average

salary; (2) years of service credit; and (3) a multiplier. At issue here is computation of the final average salary component:

- State Employees Retirement System (SERS): final average salary is based on the highest 48 consecutive months of service within the last 120 months of service. (*See* 40 ILC 5/14-103.12.)

- State University Retirement System (SURS): for hourly employees and those who receive an annual salary in installments during twelve months of each academic year, the final average salary is the 48 consecutive calendar-month period ending with termination of employment or the average annual earnings during the four consecutive academic years of service in which the employee's earnings were the highest, whichever is greater. For all other members of SURS, the final average salary is the average annual earnings during the four consecutive academic years of service in which the member's earnings were the highest. (*See* 40 ILCS 5/15-112.)

- Teachers' Retirement System: final average salary is based on the average of the highest four consecutive annual salary rates within the last ten years of service. (*See* 40 ILCS 5/16-133(b).)

Put simply, increases in compensation are key to computation of final average salary under the Pension Code and, concomitantly, a member's initial pension annuity.

Similarly, the 3%, compounded, annual annuity adjustment is the key factor in calculating the annuity amount a retiree receives in subsequent years of retirement. (*See* 40 ILCS 5/14-114 (SERS); 40 ILCS 5/15-136(d) (SURS); and 40 ILCS 5/16-133.1(a) (TRS).) The Supreme Court observed that the "annual annuity adjustments are built-in to the pension benefit and are not tied to the cost of living. As a result, the real value of annuities may either increase or erode depending on economic conditions, notwithstanding the adjustments." *Pension Litigation*, 32 N.E.3d at 5.

THE PLAN VIOLATES THE PENSION PROTECTION CLAUSE

Whether the plan violates the Pension Protection Clause is easily resolved in light of the Pension Protection Clause's protections and the Pension Code's pension computation formulas. It does. As the Supreme Court held, the Clause "means precisely what it says: 'if something qualifies as a benefit of the enforceable contractual relationship resulting from membership in one of the State's pension or retirement systems, it cannot be diminished or impaired.'" *Pension Litigation*, 32. N.E.3d at 16 (quoting *Kanerva v. Weems*, 13 N.E.3d 1228, 1239 (Ill. 2014)). But diminishment of pension benefits is all that implementation of this plan would accomplish.

Regardless of the option a pension system member elects, the member would receive a smaller pension annuity during the course of the member's retirement compared to the annuity the member would receive under the current Pension Code. Simply stated:

- if a member elects option 1, the final average compensation used to compute the initial pension amount would be less than under the current Pension Code, resulting in a diminished initial pension amount. In turn, the annual annuity adjustment that the member receives in each subsequent year of retirement also would be diminished because the 3% adjustment would be based on the lesser initial pension amount that the member received during the first year of retirement; and

- if a member elects option 2, the member would receive automatic annuity adjustments in subsequent years that are diminished compared to the annual adjustments the member would receive under the current Pension Code.

The Supreme Court's holding in *Pension Litigation* is equally apropos here: "there is simply no way that the annuity reduction provisions in the [plan] can be reconciled with the rights and protections established by the people of Illinois when they ratified the Illinois Constitution of 1970 and its pension protection clause." *Pension Litigation*, 32 N.E.3d at 17.

Indeed, the plan ignores that the Supreme Court considered and rejected the same pension benefit reductions the State promoted in *Pension Litigation* and the City of Chicago promoted in *Jones*:

- cap on the maximum salary that may be considered when calculating the amount of a member's initial retirement annuity. *Pension Litigation*, 32 N.E.3d at 11 and 17-18; and

- replacement of 3% annual annuity adjustment, compounded, with annual annuity adjustments that are determined according to a variable formula, not compounded. *Pension Litigation*, 32 N.E. 3d at 11 and 17-18; *Jones*, 2016 IL 119618, ¶ 31.

There can be no serious dispute that the options encompassed by the plan would have the same negative impact. They unquestionably reduce the value of the retirement annuities members of the state-funded retirement systems were promised when they joined those systems. As such, the plan's "annuity reducing provisions contravene the pension protection clause's absolute prohibition against diminishment of pension benefits, and exceed the General Assembly's authority." *Jones*, 2016 IL 119618, ¶ 31.

In short, there can be no reasonable dispute that the Supreme Court would declare the plan unconstitutional and invalid. So why adopt it?

SO-CALLED JUSTIFICATIONS FOR THE PLAN HAVE NO MERIT

Despite the Pension Protection Clause's absolute protection against legislation that reduces pension benefits, the We Are One Illinois coalition understands that supporters of the plan nevertheless maintain that it would withstand a constitutional challenge for two reasons. First, they apparently assert that no public employee is entitled to a pay raise as a matter of course. From this premise, they apparently assume that the General Assembly may amend the Pension Code to disregard future salary increases when calculating a member's retirement

annuity. Second, they note that the Pension Protection Clause is modeled on New York's pension protection clause, and, therefore, New York case law which they contend has upheld similar options is applicable here. Neither argument has merit.

Like the plan's constitutionality overall, whether the first rationale has merit is easily resolved. It does not. Even if supporters' observations about the State's ability to foreclose future pay raises for active employee members of the state-funded retirement systems were accurate, it would make no difference here. (There is therefore no need to analyze the accuracy of the contention that the State has authority to foreclose raises for state employees, teachers and others who are members of one of the state-funded retirement systems.) If a member receives a pay raise, the pension system must consider whether it impacts the member's final average salary. This is so for two reasons, contractual and constitutional.

From a contractual perspective, there is no new benefit that might constitute meaningful consideration. The question that the plan raises is ***not*** whether state employees are entitled to a particular salary increase. Rather, the question is whether the legislature may condition the receipt of a constitutionally guaranteed pension benefit (annual annuity adjustment) on the abandonment of another constitutionally guaranteed pension benefit (the inclusion of future salary increases in the computation of the initial annuity). Under the current Pension Code formulas, members are ***already*** entitled both to a compounded 3% annual adjustment and to an initial annuity that takes into account cumulative salary increases (whatever those turn out to be). Therefore, the preservation of one component (computation of pensionable salary based on pay increases) cannot be "consideration" for diminishment of the other component (automatic annuity adjustments).

As noted above, from a constitutional perspective the contention that the State could foreclose future pay raises fares no better. As just described, the existing Pension Code formulas take into account salary increases that a member received throughout public employment. As a result, the Pension Protection Clause requires that the system include in its analysis of the member's final average salary each increase in the member's pay and count them if those increases positively impact the final average salary amount. Anything less would be unconstitutional. *See, e.g., Pension Litigation*, 32 N.E.3d at 11 and 17-18 (finding unconstitutional cap on the amount of a member's salary in computing the initial annuity amount).

The purported reliance on New York case law does not cure this plan's contractual and constitutional ills. First, because the Illinois Supreme Court's holdings regarding the scope of the Illinois Pension Protection Clause protection of pension benefits is clear, and that protection unequivocally forecloses the pension benefit reductions each option embodies, there is no need to look to rulings from another state.

Second, and regardless, New York decisions on which supporters of this plan purportedly rely do not involve reduction of existing constitutionally protected pension benefit rights with no countervailing new benefit. Instead, those cases involved the question of whether actual payment of particular forms of new compensation apart from and in addition to base salary could

be conditioned on an employee's agreement to exclude that specific additional compensation from calculation of the employee's pensionable salary. None of those cases involved the wholesale or prospective exclusion of all future pay increases from the computation of pensionable salary. As such, those cases have no application here.

IT'S TIME TO STOP KICKING THE CAN DOWN THE ROAD

Enactment of this so-called "consideration"-based plan would only accomplish one thing—delay in implementation of a lawful and just funding solution to Illinois' pension funding obligations. Further delay is unacceptable. And, it would only exacerbate the funding deficit as the State continues to underfund its pension systems. The Coalition recognizes that some form of a consideration-based model might pass constitutional muster and help to alleviate part of the State's funding obligation. But the plans that have thus far been suggested—with their contractual and constitutional infirmities—definitely do not pass constitutional muster. It bears repeating in conclusion the summons urged by our Supreme Court: "the magnitude of the difficulty facing our elected representatives … is not an excuse to abandon the rule of law. It is a summons to defend it." *Pension Litigation*, 32 N.E.3d at 28. We Are One Illinois urges the General Assembly and Governor Rauner to heed that call.