THE LEGAL LANDSCAPE OF PUBLIC EMPLOYEE PENSION REFORM

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The Legal Landscape of Public Pension Reform

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Contract Clause, U.S. Const., art. I, § 10

• “No state shall . . . pass any . . . law impairing the obligation of contracts.”

• The rise and fall of the Contract Clause

• Revival, at least as to public contracts, U.S. Trust Co. of New York v. New Jersey (1977)

• Three-part test
  • Has there been a “substantial impairment” of a contractual relationship”?
  • If so, does the state have a “significant and legitimate public purpose”?
  • If so, is the impairment reasonable and appropriate?
Are public-employee pensions contracts?

- Pension terms and rules tend to be written in statutes, not contracts.
- Courts don’t lightly read statutes as creating contractual obligations.
- For a long time, pensions were considered gratuities.
- This is *ultimately* a matter of federal law, because states can’t define real contracts out of existence; but *usually* courts defer to state law.
  - *Dodge v. Bd. of Ed. Of Chicago* (1937): U.S. Supreme Court holds that pensions are gratuities that can be abolished at the pleasure of the legislature; but this is because Illinois law treated pensions that way at the time.
  - *Indiana ex rel. Anderson v. Brand* (1938): U.S. Supreme Court holds that Indiana teacher tenure law is contractual, and so Indiana repeal of the law as to current teachers is unconstitutional; but this is because Indiana law treated it that way.
The rise of the contractual approach

• Today, most states recognize that pensions are deferred compensation and therefore just as contractual as salary.
  • This makes sense, because surely you can’t just repeal an ordinary salary statute?
• But the contractual approach hasn’t been adopted everywhere
  • Gratuity approach (e.g. Arkansas, at least for pensions with no employee contribution)
  • “Property interest” that can’t be eliminated without “due process of law” (very weak test, e.g. Maine and Connecticut)
  • Property right protected by Takings Clause (as strong as contractual approach, e.g. New Mexico)
  • Property right protected by “regulatory takings” doctrine (sort of weak approach, possibly also used in Maine and Connecticut)
  • Modified contractual approach: “promissory estoppel” or “reliance” (Minnesota)
• Sloppiness in use of term “vested”
What is in the contract?

• (Again) mostly an issue of state law
• Does the contract promise that the current rules will continue?
  • I.e., Constitution could protect the pension accrued based on work done so far.
  • Or Constitution could guarantee that one can continue earning a pension on substantially equivalent terms as long as one holds the job. (“California Rule”)
  • California Rule makes pensions inflexible, and provides protections for pensions that don’t exist for salaries, working conditions, job tenure, or even continued existence of the job.
State constitutional protections

• States can always protect *more* than the federal Constitution requires.

• State Contract Clauses often mimic the federal Contract Clause.
  • Often not clear whether states are relying on state or federal clause.

• State Pension Clauses may provide special protection for pensions.
  • Some of these are interpreted as merely mimic Contract Clauses.
  • In other states, they are interpreted as providing super-strong pension protection.
Conclusion

• Need to understand your state’s treatment of pensions.
• Need to understand your state’s constitutional law.
• Other issues
  • Municipal bankruptcy
  • Etc.