

# THE LEGAL LANDSCAPE OF **PUBLIC EMPLOYEE** **PENSION REFORM**



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# The Legal Landscape of Public Pension Reform

Alexander “Sasha” Volokh  
Associate professor of law, Emory University  
Adjunct Scholar, Reason Foundation

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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.

