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**THE GENERAL ASSEMBLY'S AUTHORITY TO ENACT COMPREHENSIVE PENSION REFORM LEGISLATION: A RESPONSE TO ERIC MADIAR**

## Introduction and Summary

In prior memoranda, we stated that it is our legal opinion that the Pension Clause of the Illinois Constitution allows the General Assembly to respond to the State's massive and systemic financial challenges by enacting comprehensive pension reform legislation that would fund all pension benefits that have been earned to date but that would prospectively reduce benefits that current employees will *hereafter* earn so that they would be the same that new state employees earn and would be more comparable to those earned in the private sector.

This constitutional question is relevant to political issues that are very emotional for many Illinois citizens, and our legal opinions have been vehemently criticized by several interested parties. The most substantial of these critiques is a 76 page article that was recently written by Eric Madiar, the Chief Counsel of the President of the Illinois Senate. Mr. Madiar has comprehensively researched the historical record and made a formidable attempt to argue that the Pension Clause now gives current state employees an absolute contractual right to earn future benefits under whatever pension formula was in effect on the employee's first day of work.

However, we are not persuaded by Mr. Madiar's analysis, and we now reaffirm our earlier opinion. First, we continue to believe that the Pension Clause protects only benefits that have been earned to date. That was the original judicial interpretation of the Clause, and we believe it is compelled by the terms of the Clause, by its sponsor's explanation of it during the 1970 Convention, and by common sense. Particularly because the State's current financial crisis

can be partially attributed to *dictum* in intervening decisions that suggested a different rule, we believe the Illinois Supreme Court should now return to its original understanding of the Clause.

Second, regardless of how that first issue is resolved, we believe that the General Assembly has authority to modify the level of pension benefits that will be earned in the future when, as here, the legislation enables the funding of the benefits that have been earned to date and is necessary to allow the State to continue to provide essential governmental services. Even with the recent tax increases, if the State of Illinois does not prospectively modify benefit formulas and hereafter pays 100% of all pension benefits, pension costs will increase from 8% of state tax revenues in 2000 to 30% by 2020 and thereafter, crowding out expenditures on health, education, and public safety. Thus, the constitutional question that would be raised by the comprehensive pension reform legislation is whether contractual pension rights of state employees trump the State's duty to provide essential functions.

In our view, the answer to that question is clear. No constitutional rights are absolute, and all individual rights presuppose the existence of a state government that is capable of creating a social and economic climate in which individuals may live and work. *That* is the meaning of the truism that a constitution is not a suicide pact. Further, the Pension Clause, by its terms, does not confer absolute rights. It does not categorically prohibit all modifications of pension contracts to which individual employees do not assent. Rather, the Pension Clause prohibits the "impairment" or "diminution" of the "benefits" of pension contracts.

Under the Illinois Supreme Court's decisions, this language "does not immunize contractual obligations . . . from every conceivable kind of impairment or from the effect of a reasonable exercise of the police power." *Felt v. Bd. of Trustees of Judges Retirement System,* 107 Ill.2d 158, 165 (1985). Rather, to assess the constitutionality of pension reforms, the Court

applies a balancing test in which it weighs the extent of the interference with the contractual interests of individual employees against the governmental purposes advanced by the legislation. *Id.* Under this test, it is our opinion that the comprehensive pension reform legislation would be valid.

This legislation does not "impair" or "diminish" pension benefits; it enhances them. Today, the pension systems are underfunded by some $85 billion, and are grossly insufficient to pay the benefits that state employees have earned to date. By modifying pension benefits that are earned in the future, the comprehensive pension reform legislation will enable and require funding of all benefits earned to date and to be earned in the future. The legislation would thus be an exercise, in the Illinois Supreme Court's words, of the General Assembly's "undeniable interest and responsibility in ensuring the adequate funding of State pension systems." *Felt*, 107 Ill.2d at 166. The legislation would be constitutional for this reason alone.

Also, those would not be the only benefits to state employees. Because the legislation would assure continued expenditures on health, education, and public safety, it would also preserve the jobs of many employees and, therefore, allow them to continue to earn pension benefits. Obviously the earning of future benefits requires future jobs.

Finally, under any view, the legislation would not have a significant adverse effect on current state employees. It protects the benefits earned to date and merely reduces benefits to be earned from future work and would have no greater adverse impact than would the prospective salary reductions that the State has the constitutional authority to impose. Under *Felt*, any adverse effect would be modest and overridden by the State's need to provide essential services.

Mr. Madiar argues that the Illinois Supreme Court's statements in *Felt* were *dictum.* We disagree. But even if Mr. Madiar were correct, we believe the statements in *Felt* were dictated by the terms and history of the Pension Clause and by simple common sense – and are correct.

The reality is that if the State of Illinois were a private company, it would be bankrupt. We understand that the State's actual and prospective tax revenues are woefully insufficient both to discharge its alleged obligations to state pensioners and provide essential services. If States were subject to the bankruptcy laws, participants in Illinois pension plans would be unsecured creditors to the extent that they have contractual rights to previously earned benefits that are not now funded. Similarly, any contract right to earn future benefits at a particular rate would be an "executory contract" that would be unilaterally modified, and a federal court would then order a restructuring of Illinois' obligations that would allow it to provide essential services and pay reduced pensions that still provide adequate retirement income to state employees – which is the same result that would be achieved by the proposed comprehensive pension reform legislation.

To be sure, States are not subject to bankruptcy laws, but that is because States do not need these laws to achieve these same results in situations like those facing Illinois. Under the Tenth and Eleventh Amendment, no federal court could oversee and prescribe the overall budgets and expenditures of the State, and under the doctrine of sovereign immunity, Illinois courts cannot assume that function. Under the Pension and Contract Clauses, the General Assembly now has the authority to restructure state obligations when necessary to serve legitimate interests. Because state employees are politically powerful, because they are well represented in the political process, and because their interests are aligned with those of state legislators, it should be presumed that the political process will reasonably balance the competing interests, and courts should here defer to legislative judgments. Indeed, this General

Assembly will not enact comprehensive pension legislation unless it promotes the core purpose of the pension system by securing adequate retirement income for state employees and unless it is genuinely necessary to achieve essential government purposes. Fair and reasonable attempts to achieve these objectives do not violate the prohibition on the impairment of contracts.

Nor does the Pension Clause prohibit such legislation. As Mr. Madiar's comprehensive historical research demonstrates, the framers of the Pension Clause understood very well that the new constitutional right that they were creating would not guarantee full recoveries in a bankruptcy situation. In particular, the framers *rejected* proposals that they adopt the only constitutional provision that would have avoided the current situation and assured payment of 100% of pensions in that event – a constitutional requirement of full annual funding. Also, the framers acted with full knowledge that the grant of a "contractual right" would not result in priority in bankruptcy and actually weakened pension rights – which is why many delegates opposed the amendment. While one sponsor indicated that employees had a right to seek judicial relief in the event of a bankruptcy of the pension *funds*, no delegate even suggested that employee claims against the State would have absolute priority and override the State's duty to provide essential governmental services when the State itself is effectively bankrupt.

Finally, the ultimate question is not what the delegates thought, but what voters understood when they ratified the 1970 Constitution. The delegates told the voters only that the Pension Clause is "self-explanatory" and on its face, this Clause provides no protection when, as here, the State itself is effectively bankrupt and cannot keep all its promises in full.

In short, for these reasons and those stated more fully below, it is our opinion that the terms of the Pension Clause, its history, the relevant judicial decisions, and common sense all establish that the comprehensive pension reform legislation would be constitutional.

## RELEVANT BACKGROUND

### Factual Assumptions

Mr. Madiar begins his article[1] with a high level summary of the dire financial condition of the State's five pension systems and of the State itself. Madiar 1-2. Several of his assertions are inconsistent with our understanding of the relevant facts. In the interest of clarity, we set forth the factual assumptions that underlie our earlier opinions[2] and this opinion.

1. We understand that Illinois has five different pensions systems for state employees, each of which covers a particular set of employees. These pension systems are funds that are held by boards who act as trustees and who invest the amounts in the funds. These are trust funds that exist for the benefit of state employees and that the State cannot reach for any other purpose. That is one reason that adequate funding of the systems is important to employees.

Each of the five systems would be known in the private sector as a "defined benefit" plan in which employees will, upon retirement, receive monthly annuities for life. Roughly speaking, the amount of this annuity is calculated by taking the employee's annual salary at or near the last year of service and multiplying it by years of service and a particular rate. There are also provisions allowing "early retirement" when certain age and service requirements are met.

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[1] E. Madiar, *Is Welshing On Public Pension Promises An Option For Illinois? An Analysis Of Article XIII, Section 5 Of The Illinois Constitution* available at http://www.illinoissenatedemocrats.com/images/pensions/D/Pension%20Clause%20Article%20Final.pdf ("Madiar").

[2] Sidley Austin LLP, Memorandum, *Illinois' Authority To Reduce The Pension Benefits That Current Employees Will Earn From Future Service* (April 27, 2010) available at http://www.illinoissenatedemocrats.com/images/pensions/C/Sidley%20Memo%2004-27-10.pdf ("Sidley Opinion"); Sidley Austin LLP, Memorandum, *The State of Illinois, And The City Of Chicago And Smaller Municipalities, Are Not Guarantors Of The Payment Of Pension Benefits* (Dec. 7, 2010) available at http://www.illinoissenatedemocrats.com/images/pensions/A/Sidley%20Supplemental%20Guarantor%20Memo%2012-07-10.pdf ("Sidley Dec. 7 Opinion").

Under this formula, the amount of any employee's pension is a result not merely of the "rate," but also of salary at retirement and length of service. The latter two factors are outside the control of any employee. At any given point in an employee's government service, he or she will have earned a pension for life based on his or her current salary and term of service up to that time. That is the "earned benefit." At the same time, the employee will have expectations that the pension will increase as a result of future service and salary. But those are only expectations because they are subject to conditions outside the employee's control.

A defined benefit plan is different than a defined contribution plan. In a defined contribution plan, the employee and/or the employer make annual contributions to a pension plan that is beneficially owned by that employee, and it is the amount in the fund at retirement that determines the retirement income that the plan will generate.

By contrast, in a defined benefit plan, retirees receive a particular amount for life, and there is no necessary relationship between that amount and the employer's and employee's annual contributions to the pension system. However, it is most efficient if annual contributions are made to the pension plan that are reasonable estimates of the additional benefits that all employees subject to the plan earn each year. This is complicated as an actuarial matter, for it requires assumptions about salary at retirement, life expectancy, and an array of other factors. Because of the difficulty of making accurate such predictions, employers who adopt defined benefit plans assume substantial risks of incurring far greater liabilities than had been contemplated at the time of the plan's adoption. For this reason, many employers in the private sector have abandoned defined benefit plans and instead now provide defined contribution plans.

But there are defined benefit plans for Illinois employees, and actuaries determine the annual State contributions to the plans. The current statutory requirement is that the State's

contributions be sufficient, when added to employee contributions, investment income and other income, to bring the total assets of the plans to 90% of the actuarial liabilities by Fiscal Year 2045. We understand that the plans were underfunded during the past decades and that even with annual State contributions to the plans, the unfunded liabilities have increased each year and now are an estimated $85 billion.[3] We understand that one of the reasons for this underfunding is that the annual State contributions have been less than what actuaries refer to as "normal cost plus interest," where "normal cost" is the value of pension benefits earned during a particular year and "interest" is the amount needed to cover what is colloquially referred to as the interest on the unfunded liability.[4] During this period, we understand that the annual State contributions have been sufficient to cover half of the "normal cost" (employee contributions cover the other half), but that the remainder of the State contributions has not been sufficient to cover the entire "interest" cost, causing annual increases in the amount of unfunded pension liabilities.

2. At the same time, we understand that the current extent of the unfunded liabilities is a consequence of a number of factors and that Mr. Madiar is incorrect in asserting that the underfunding results solely from past failures of the State to provide full annual funding in past years. Madiar 1-2.

First, we understand that less than half of the growth in the unfunded liability from 1995 to 2010 (approximately 43%) is attributable to the fact that, in nearly all those years, the State's

[3] "A Report on the Financial Condition of the IL State Retirement Systems," March 2011, Commission on Government Forecasting and Accountability, p. 23, http://www.ilga.gov/commission/cgfa2006/Upload/FinCondILStateRetirementSysMarch2011.pdf

[4] In reality, it is not "interest" on the unfunded liability. The unfunded liability of a plan is the present value of the annuity payments that have been earned to date and that will be paid in the future *minus* the value of the current assets of a plan. To determine the present value of the future payments requires use of a discount rate, now 8.5%. The "interest" that must be paid to prevent further increases in the unfunded liabilities in any one year is the "reversal of the discount rate" to reflect the passage of a year and the fact that future annuity payments will have to be made a year sooner.

contribution to the pension funds, in addition to employee contributions, was less than the "normal cost plus interest" contribution.[5] We disagree with Mr. Madiar's statement that the State used the pension systems as a "credit card" during this period. Madiar 2. It is our understanding that the State did not take any money out of the pension system or borrow against those funds. Rather, the State failed in those years to provide the funds with the annual contribution that would have been required to keep the unfunded liability from growing.

We agree with Mr. Madiar that the reason that the State did not do so is that it had insufficient revenues both to fund pensions and to support health, education, and public safety at the desired levels. We assume that when it failed to fund its share of normal cost, plus the interest, the General Assembly believed that the State would generate sufficient revenues in the future to make up the shortfall. As we explain below, the Pension Clause allowed the General Assembly to proceed in that way.

Second, we understand that there would now be a severe shortfall even if the "normal cost plus interest" contribution had been provided by the State in the past. In particular, we understand that about 36% of the growth in the unfunded liability from 1995 to 2010 is attributable to the fact that the original actuarial assumptions were too optimistic due to changes

[5] "A Report on the Financial Condition of the IL Statement Retirement Systems," March 2011, Commission on Government Forecasting and Accountability, p. 104, http://www.ilga.gov/commission/cgfa2006/Upload/FinCondILStateRetirementSysMarch2011.pdf (Note: change in unfunded in 1996 reports causes for change from 1995 to 1996).

in life expectancy and other factors.[6] We also understand that lower than expected asset returns caused about 21% of the growth in the unfunded liability.[7]

3. We understand that, absent pension reform, the State cannot both pay pensions and continue to provide essential levels of service. Pension-related payments were about 8% of the "Big Three" state taxes in 2000; they were about 28% in 2010. We understand that the State had a budget deficit of $15 billion in 2010, and that the increased pension costs account for much of that deficit. In this regard, we understand that, even with the recent temporary tax increase and even though the State will not provide pension funding of "normal cost plus interest" this year, the budget deficit is projected to be $12 billion this year. We understand that, absent pension reform, pension costs will increase in future years and "crowd out" state expenditures on essential services.[8]

For example, we understand that if the State began contributing only its share of the amount of additional benefits that accrue each year under the current formula (half of the "normal cost" or about $1.7 billion), the plans would run out of money in about 7 years (2018). In that event, 100% of benefits would be paid only if the State's general fund made the entire payment thereafter. We are not aware of any data from the State on what the aggregate annual

[6] "A Report on the Financial Condition of the IL State Retirement Systems," March 2011, Commission on Government Forecasting and Accountability, p. 104, http://www.ilga.gov/commission/cgfa2006/Upload/FinCondILStateRetirementSysMarch2011.pdf (Note: change in unfunded in 1996 reports causes for change from 1995 to 1996).

[7] "A Report on the Financial Condition of the IL State Retirement Systems," March 2011, Commission on Government Forecasting and Accountability, p. 104, http://www.ilga.gov/commission/cgfa2006/Upload/FinCondILStateRetirementSysMarch2011.pdf (Note: change in unfunded in 1996 reports causes for change from 1995 to 1996).

[8] Presentation to the 2011 Spring Legislative Conference, J. Thomas Johnson, President, Taxpayers' Federation of Illinois, March 30, 2011, slide 11. The analysis described in that presentation assumes a 2.3% annual growth in "Big Three" state taxes. The analysis presented here was provided by the Taxpayers' Federation of Illinois and assumes a 2.8% annual growth in "Big Three" state taxes and therefore provides a more conservative estimate of the extent of "crowding out."

payments would be under such a "pay as you go" scenario, but it has been estimated by one source that annual payments would then be over $13 billion annually – which would be over 30% of the state's predicted tax revenues.[9]

Similarly, if the State makes its required contributions to the pension plans under the formulas now applicable to current employees (in addition to its required payments for its pension bonds and notes), pension-related payments will account for about 30% of "Big Three" state taxes in 2020 and over 49% in 2045.[10]

4. We assume that, particularly with the recent tax increases, there is a substantial risk that further tax increases would not raise overall tax revenues because increased revenues from higher rates would be offset by the effects of reductions in business activity in the State that would result from the tax increases. We understand that the States' ability to take on large amounts of additional debt are severely constrained and that its expenses and tax revenues generally must be closely related in future years.

5. Finally, we understand that the pension benefits now earned by current state employees exceed those enjoyed by private sector employees with comparable salaries and periods of service. For this reason, we understand that some prospective reductions in the level of future benefits earned by current employees would not deny them adequate retirement income.

**The Pending Comprehensive Pension Reform Legislation**.

Last year, the General Assembly took one small step towards addressing the problem. It

[9] Rauh, Joshua D., "*Are State Public Pensions Sustainable? Why the Federal Government Should Worry About State Pension Liabilities*," (May 15, 2010), p. 26. Available at SSRN: http://ssrn.com/abstract=1596679

[10] Presentation to the 2011 Spring Legislative Conference, J. Thomas Johnson, President, Taxpayers' Federation of Illinois, March 30, 2011, slide 11. The analysis described in that presentation assumes a 2.3% annual growth in "Big Three" state taxes. The analysis presented here was provided by the Taxpayers' Federation of Illinois and assumes a 2.8% annual growth in "Big Three" state taxes and therefore provides a more conservative estimate of the extent of "crowding out."

enacted legislation in which employees hired after the effective date would accrue benefits that are comparable to, or better than, those generally available in the private sector, but significantly lower than those applicable to existing employees.

We understand that there is at least one pending bill (House Bill 149) that would comprehensively reform pension benefits for current state employees. It protects all benefits that have been earned to date by requiring funding of the current unfunded liabilities in level dollar payments to the pension systems – without the deferrals and backloading under the current statutory formula.

We understand that this funding of the previously-earned benefits is enabled by prospective reductions in the additional benefits that current employees will earn as a result of their future service to the State. The reform bill also requires current annual funding of future benefits that accrue each year.

For these future benefits, the proposed legislation would provide several basic options for current employees. Under one, their future benefit accruals would be the same as now applies to new employees, and the size of the employees' monthly pension contributions would decrease. Under another option, employees would participate in a defined contribution plan. Under the final option, employees could continue to accrue benefits at the levels that apply under current law, but employees would have to make significantly increased contributions. In particular, the contributions of these employees would essentially be the difference between the State's contribution under the new options and the required annual contribution to cover the benefits that accrue under the prior formula.

Under this legislation, even existing employees who do not elect to continue the preexisting formula will retire with much higher pensions than will new employees who end up

with identical salaries and years of service. The reason is that existing employees will have earned benefits under the earlier higher formulas prior to the effective date of the legislation, and the longer an employee's prior service, the greater the benefit that will be derived from the years of service under the prior formula.

We understand that this legislation will provide that employees have rights to enforce funding requirements under particular circumstances. We thus understand that the legislation will prospectively overrule the three Illinois Supreme Court decisions that rejected employee attempts to enforce funding requirements.[11]

Finally, we understand that this legislation will not reduce future pension benefits of judges during the periods in which their salaries cannot constitutionally be reduced.

## DISCUSSION

In his article, Mr. Madiar argues that House Bill 149 is unconstitutional and that any other legislation that prospectively reduces pension benefits that will be earned in the future is unconstitutional as applied to any current employee who does not affirmatively consent to the "modification" of the pension "contract." In his view, the Pension Clause of the Illinois Constitution gives state employees an absolute, unconditional, and judicially enforceable contractual right to have future pension benefits calculated under the method in effect when they began work and to be paid 100% of those benefits upon retirement.[12]

Mr. Madiar also believes that this constitutional right is not limited to the pension benefit formulas, but extends to any "advantageous" features of the system for calculating and funding

[11] *People ex rel. Sklodowski v. Illinois*, 182 Ill.2d 220 (1998); *McNamee v. Illinois*, 173 Ill.2d 433 (1996); *People ex rel. Illinois Fed'n of Teachers, AFT, AFL-CIO v. Lindberg*, 60 Ill.2d 266 (1975).

[12] Indeed, Mr. Madiar also argues that this contractual right extends to "subsequent [pension] benefit increases" that the State unilaterally adopted after any employee's first day of work. Madiar 2. By contrast, Mr. Madiar argues that a prospective reduction in future benefits cannot be adopted unless the State makes "commensurate" improvements in other features of the plan and the employee affirmatively agrees to a contract modification. Madiar 60-65.

pensions in effect on the employee's first day of work. Thus, absent the affirmative consent of each employee, Mr. Madiar believes that House Bill 149 is unconstitutional not merely because it reduces future benefits for some employees, but also because (1) employees would have to make greater contributions if they are to earn future benefits under prior formulas and (2) the State's establishment of new defined contribution plans for employees who elect them could result in lesser contributions to the State's defined benefit plans. Madiar 71-74.

Mr. Madiar's article is pervaded with rhetorical statements that are commonplace in legal briefs and in political debates, but that, in our view, should have no place in any dispassionate and objective analysis of the legal options that the State of Illinois has in the difficult position that it and its employees now occupy. For example, throughout his article, and in its title, he states that the issue is whether "welshing on public pension promises is an option for Illinois." However, the threshold issue that has been raised is *whether* Illinois has made enforceable promises that it will calculate future benefits under a particular formula. Mr. Madiar's rhetoric assumes the disputed issue, and as we explain below, our opinion is that it is actually quite clear that no such promise has ever been made by the State.

Further, even if there had been such a promise, a second question that would be raised by the comprehensive pension reform legislation is whether it "impairs" or "diminishes" pension benefits, for that is the prohibition of the Pension Clause. That, too, is an issue that deserves dispassionate analysis, not rhetoric, and as we explain below, it is our opinion that, given the systemic financial challenges that are faced by Illinois and its pension systems, comprehensive pension reform would not "impair" or "diminish" the benefits of current employees under the settled interpretations of those terms. Rather, the legislation would enhance those benefits.

## I. UNDER THE TERMS OF THE PENSION CLAUSE, THE STATEMENTS OF ITS SPONSORS, AND THE SETTLED INTERPRETATIONS OF THE PENSION CODE, THE PENSION CLAUSE PROTECTS ONLY PREVIOUSLY-EARNED BENEFITS.

First, we do not believe that the comprehensive pension reform legislation even implicates the Pension Clause. This legislation would protect the benefits that employees have earned to date, and we believe that these are the only benefits that the Pension Clause should be construed to protect. This construction of the clause is supported by the Illinois Supreme Court's initial interpretation of the Clause, which held that the "purpose and intent of the constitutional provision was to insure that pension rights of public employees *which had been earned* should not be 'diminished or impaired.'" *Peters v. City of Springfield*, 57 Ill.2d 142, 152 (1974) (emphasis added). The Court there upheld legislation that had reduced the pension benefits that employees could earn in the future by lowering the mandatory retirement age and thereby reducing the number of years that employees could work.

Mr. Madiar correctly notes that there are subsequent Illinois court decisions that have held, or stated in *dictum*, that the Pension Clause does not merely protect previously earned benefits, but gives employees a vested contractual right to have pension benefits calculated throughout their careers under whatever formula was in effect under the Pension Code on their first day of government service. Madiar 57-59. One of these decisions stated that *Peters* rested on the ground that the mandatory retirement age at issue was not contained in the pension code itself and that it is the terms of the Pension Code on an employee's first day of service that defines the "pension contract." *Buddell v. Board of Trustees, State University Retirement Sys. of Illinois*, 118 Ill.2d 99, 103-04 (1987). There is also *dictum* in the Supreme Court's funding

decisions that is to the same effect.[13] Mr. Madiar is correct that, if this were the applicable standard, the comprehensive pension reform legislation would implicate the Pension Clause, for this legislation would amend provisions of the Pension Code that determine how future benefits are calculated.

However, contrary to the implication of Mr. Madiar's article, our prior opinion acknowledged these more recent decisions. It stated that because of the magnitude of the State's fiscal crisis and the role that comprehensive pension reform legislation would play in addressing it, we believe that the Illinois Supreme Court would and should analyze the Clause independently when it rules on the constitutionality of the reform legislation and that the Court should not extrapolate from the statements in earlier quite narrow decisions that can be explained on other grounds. Sidley Opinion 22.

In this regard, there are many instances in the law in which the United States Supreme Court and the Illinois Supreme Court have overruled prior decisions, distinguished them, limited them to their facts, or reformulated the applicable standard where, as is the case here, the earlier rule has been demonstrated to have had pernicious consequences.[14] Also, as we explained in our earlier opinion, *Budell* and *Felt* are the only two decisions in which the Illinois Supreme Court has invalidated legislation on the ground that it violates the Pension Clause, and each decision could have rested on grounds that are entirely consistent with the construction of the Pension Clause that we believe to be correct. Sidley Opinion 18-22. Mr. Madiar does not dispute the

[13] *Sklodowski*, 182 Ill.2d at 229 (explaining the Clause gives employees a contract right to the "actual terms of the Pension Code at the time the employee becomes a member of the pension system" or on the date that the Pension Clause was adopted – whichever is later – and thereby creates a contract right to "receive" future benefits based on the terms of the Pension Clause in effect at the relevant time); *see also McNamee*, 173 Ill.2d at 439 (same).

[14] *E.g., Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877, 889 (2007) (overruling *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911)); *Brown v. Bd. of Education*, 347 U.S. 483, 494-95 (1954); *West Coast Hotel Co. v. Parrish*, 300 U.S. 379, 400 (1937).

latter fact. Madiar 57-59. Thus, the prior statements of the Supreme Court on which Mr. Madiar relies are *dictum* in the sense that the Illinois Supreme Court could disavow the statements without overruling any prior holdings.[15]

If the Illinois Supreme Court reconsiders the issue independently, we believe that it should disavow the statements on which Mr. Madiar relies. It should reaffirm our reading of *Peters* and hold that the Pension Clause protects only benefits earned to date and confers no contractual right to have future benefits calculated under any particular formula. There are a number of factors that would dictate this holding.

**The Clause's Terms And Its Sponsors' Contemporaneous Interpretation.** First, our interpretation is dictated by the terms of the Clause and the explanation that its principal sponsors provided of its meaning during the 1970 Constitutional Convention – which are relevant to the construction of the Clause and which are the historical materials on which Mr. Madiar primarily relies for his contrary view. The clause states that "membership" in a state pension system is "an enforceable contractual relationship, the benefits of which may not be diminished or impaired." So the Clause gives employees contractual rights to enforce whatever *promise* the State has made to members of state pension systems. "A promise is a manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made." Restatement Of Contracts 2d, § 2. A promise is thus a commitment that cannot thereafter be modified without the assent of the promisee.

[15] Mr. Madiar also relies on Illinois Appellate Court decisions, suggesting that they are binding throughout the State unless and until disapproved by the Illinois Supreme Court. Madiar 53. While we do not believe that the latter suggestion is correct, it is besides the point. Our opinion assumes that it is the Illinois Supreme Court that will determine the constitutionality of any comprehensive pension reform legislation.

The threshold question is what "promise" the Pension Clause treats the State of Illinois as having made to current employees and whether it goes beyond the payment of previously earned benefits and encompasses the formula for determining benefits to be earned in the future. In our view, the debates during the Illinois Constitutional Convention squarely establish that no binding commitment has been made to calculate future pension benefits in any particular way. One of the two principal sponsors of the Pension Clause, Mrs. Helen Kinney, stated repeatedly that "all" the Clause does is guarantee the "rights that were in force at the time" individuals became state employees; she thus stated that an employee had no right to have future benefits calculated in a particular way "if a person undertook employment under a statute that provided for a contingency of lowering benefits at some future time." 4 Proceedings 2931. Neither the other principal co-sponsor, Mr. Henry Green, nor any other delegate disagreed with Mrs. Kinney's statements, and Mr. Green's explanations of the Clause were entirely consistent with Mrs. Kinney's in these respects.

Accordingly, the question is what has been *promised* by the *terms* of the *Pension Code* that govern the calculation of pension benefits. Are they provisions that, by their terms, create vested rights in employees and preclude prospective legislative modifications of the provisions that apply to current employees? Or are these provisions subject to the "contingency" in which benefits to be earned in the future can be legislatively reduced prospectively. If the latter, the pension "contract" and the Pension Clause do not give the employees any right to have future pension benefits calculated under these standards.

In our view, the answers to these questions are clear. Under Illinois' well-settled rules of statutory interpretation, the provisions of the Pension Code do not themselves confer vested rights in employees, and these provisions can be prospectively modified by the General

Assembly without breaching any promise made by the Pension Code itself. In particular, the general rule is that it is "presum[ed]" that statutes "do not create private contractual or vested rights, but merely declare a policy to be pursued until the legislature ordains otherwise." *Sklodowksi v. State*, 182 Ill.2d 220, 231 (1998) (citing *Fulmarolo v. Chicago Board of Education*, 142 Ill. 54, 104 (1990)). Under Illinois law, there is no vested private right in the mere continuation of a statute unless the statute specifically creates one. *Envirite Corp. v. Illinois EPA*, 158 Ill.2d 210 (1994).

Notably, the Illinois Supreme Court has specifically applied this rule to hold that employees have no vested contractual right to continuation of the provisions of the Pension Code itself and that the General Assembly can prospectively modify these provisions without adversely affecting any "contract" rights of state employees. That is the ground on which the Illinois Supreme Court has held that state employees do not have a contractual right to continuation of the funding schedules set forth in the Pension Code. *Sklodowski*, 182 Ill.2d at 233. It has reasoned that these provisions "do not evince a legislative intent to create vested rights in favor of beneficiaries," *id*., and in this respect, there is no difference between the funding provisions of the Pension Code and the provisions of the Pension Code that prescribe how pension benefits are calculated in the future. Neither provision contains any language giving employees a vested right in their continuation, and both provisions thus reserve the General Assembly's authority to modify the statutory language prospectively and are subject to that "contingency." So under the principal sponsors' explanation of the Pension Clause during the 1970 Convention, the Pension Clause provides no protection against prospective modifications of the formula that governs the calculation of pension benefits.

Accordingly, if the Pension Clause is interpreted in accord with the contemporaneous interpretation given by its two principal sponsors – as Mr. Madiar argues that it should be and many decisions have held – the Pension Clause applies only to previously earned benefits and cannot invalidate the comprehensive pension legislation.

In his article, Mr. Madiar did not address this feature of the Convention proceedings. But Mr. Madiar responded to similar points from our earlier opinion by engaging in circular reasoning. In particular, he argued that Illinois statutes must be interpreted in the ways that he proposes because Section 9 of the Transition Schedule of the 1970 Constitution invalidates statutes that were enacted before 1970 and that are inconsistent with the 1970 Constitution. Madiar 68-69. This argument assumes that the Illinois Constitution grants certain rights. With respect to the threshold issue of what limitations the Pension Clause imposes on prospective modifications to pension benefit formulas, this line of argument would be fallacious. The only constitutional right that the Pension Clause here created was the contractual right to require continuation of those statutory benefit formulas that were not subject to legislative modification and were therefore not "contingent." Because the formula that governs the calculation of future benefits was subject to prospective legislative modification under settled Illinois rules of statutory interpretation, this formula is not part of the enforceable contractual relationship that is protected by the Pension Clause. Section 9 of the Transition Schedule is therefore irrelevant.

Conversely, while the Clause does not protect expectations that future benefits will be calculated in a particular way, the terms of the Clause and its sponsors' statements in the Convention Proceedings make it absolutely clear that the Clause is intended to protect the previously-earned pension benefits of each employee. The benefits that an employee has already earned are unequivocally "benefits" of membership in a pension system. The statements of both

co-sponsors (Mr. Green and Mrs. Kinney) repeatedly emphasize that the Pension Clause is designed to overrule the prior rule that pension benefits are gratuities that can be eliminated under "mandatory" pension systems. For example, Mrs. Kinney stated that the Clause was designed to prevent home rule municipalities from taking money in pension plan trust funds that is needed to pay benefits that had been earned and to use it for other purposes. 4 Proceedings 2926.

Thus, it would be contrary to the terms and stated purposes of the Pension Clause if the comprehensive pension reform legislation impaired or diminished the benefits that current employees earned prior to the enactment of the legislation. However, this legislation would not adversely affect these previously-earned benefits, but would enable the funding of them.

In short, the terms of the Clause and the contemporaneous interpretations of these terms by its sponsors establish that the Pension Clause protects only the previously-earned benefits of state employees and not the expectations of current employees that they would earn future benefits at any particular level or under any particular formula.

**Common Sense, The Inherent Nature of Pensions And The Other Provisions Of The Illinois Constitution.** While the debates in the Constitutional Convention are quite clear, the Illinois Constitution of 1970 was ultimately adopted by the voters and not by the delegates. Thus, a court's ultimate task is not to construe the legislative history of the Pension Clause, but to determine what the voters understood the terms of the Pension Clause to mean. This is a search for the common sense meaning of the terms of the Pension Clause in the context of the Illinois Constitution as a whole. As the Illinois Supreme Court has stated, "Constitutions are . . . founded on the common business of life, designed for common use, and fitted for common understanding. The people make them, the people adopt them, and the people must be supposed

to read them with the help of simple common sense." *People v. McRoberts*, 62 Ill. 38, 40-41 (1871).

Here, any notion that the Pension Clause protects the formula under which future benefits will be calculated defies common sense. Pensions are deferred salaries, and when future salaries can be reduced, the formula for calculating the benefits that will be earned in the future can be reduced. Whereas there are other provisions of the Illinois Constitution that prohibit prospective reduction in salaries, the Pension Clause does not. Therefore, common sense demonstrates that the Pension Clause does not prohibit prospective changes to benefit formulas.

First, this construction of the Clause comports with the common sense everyday understanding that businesses and individuals have of the nature of pensions. As we explained in our prior opinions, and as Mr. Madiar accepts (Madiar 67-68), pension benefits are deferred compensation: that is, deferred salaries. Under the Pension Code, employees earn pension benefits with each day of work, just as they earn salaries and health benefits with each day of work. From the perspective of the State and any other employer, the cost associated with each employee is the sum of the employee's salary, the pension benefits that are earned, and the costs of medical and other "fringe" benefits. Any employee will consider that total package in determining the actual value of his or her compensation. As a logical matter, pension benefits should be treated the same way as salaries and health benefits. Just as salary and health benefits cannot be retroactively changed, pension benefits that have been previously earned cannot be diminished or impaired. When salaries and health benefits can be prospectively reduced, the State may prospectively modify the formula for calculating the pension benefits that will be earned in the future.

It makes no sense that the Illinois Constitution would have extended constitutional protection to the formula for calculating future pensions benefits when, with one narrow exception discussed below, the Illinois Constitution does not prohibit prospective reductions in the salaries or health benefits paid to state employees.

In addition, the ability prospectively to earn pension benefits presupposes that the employee has a state job. Because the Constitution does not protect the tenures of ordinary state employees, it is illogical that it would confer rights to have future pension benefits calculated under a particular formula.

These common sense understandings of the plain meaning of the Pension Clause are confirmed by the provisions of the federal Employee Retirement Income Security Act (ERISA). Contrary to Mr. Madiar's suggestion (Madiar 46), we are well aware that ERISA was enacted in 1974 and that the Pension Clause was adopted in 1970. The significance of ERISA is twofold. First, it is roughly contemporaneous with the Pension Clause; indeed, the public debate that led to ERISA had begun well before the 1970 Illinois Convention. Second, ERISA has the same objective as the Pension Clause: to make pension plans enforceable contracts and to hold employers to the promises made in pension plans.[16] To implement this purpose, ERISA protects the pension benefits that each employee has earned to date and does not place any limitations on the ability of employers prospectively to modify the formula for calculating future pension benefits. In ERISA, Congress thus treated pension benefits the same way as salaries, and ERISA

[16] *See, e.g.*, *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 148 (1985) (noting that Congress, in enacting ERISA, sought "to protect contractually defined benefits" in pension plans). *See Lockheed Corp. v. Spink*, 517 U.S. 882, 887 (1996) (ERISA "seek[s] to ensure that employees will not be left empty-handed once employers have guaranteed them certain benefits."); *Nachman Corp. v. Pension Benefit Guaranty Corp.*, 446 U.S. 359, 375 (1980) (ERISA assures that "if a worker has been promised a defined pension benefit upon retirement – and if he has fulfilled whatever conditions are required to obtain a vested benefit – he actually will receive it."); *Central Laborers' Pension Fund v. Heinz*, 541 U.S. 739, 743 (2004) ("There is no doubt about the centrality of ERISA's object of protecting employees' justified expectations of receiving the benefits their employers promise them.")

is stark confirmation of the common sense understanding of what it means to give an employee a contractual right to enforce the terms of pension plans.

Second, that the Pension Clause adopts this common sense understanding of its terms is starkly confirmed by the fact that *other* provisions of the Illinois Constitution do prohibit prospective legislative diminutions in salaries of a small subset of state employees. For example, Article VI, Section 14 provides: "Judges shall receive salaries provided by law which shall not be diminished to take effect during their terms of office." This provision has been broadly construed to cover all forms of compensation. *Jorgenson v. Blagojevich*, 211 Ill.2d 286, 287 (2004). We thus believe that this Clause prohibits prospective reductions in the formula used to calculate the pension benefits that any judge will earn during his or her term of office. Pensions are just deferred salaries, so we believe that Article VI, Section 14 dictates this rule. Also, a different rule would allow the General Assembly to accomplish indirectly what cannot be done directly.

Article VI, Section 14 shows that the framers knew how to provide constitutional protection against prospective modifications in pension benefit formulas and other forms of compensation. It confirms that the framers intended to do so in Article VI, Section 14, and that they did not do so in the Pension Clause.

Third, the historical record demonstrates that the framers understood that pension benefits are part of compensation and that they could not have intended categorically to bar prospective reductions to pension benefits that will be earned in the future. As Mr. Madiar correctly states, a major reason that the delegates wanted to protect pension benefits was the fact that government salaries *then* were lower than in the private sector and "liberal and attractive" pension benefits were an "equalizing factor" that made government service competitive in labor markets. Madiar

5; *see also* 4 Proceedings 2926 (Delegate Kemp). It is our understanding that, over the past 40 years, government salaries have been made more competitive with the private sector, so it would be illogical now to bar reductions to pension benefits that will be earned in the future so that they, too, are more comparable to those earned in the private sector.

For these reasons, before a court could even consider giving the Pension Clause the construction urged by Mr. Madiar, there would have to be clear evidence that the voters understood that the Pension Clause departs from this common sense understanding. There is none. The newspaper accounts of the Clause were vague and consistent with the view that it protects only previously earned benefits. Madiar 24-25 & nn. 200-202. Similarly, in the Convention's official explanation of the Clause to voters, the Convention said that the Clause was a new provision and "self-explanatory." VII Proceedings 2747. There was no suggestion that the Clause departed from simple common sense and logic.

Finally, it is irrelevant that significant numbers of state employees have statutory protections against discharge and are covered by collective bargaining agreements that guarantee wage levels during the contract term. *Compare*, Madiar 60. The issue here is what the Illinois Constitution means and whether it prohibits the comprehensive pension reform legislation. Whether there are agreements that would require delays in the implementation of the reform legislation for particular employees is a question that is outside the scope of this memorandum. However, we note that it is our understanding that pension benefits are not a subject of collective bargaining, so prospective modifications of pension benefit formulas could not violate any collective bargaining agreement.

**Mr. Madiar's Different Rule Of Construction.** For these reasons, Mr. Madiar's construction of the Clause ignores the common sense understanding of pension benefits, the

common sense understanding of the promises made in pension plans, the common sense understanding of the Clause, and the principal co-sponsors' explanation of the Clause. Ultimately, his argument that the Clause should be construed to limit prospective modifications of pension benefit formulas rests on a dictionary that defines "benefits" to include "advantages" and his assertion that "a constitutional guarantee, such as the Pension Clause" should be "liberally construed." Madiar 4-5.

However, the settled rule is that constitutional provisions are to be interpreted based on the common sense and the ordinary meaning of their terms in the context in which they are used, the contemporaneous explanations of their sponsors, and the objectives of the Clause. *Wolfson v. Avery,* 6 Ill.2d 78, 88 (1955); *People v. McRoberts,* 62 Ill. 38, 40-41 (1871). Particularly because a grant of rights to individuals is simultaneously a limitation on legislative power, it is manifestly not the law that the foregoing guides to their meaning may be ignored and that constitutional provisions may be given the broadest interpretation that can be justified in light of dictionary definitions that would apply if a term of the Clause were used in isolation – and outside the context in which it is used in the Clause. That rule has special force here, for as we note below, the construction that Mr. Madiar urges has contributed significantly to the financial crisis that is now faced by the State and by its pension systems.

**The Other Historical Materials Do Not Support Mr. Madiar's Position.** Mr. Madiar has conducted exhaustive historical and archival research, and he has uncovered several documents of which we were previously unaware.

The materials that Mr. Madiar has uncovered include two letters that were written to one of the co-sponsors of the Clause (Henry Green) by members of the Illinois Public Employees Pension Laws Commission *after* the Pension Clause was approved by the delegates and before it

was submitted to the voters for approval. One letter proposed an amendment to the Clause under which its prohibitions would be subject to the General Assembly's authority to enact reasonable modifications to respond to changes in conditions affecting actuarial assumptions and otherwise to promote the "fiscal soundness of the retirement systems." Madiar Appendix B. The other letter asked that the delegates adopt a statement to the effect that the Pension Clause should be so construed, stating that the "interests of public employees will not be impaired by either the proposed Commission amendment or by the [proposed] statement [of the delegates' intent]." Madiar Appendix C. Because the delegates did not act on either request, Mr. Madiar states that the Convention delegates believed the Pension Clause imposed broad limitations on legislative powers regarding prospective modifications to benefit formulas and intended to "immunize pension benefit rights (*e.g.*, employee benefits payments, conditions or contribution rates) from *any* adverse unilateral action by [the] General Assembly." Madiar 24.

We disagree. The Convention never acted on these proposals in any formal way. But even if it had done so and had voted to reject the proposals, that would be irrelevant, for reasons that were first stated in *M'Culloch v. Maryland*, 17 U.S. 316 (1819). There, it was argued that because the delegates to the United States Constitutional Convention had rejected a proposal to give Congress express authority to charter national banks, the U.S. Constitution did not confer this authority. The Supreme Court disagreed, recognizing that the delegates may have rejected that specific provision because they believed the authority was already conferred by the Commerce Clause and Necessary and Proper Clause; it thus held that the only germane question was how the Clauses that had been adopted should be construed. *Id*. at 421.

Similarly, here, Delegate Green could have rejected the Pension Commission's proposals because he understood that the Pension Clause, as written, would not prohibit prospective

modifications of benefit formulas and feared the proposed amendment would permit legislative impairments of previously-earned benefits. And there was no reason for Delegate Green even to entertain the proposals, for he was assured that the amendments would not "impair" the pension benefits of employees. If that was correct, the Pension Commission's proposed amendment was superfluous, for the Pension Clause, by its terms, prohibits only "impair[ments]" of contractual pension benefit rights.

Similarly, the Pension Commission's proposals do not establish that it was "cognizant of the Clause's broad limitations on legislative power." *Compare*, Madiar 24. The correspondence shows that the members of the Commission ultimately did not believe that the Clause imposed such restrictions, for they believed that the legislation that they were seeking to authorize would not "impair" the pension rights of employees – and thus would not violate the Pension Clause as written.

Rather, the Pension Commission members were seeking *clarifications* of the Pension Clause because they feared that it otherwise might be interpreted in ways that would be harmful to employees, to the pension systems, and to the State. Subsequent events have shown that those concerns were prescient. In more recent years, the Pension Clause has been construed by Illinois Appellate Courts in the very way that members of the Pension Commission feared it would be, and there is *dictum* in Illinois Supreme Court decisions that endorses that construction. It is highly likely that these decisions and statements inhibited the General Assembly from enacting modest prospective changes to the pension system in the past that would have enabled the pension systems and the State to be much stronger financially than they are today – and that could have even led to the full funding of the pension systems.

In particular, we understand that well over half of the $85 billion in the State's unfunded pension liabilities has resulted from increased life expectancies, other actuarial assumptions that were proven incorrect, and changes in the economy resulting in lower than anticipated investment returns. The pension systems, and the State as a whole, would be in dramatically better financial condition today if the General Assembly had, in the past, made prospective modifications to pension benefit formulas to account for these changes in conditions. Because the General Assembly did not do so, the pension systems' unfunded liabilities increased by as much as an additional $45 billion; these pension systems now have palpably insufficient assets to pay benefits earned to date, and it is also now the case that the State cannot hereafter both pay benefits under current formulas and provide essential government services.

It is because the members of the Pension Commission feared occurrences like these in 1970 that they wanted the Convention to take prophylactic measures to assure that the Clause would not be interpreted in these ways. They obviously did not believe that the terms of the Clause foreclosed their interpretation, for one proposal was to have a statement endorsing their preferred interpretation read into the Convention Proceedings, demonstrating that they believed that the terms of the Clause permitted that interpretation. Furthermore, as noted, the members of the Pension Commission stated that there would be no "impairment" of the interests of employees under the legislation that the Pension Commission wanted to expressly authorize, so the members of the Pension Commission necessarily believed that as originally drafted, the Pension Clause should be interpreted to authorize such legislation.

Accordingly, we do not believe that the communications from the Pension Commission have any pertinence for the interpretation of the Pension Clause – except insofar as they provide some modest additional contemporaneous evidence that the Pension Clause's terms and history

do not dictate the rule that Mr. Madiar urges and insofar as they illustrate the pernicious consequences of such a rule.

## II. IN ALL EVENTS, THE COMPREHENSIVE PENSION REFORM LEGISLATION WOULD NOT "IMPAIR" OR "DIMINISH" PENSION BENEFITS IN VIOLATION OF THE PENSION CLAUSE.

But even if the Pension Clause were held to protect expectations that future benefits will be earned under a particular formula, that would be only half of the constitutional analysis under the Pension Clause. If state employees have contractual rights to have future benefits calculated in a certain way, the comprehensive pension legislation will still not violate the Pension Clause unless the legislation "impairs" or "diminishes" the "benefits" of "membership" in the state pension system at issue.

In our prior opinion, we explained that, under the Illinois Supreme Court's decision in *Felt v. Bd. of Trustees*, this determination would be made under a balancing test in which the court would weigh the severity of the interference with the pension contract against the state interest advanced by the legislation. We noted that the Illinois Supreme Court there stated that the General Assembly "has an undeniable interest and responsibility in ensuring the adequate funding of State pension systems," 107 Ill.2d at 166, and that interference with contract rights is justified by "a reasonable exercise by the States of their police power." *Id.* at 165. In *Felt*, the Supreme Court held that, under this test, legislation that changed the salary base for calculating judicial annuities (from the salary on the last day of work to the average salary for the last year of work) violated both the Pension Clause and the Contract Clause of the Illinois Constitution. It reasoned that the impairment was "severe" and that it was not justified by the State's legitimate interest in assuring the adequate funding of State pension systems because the change in the formula affected only those judges who retired shortly after a salary increase and there was no

indication in the record that "such retirements are a cause of the retirement system's underfunding." *Id.* at 166.

We demonstrated that, under this test, the comprehensive pension reform legislation is constitutional. In contrast to the situation in *Felt*, the aspects of the pension benefit formula that would here be changed are a major cause of the retirement system's $85 billion in unfunded liabilities, and by prospectively modifying the formula, the General Assembly would provide for funding of both previously earned benefits and the benefits that would be earned in the future. That does not "impair" or "diminish" the benefits of membership in the pension system, but enhances those benefits. In addition, because the legislation enables the State to continue providing essential services, it enhances the benefits of membership in the pension system by maintaining an environment in which it is possible to enjoy the fully adequate retirement income that employees will receive under the legislation. Conversely, we demonstrated that any interference with contract rights is here minor because previously earned benefits are protected and the prospective reduction in benefits to be earned in the future is less significant than the salary decreases that the State could impose and will still leave current employees with future benefits that are superior to those in the private sector.

Mr. Madiar's response to this aspect of our opinion is primarily to misstate our analysis by claiming that we have urged an exigent economic circumstances "exception" to the Pension Clause that is contrary to its terms and purposes. *E.g.*, Madiar 4, 75. He also argues that the categorical statements from *Felt* are *dictum*, are inconsistent with subsequent Illinois Supreme Court decisions, and are contrary to the terms and history of the Pension Clause. Similarly, he argues that the history of the Pension Clause establishes that the State must allow a state employee to continue to accrue benefits – in some cases for decades – under the formula in effect

on his first day of work, even when the State is effectively bankrupt and cannot both pay those benefits and provide essential services.

In our opinion, Mr. Madiar's arguments are incorrect and do not withstand analysis. First, under the plain meaning of the Clause and its history, a balancing test is required to determine *whether* legislation has "impaired" or "diminished" the benefits of membership in state pension systems. The Clause does not grant the "absolute" rights that Mr. Madiar claims.

Second, under this balancing test, the economic circumstances that now apply to the pension systems and the State *must* be considered, for they demonstrate whether the value of the benefits has *already* been reduced and made less certain. If so, the question under the Pension Clause is whether the reform legislation would *further* "diminish" or "impair" these benefits or whether it would enhance them.

Third, even if the legislation were to effect some impairment of overall benefits, the impairment would be minor. The comprehensive pension legislation enables funding of previously-earned benefits and creates new judicially enforceable rights to require particular levels of funding. Any adverse effects are purely prospective and less significant than other modifications to compensation that the State has constitutional authority to impose.

Fourth, contrary to Mr. Madiar's claims, the terms and history of the Pension Clause demonstrate that the framers understood that pension benefits would not be fully paid in a bankruptcy and the history does not establish that the State must pay 100% of pension benefits in a bankruptcy situation.

Fifth, contrary to Mr. Madiar's claims, *Felt*'s statements are correct, and the "judicial salary" and other Illinois Supreme Court decisions on which Mr. Madiar relies are not relevant to the Pension Clause and the comprehensive pension reform legislation.

Finally, while Mr. Madiar is certainly correct that comprehensive pension reform legislation would be valid if it provides "consideration" to employees and if the legislation applies only to employees who affirmatively consent to its provisions, we disagree that those are the only conditions in which such legislation would be valid under the Pension Clause. For all the other reasons that we provide, the reform legislation would be valid because it does not "impair" or "diminish" the benefits of the pension contracts.

### A. Under The Terms Of The Pension Clause, Its History, And Case Law, Determinations Whether Legislation Has "Impaired" Or "Diminished" Benefits Requires A Balancing Test.

Mr. Madiar's main argument is that, under the Pension Clause, any legislation that "unilaterally" reduces the formula for calculating pension benefits that will be earned in the future is unconstitutional *per se*, *regardless* of whether the overall effect of the legislation is to make the overall benefits of membership in the pension system more valuable than they otherwise would be and *regardless* of the state interests that the legislation promotes.

Mr. Madiar believes that the terms of the Clause grant these absolute and unconditional rights because it provides that "[m]embership in any pension or retirement system of the State . . . shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired." Ill. Const. art. 13, § 5. Mr. Madiar notes that dictionaries define "impair" as "to make worse, weaker, etc. damage, reduce" and define "diminish" as "to make smaller, lessened, reduced." Madiar 4. He argues that the comprehensive pension legislation is unconstitutional because it will reduce future benefits. He claims that no other facts are relevant because the Clause is "cast in absolute terms and lacks any exceptions." Madiar 26; *see also id.* at 44. In our opinion, these arguments are incorrect for several separate reasons.

First, Mr. Madiar's analysis is contrary to the plain terms of the Pension Clause itself. To argue that the comprehensive pension legislation impairs or diminishes benefits, he myopically

focuses on the effect of the legislation on one benefit of membership in pension systems: the benefits that will be earned (on paper) in the future in the absence of the legislation. But the question under the Clause is whether the "benefits" of membership in the system will be impaired, so a court will have to focus on the effects of the legislation on *all* these benefits, including the benefits that have been earned to date and not just those that would be earned in the future. Under the Clause's plain terms, a court must address the *overall* effect of the legislation on the pension benefits that employees will actually receive from the pension systems. If the legislation is found to enable and assure the payment of previously earned benefits by slightly reducing future benefits that likely would not have been fully paid in the absence of the legislation, the legislation will enhance the benefits of membership in the pension systems and will not "impair" or "diminish" them. Indeed, if the overall effect of the legislation were neutral or arguably neutral, the legislation would not "impair" or "diminish" these benefits.

Also, an assessment of whether legislation will reduce the overall benefits of membership in the system must focus not just on the pension rights that exist on paper. It must address the likelihood that benefits that exist on paper will in fact be paid in the absence of legislation. To make that determination requires consideration of the current economic circumstances of the pension systems and of the State, for if they mean that benefits would not be paid in the absence of legislation, the fact that the legislation impairs "paper rights" is irrelevant – as the Supreme Court has expressly held. *See infra.*

Second, contrary to Mr. Madiar's view, it is well-settled that "no [constitutional] rights are absolute." *Pena v. Mattox*, 84 F.3d 894, 897-98 (7th Cir. 1996). Even when constitutional rights are stated in absolute terms, the scope of the protection is never "gathered solely from a literal reading" of the provision and is therefore not "absolute." *Konigsberg v. State Bar of Cal.*,

366 U.S. 36, 49 (1961); *accord In re Marriage of Diehl*, 221 Ill. App. 3d 410, 427 (2d Dist. 1991). All constitutional rights presuppose the existence of state governments capable of securing public safety, creating a transportation infrastructure, promoting public health, providing education, and otherwise creating the economic and social conditions that allow individual citizens to live, work, and prosper. When laws are reasonably necessary to promote these compelling government interests, constitutional rights yield to the State's police power. *Chicago Tribune Co. v. Village of Downers Grove*, 155 Ill. App. 3d 265, 282 (2d Dist. 1987).

Third, previous decisions have uniformly held that the prohibitions that are now contained in the Pension Clause are not absolute, but require the application of a balancing test. The Pension Clause is based on the prohibition against the impairment of the obligation of contracts that is contained in Article I, Section 10 of the U.S. Constitution and Article I, Section 16 of the Illinois Constitution. As the Convention Proceedings demonstrate, the purpose of the Pension Clause was to define all pension benefits as contractual and thereby grant participants in "mandatory" pension plans the same protections and rights that only participants in "optional" pension plans had previously had under the Contract Clause. 4 Proceedings 2925; *accord McNamee*, 173 Ill. 2d at 440; Madiar 35. As the official Commentary on the Illinois Constitution states, the Pension Clause "provides that benefits prescribed in the [pension] contract may not be diminished or impaired" and "states explicitly what is found in the more general language of Section 16, Article I ['s Contract Clause]." Ill. Const., art. 13, § 5 (Constitutional Commentary) (Smith Hurd).

In turn, it is well-settled that "[a]lthough the Contract Clause appears literally to proscribe 'any' impairment," "the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula." *United States Trust Co. v. New Jersey*, 431 U.S. 1, 20

(1977) (citation and quotation omitted); *accord George D. Hardin, Inc. v. Village of Mount Prospect*, 99 Ill.2d 96, 103-104 (1983). Rather, to determine whether there is unconstitutional impairment, courts ask whether legislative action effected a substantial impairment of a contractual obligation and, if so, whether the impairment is reasonable and necessary to serve an important government interest. *United States Trust Co.*, 431 U.S. at 31-32; *Royal Liquor Mart, Inc. v. City of Rockford*, 133 Ill. App.3d 868, 877 (2d Dist. 1985). As the Illinois Supreme Court stated in *Felt*, "'the contract clause does not immunize contractual obligations from every conceivable kind of impairment or from the effect of a reasonable exercise by the States of their police power.'" *Felt*, 107 Ill.2d at 165 (quoting and citing other Illinois Supreme Court decisions).

Thus, in *Felt*, the Illinois Supreme Court applied the *same* balancing test to determine that the legislation at issue violated both the Pension Clause and the Contract Clause. *Id*. at 166. Contrary to Mr. Madiar's statement, *Felt's* balancing test is not "little more than a holding on a hypothetical before the court." Madiar 57. For all the foregoing reasons, the terms of the Pension Clause and settled law establish that the Pension Clause does not grant absolute rights, and the determination whether the comprehensive pension reform legislation violates the Pension Clause requires *Felt's* balancing analysis. There must be a careful assessment of the extent to which the law will adversely affect interests of employees and of the governmental interests that are furthered by the legislation. As detailed below, under that standard, it is our opinion that the pension reform legislation would not violate the Pension Clause (or the Contract Clause).

### B. The Legislation Would Not "Impair" Or "Diminish" The Benefits Of Membership In The State Pension Systems.

First, the comprehensive pension reform legislation would not "impair" or "diminish" the benefits of membership in the state pension systems, but would enhance those benefits. Today,

the pension rights of current employees exist largely only on paper. The pension systems are today underfunded by some $85 billion, and the amount of the unfunded liabilities has increased virtually every year for the past 15 years, primarily because the State has not made the "normal cost plus interest" payments that covered the additional benefits earned each year and prevented increases in unfunded liabilities. Also, to make even these actuarially inadequate payments to the fund in many recent years, the State has borrowed billions of dollars, thereby increasing the State's debt (and increasing its budget deficit to $15 billion last year). We understand that even with this year's temporary tax increase and actuarially inadequate contributions to state pension systems, the State's deficit will be $12 billion this year (and the deficit would be increased if actuarially adequate level of pension funding were provided this year). We also understand and assume that the State cannot pay the pensions that have been earned to date and those that will be earned in the future under current formulas *unless* the State substantially curtails expenditures on essential state health, education, and public safety services.

In these financial conditions, it is unlikely that current state employees will receive 100% of the pension benefits that they have earned to date, much less 100% of the pension payments that they would earn in the future in the absence of legislation. We do not believe that any court has jurisdiction to order these payments given the doctrine of sovereign immunity and the $5,000 limit on enforcement of Court of Claims judgments in the absence of special appropriations. December 7 Sidley Opinion 35-37.[17] In any case, we do not believe that the result would be

[17] We disagree with Mr. Madiar's contention that a Circuit Court could issue a writ of mandamus directing the State Comptroller to pay all benefits if the pension systems were on the verge of default. Madiar 70. The Pension Clause establishes a contractual right to benefits, and under the State's limited waiver of sovereign immunity, an action sounding in contract against the State can only be brought in the Court of Claims, with its jurisdictional limits on recovery. 705 ILCS 505/8. In this regard, to claim that the State's general funds could be required to pay pension benefits, Mr. Madiar relies on cases that hold that claims against pension funds be brought in the Court of Claims. *Compare* Madiar 67 *with Jones v. Jones-Blyth Construction Co.*, 150 Ill. App. 3d 53 (4th Dist. 1986) & *Shields v. State Employees' Retirement Sys.*, 363 Ill. App. 3d 999 (1st Dist. 2006). So these decisions support neither mandamus nor Circuit Court jurisdiction. Similarly, we do not agree that *Jorgensen v. Blagojevich*, 211 Ill. 2d 286

different if courts had this jurisdiction, for we do not believe any court would order the disbursement of these funds if that would require curtailing essential government services.[18] If a court had this jurisdiction, it would act like a bankruptcy court and try to strike a balance of the competing interests that is fair and reasonable.

In this regard, a major reason that we believe that comprehensive pension reform legislation should be held constitutional is that the General Assembly is far better equipped to strike appropriate balances than any court. While "complete deference" to the legislative judgment would be inappropriate because the State's "self-interest" is nominally at stake, *United States Trust Co.*, 431 U.S. at 25-26, this is a context in which the political process can be trusted to achieve a fair result. State employees are well organized and politically powerful, and their interests are aligned with state legislators (who themselves have rights in a state pension system).

In any case, it is our opinion that the comprehensive pension reform legislation is a fair and reasonable accommodation of the competing interests. It should ensure payment of benefits earned to date by reducing future benefits, by establishing funding requirements for previously-earned and future benefits, and by granting employees the entirely new right to obtain judicial enforcement of funding requirements. And the reduced benefits that will be earned in the future are the same that new employees earn and comparable or higher than those generally available in

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(2004), supports Mr. Madiar's claim. *See* Madiar 70. The *mandamus* order in Jorgensen did not interpret a pension contract and enforce a contract right. It enforced a constitutional prohibition on reduction of judicial salaries, and it rested on the "court's administrative authority over the judicial branch," a source of authority not relevant here. *Id.* at 312.

[18] Contrary to Mr. Madiar's suggestion (Madiar 70), *Antle v. Tuchbreiter,* 414 Ill. 571 (1953), does not support a contrary view. It holds that where a statute "categorically commands the performance of an act, so much money as is necessary to obey the command may be disbursed without any explicit appropriation." *Id.* at 581. On this basis, the court ordered disbursement under a contract with the Federal Social Security Administrator from a special fund in the State Treasury that contained social security contributions. Following the enactment of the comprehensive pension reform legislation, there would be no statute categorically commanding payment of the monies that employees would seek, and determinations of the constitutionality of the legislation, or how much state money should be reserved for essential services, is scarcely a ministerial act. *See, e.g., Board of Trustees v. Rockford*, 96 Ill. App. 3d 102,108 (1981).

the private sector for comparable work. In these circumstances, the relevant judicial decisions establish that the comprehensive reform legislation will not "impair" or "diminish" benefits.

This common sense proposition is established by the United States Supreme Court's decision in *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942). There, the court sustained the alteration of a municipal bond contract. A New Jersey city had issued bonds to fund an "optimistic and extravagant municipal expansion," but had insufficient tax revenues to pay off the bonds because of the "destructive grip" of the Great Depression. *Id.* at 503. The State's Municipal Finance Commission approved a restructuring of the city's obligations that allowed the city to meet its obligations more effectively. *Id.* at 504. The result was that existing bonds were converted into new bonds that paid lower interest than the old bonds. *Id.* at 509.

The Supreme Court held that the State and the City had not impaired the obligations of their contracts. It reasoned that prior to the adoption of the restructuring plan, any right the bondholders may have had "to enforce claims against the city through mandamus" was an "empty right to litigate," and existed only "on paper" because of the economic reality that the City had insufficient revenues to meet all its obligations. *Id.* at 510-11, 516. The Court held that "the necessity compelled by unexpected financial conditions to modify an original arrangement for discharging a city's debt is implied in every obligation" and concluded that the New Jersey law had not "impaired" the prior obligations because it was a reasonable attempt to enable bondholders to be paid interest on the debt (albeit at a reduced rate) and ultimately to be repaid the principal amount of the bonds in full.

The Court held that "[i]mpairment of an obligation means refusal to pay an honest debt; it does not mean contriving ways and means for paying it." *Id.* at 511. The Supreme Court squarely rejected the argument (now advanced by Mr. Madiar) that impairment determinations

must be made by focusing on "paper rights" and ignoring the economic circumstances that would preclude their full satisfaction and the practical benefits of the legislation for the claimants:

> To call a law so beneficent in its consequences on behalf of the creditor who, having so much restored to him, now insists on standing on the paper rights that were merely paper before this resuscitating scheme, an impairment of contract is indeed to make of the Constitution a code of lifeless forms instead of an enduring framework of government for a dynamic society.

*Id.* at 516.

Like the New Jersey law at issue in *Faitoute*, the comprehensive pension reform proposal is a "necessity compelled by unexpected financial conditions:" the fact that the actuarial assumptions that underlay the Code's provisions and the funding requirements turned out to be incorrect, the fact that investments on plan assets have not achieved the predicted returns, and the fact that the State's actual and projected tax revenues are now palpably insufficient both to pay all benefits that would be due if there were no reform and to provide essential services. Far from impairing the rights of pension participants, the reform legislation would bail out the badly underfunded pension systems, assure that they hereafter will be far more adequately funded, and greatly enhance the prospects that previously-earned benefits will be paid in full – by reducing the future benefits that would still be earned to levels that are equal or better than those available in the private sector for comparable work. In short, it is the near precise analogue to what was held not to "impair" the contract in *Faitoute.*

Similarly, several state courts have stated there is no unconstitutional impairment of pension rights so long as legislation is reasonably designed to foster the operation of the pension system and also provide new benefits or advantages for employees. For example, the Supreme Court of Massachusetts has upheld one such legislative modification to pension rights. *Madden v. Contributory Ret. Appeal Bd.*, 729 N.E.2d 1095, 1098 (Mass. 2000). Also, California courts have recognized that reasonable modifications can be made to pension benefit rights when, as

here, they substantially advance the pension system's purpose of providing adequate retirement income for state employees (rather than merely saving money for the state) and when, as here, any adverse effects are reasonably balanced by new advantages for public employees. *Miller v. State of Cal.*, 18 Cal.3d 808, 816 Cal. (1997). In addition, the Vermont Supreme Court has held that there was no unlawful impairment when, as here, a law required greater contributions by employees but provided other benefits for public employees. *Burlington Fire Fighters' Ass'n v. City of Burlington*, 543 A.2d 686, 690 (Vt. 1988). Under these principles, the comprehensive pension reform legislation does not diminish or impair the benefits of membership in pension systems.

In this regard, the reality is that, if the pension systems and the State of Illinois were private corporations, their obligations could be restructured in bankruptcy proceedings under Chapter 11. In such proceedings, employees' claims for pension benefits would be paid only to the extent that the pension fund's assets are adequate to satisfy those claims; any claims for unfunded pension benefits would be unsecured. *See* Richard S. Soble, John H. Eggersten, and Stanley B. Bernstein, *Pension-Related Claims in Bankruptcy,* 56 Am. Bankr. L.J. 155, 159 (1982). Here, the pension systems have $85 billion in unfunded liabilities and are grossly insufficient to pay the pension benefits that have been earned to date. In bankruptcy proceedings, a claim that the employer (here the State) had not adequately funded the pension obligations would be treated as an unsecured claim, except for a very limited priority applicable to pension benefits earned within 180 days prior to the bankruptcy filing. 11 U.S.C. § 1114(l). By contrast, the comprehensive pension legislation provides for funding and payment of previously earned benefits and gives the employees enforceable rights to require funding of these benefits (and future benefits).

Further, when (as we understand to be the case here) a collective bargaining agreement does not provide for pension benefits, an employee's right to earn benefits in the future is an "executory contract" that can be rejected. In particular, a company has the right to revoke future pension benefit commitments, subject only to damages claims that are treated as prepetition unsecured claims against the bankrupt estate. *See* Richard S. Soble, John H. Eggersten, and Stanley B. Bernstein, *Pension-Related Claims in Bankruptcy*, 56 Am. Bankr. L.J. at 159. Here, too, the comprehensive pension reform legislation would grant state employees far superior rights than they would have in a bankruptcy. It grants employees rights to fully adequate future benefits and provides rights to require specific levels of funding of those benefits.

To be sure, States are not subject to bankruptcy law. But that does not reflect a legislative determination that States cannot restructure their own pension and other obligations. To the contrary, States are not subject to bankruptcy laws because it would violate the Tenth and Eleventh Amendments to the U.S. Constitution for a federal court to dictate the future budgetary decisions of States. *See, e.g., Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 72 n.16 (1996). In addition, States do not need the bankruptcy laws to restructure their obligations. Under the Contract Clause (and thus also under the Pension Clause), a State has the authority to "modif[y] . . . its own financial obligations" when necessary to advance legitimate state interests, *United States Trust Co.*, 431 U.S. at 25-26, which necessarily include providing more certain funding for pension benefits, assuring adequate retirement income for all employees, and assuring the State's ability to perform essential governmental functions. Here, the fact that the comprehensive pension reform legislation grants State employees benefits that exceed those that would be available in a private bankruptcy is further confirmation that the legislation does not impair or diminish the benefits of membership in state pension systems.

### C. Because The Modification of Contractual Obligations Operates Only Prospectively, A Substantial Impairment Should Not Be Found In These Conditions.

Further, if there were an impairment here, it would be modest. That is so because the comprehensive pension reform legislation protects the pension benefits that have been earned to date, and "reduces" only the pension benefits that current employees would earn (on paper) in the future if there were no reform legislation. The legislation would thus have no adverse retroactive effects, but would apply only prospectively. In this regard, the "reduction" in future benefits would have no greater economic consequences than would the prospective reductions in salary or in fringe benefits that the State has constitutional authority to impose on all current employees subject to the legislation. Further, to the extent that collective bargaining agreements would now prevent those reductions, that restriction would end when the agreements expire.

The fact that any adverse effects of the legislation are prospective means that any impairment is attenuated and slight, for state employees have the ability to take proactive steps to prevent any adverse effects of legislation: *e.g.*, by obtaining a private sector position that provides greater overall compensation (*i.e.* salary plus benefits). In this regard, federal courts have recognized that pension benefits are a form of compensation, and prospective changes in benefit formulas should not give rise to impairment because an earlier legislature should not "bind subsequent legislatures for work and services to be performed by State employees and teachers *in the future.*" *Maryland State Teachers Ass'n, Inc. v. Hughes*, 594 F. Supp. 1353, 1361 (D. Md. 1984); *accord Butler v. Pennsylvania*, 51 U.S. 402, 417 (1850) (regulation of compensation is part of the "class of powers and obligations by which governments are enabled, and are called upon, to foster and promote the general good; functions, therefore, which governments cannot be presumed to have surrendered, if indeed they can under any circumstances be justified in surrendering them"); *Newton v. Commissioners*, 100 U.S. 548, 559

(1879) (under the police power a state may "increase or diminish the salary or change the mode of compensation").

*Maryland State Teachers Association, Inc.* is instructive. It addressed the validity of a Maryland statute which gave pension participants the option to keep their current pension benefits in exchange for an increase in employee contributions in the future or to pay the same contributions and accept pension benefits for future service subject to a cost of living cap. *See* 594 F. Supp. at 1358. Because the legislation did not affect pension benefits based on prior service, the court held that the statute did not impair any contractual rights under the United States Constitution. *Id.* at 1363. The court contrasted the Maryland legislation with the state law that had been held to be an impairment by the Supreme Court in *United States Trust* and that had "'totally eliminated an important security interest.'" *Id.* at 1359 (quoting *United States Trust*, 431 U.S. at 19).

In short, because the proposed comprehensive pension reform legislation has no adverse effect on previously earned benefits, but merely reduces benefits to be earned in the future, any impairment of pension contracts would not be substantial.

### D. Even if the Proposed Pension Reform Legislation Would Impair the Rights of Pension Participants, the Proposal Is a Reasonable and Necessary Exercise of the Police Power and Serves an Important Public Purpose.

Finally, even if the reform legislation were held to substantially impair benefits of membership in state pension systems, it is our opinion that the legislation would not violate the Pension Clause. The United States Supreme Court and the Illinois Supreme Court have long held that there is no unconstitutional impairment of any contract if the legislation "is reasonable and necessary to serve an important public purpose," *United States Trust Co.*, 431 U.S. at 25, for the Contract and Pension Clauses do not "immunize contractual obligations . . . from the effect of a reasonable exercise by the States of their police power." *Felt*, 107 Ill.2d at 165 (and cases

cited). Legislation that impairs contractual rights may be "reasonable" when, as here, the contractual obligation under the prior statute "had effects that were unforeseen and unintended by the legislature when originally adopted." *United States Trust Co.*, 431 U.S. at 31; s*ee also City of El Paso v. Simmons*, 379 U.S. 497, 515 (1965). Such legislation may be "necessary" if a less drastic modification could not be implemented, or if the State could not achieve its stated goals without a modification. *United States Trust Co.*, 431 U.S. at 431 U.S. at 29-31. As recognized in *Felt*, "'[t]he severity of the impairment measures the height of the hurdle the state legislation must clear.'" 107 Ill.2d at 166 (quoting *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 245 (1978)).

Given the systemic financial crisis facing the State of Illinois and its pension systems, it is our opinion that prospective comprehensive pension reform is necessary to assure adequate funding of the pension systems, to advance the pension system's purpose of providing adequate retirement income to state employees, and to enable the State to continue to provide essential services. In our opinion, these state interests justify any impairment of pension benefit contracts that could be found in the economic conditions that exist.

### E. Mr. Madiar's Claims Are Barred By The Historical Record Of The Objectives Of the Pension Clause.

Despite these settled principles, Mr. Madiar appears to contend that the historical record establishes that the Pension Clause gives each employee an absolute right to earn new benefits – often for decades – under the formula in effect on the employee's first day of work. In Mr. Madiar's view, it was understood by the framers of the Pension Clause, and by the voters who approved it, that the employee, upon retirement, would have an absolute right to full payment of these benefits by the State itself if the pension systems could not make them. Madiar 15-26. In his further view, it was understood that the State would be required to make these payments even

if it could not do so without curtailing essential services, even if the State was effectively bankrupt, and even if unforeseen intervening economic changes in conditions were a substantial cause of the State's and the pension system's inability to make those payments. Madiar 44-46. Consequently, Mr. Madiar suggests that the comprehensive pension legislation would be a substantial and severe impairment of explicit contractual rights that cannot be justified.

It is our opinion that Mr. Madiar has fundamentally misread the historical record. In our view, it demonstrates that the framers knew that they were not providing significant protections to the pension rights of state employees in the event of the *de facto* bankruptcy that the State of Illinois now faces. Indeed, while that point is clear from Convention proceedings, it has been further confirmed by the additional historical material that Mr. Madiar unearthed as a result of his comprehensive archival research.

**The Delegates Understood That Full Funding Was Required To Fully Protect Pension Benefits.** As Mr. Madiar correctly states, the Pension Clause was adopted against the background of the views that had been expressed by Professor Rubin Cohn, an Illinois law professor who was a member of the State Pension Commission and a legal advisor to the Convention. *See* Madiar 5. Professor Cohn had explained that the only means of fully protecting the pension rights of state employees is full and adequate funding of pension systems and that if "a fund is or may become insolvent," a contract right to pension benefits will have no or little value and "may turn out to be the stuff of which dreams are made." Madiar, Appendix D, p. 67; Cohn, *Public Employee Retirement Plans – The Nature Of the Employee Rights*, 1968 Ill. L. F. 32, 62 (1968).

Mr. Madiar has stated that, in 1970, the five state systems each had unfunded liabilities which, as a percentage of predicted liabilities, were not dissimilar to that which exists today.

Madiar 12. The state system that was least well funded was the Judicial Retirement System, then only 32.3% funded. *Id.* The Judicial Retirement System was a state system that was "an optional system" and in which state employees had contractual rights to benefits. *See Bardens v. Board of Trustees,* 22 Ill. 2d 56 (1961).

In addition, as Mr. Madiar's research has disclosed, the genesis of the Pension Clause was a proposal by the Executive Director of the State Universities Retirement System. It was to adopt a constitutional provision that not only granted "vested rights" to pension benefits, but also "contain[ed] a mandate to the General Assembly *to fund the obligations in accordance with sound actuarial principles.*" Madiar Appendix A, pp. 4-5.

Adoption of that proposal – and only the adoption of that proposal – could have ended the underfunding that existed at the time, assured adequate funding of new benefits earned in future years, and prevented the massive unfunded liabilities that now exist. That proposal also would have prevented diminution of previously earned benefits in the event that the State no longer had sufficient revenues to both provide essential services and pay pension benefits. In that event, previously earned benefits would then have been fully funded and deposited in a trust fund for the benefit of state employees – before the financial crisis hit the State.

**The Delegates Expressly Refused To Require Full Funding.** However, as the terms of the Pension Clause and the Constitutional Convention Proceedings make explicit, the delegates *rejected* the proposal to require full actuarial funding of pension benefits. The Clause merely makes membership in state pension systems an enforceable contract right and bars impairment of the benefits of this right. It imposes no funding requirements.

Thus, when one delegate stated that the State should be allowed to pay "the benefits out of income as they come due" (4 Proceedings 2927), the sponsors of the Clause made it explicit

that the State could do so. They said that the Clause does not require funding of the unfunded liabilities that then existed, that it does not require annual funding of new benefits earned each year at the actuarially required levels, that it does not require that any particular levels of funding be achieved, and that it does not create any rights to bring court actions when systems were inadequately funded. *Id.* 2927-29. One of the principal co-sponsors (Mrs. Kinney) stated that the only exception was that "if a pension system would be on the verge of default, a group [court] action could be taken to show that these rights should be preserved." *Id.* 2926; *see id.* 2929.

Similarly, one of the two principal co-sponsors, Mr. Green, stated that, unlike New York's constitutional provision, the Illinois Pension Clause would not impose a requirement of full actuarial funding of each year's new benefits and did not impose a schedule in which full funding of all previously earned benefits must be achieved by a certain year. He stated that, "in lieu of a [funding] scheduling provision," the Clause would "put the General Assembly on notice that these memberships [in pension systems] are enforceable contracts that shall not be diminished or impaired." *Id.* 2925.

Mr. Green then went on to make the curious and ironic statements that there was "reason to believe" that the provision of this notice would lead the General Assembly to "fully fund[]" state pension plans and that the Pension Clause would lead to funding indirectly. *Id; see also id.* at 2929. The statement was curious because members of the judicial pension system had long had contractual rights to benefits, and it then was only 32% funded and was the least well-funded of the five state systems. The statement was ironic because if the Convention's intent had been to require funding, the way to achieve it would have been to adopt the proposal that had been made by the State Universities Retirement System and to adopt an amendment that expressly

required full actuarial funding of new benefits earned each year and that also adopted a schedule for eliminating the existing unfunded liabilities – as New York had done. Instead, the framers adopted the Pension Clause and made it explicit that there was no funding requirement.

In this regard, the delegates' rejection of an amendment that would require full funding squarely forecloses a principal theme of Mr. Madiar's article. He suggests that the General Assembly was at "fault" for failing to provide the actuarially required levels of funding and for a "decades long failure" to make required contributions. Madiar 1-2. That is a public policy view of Mr. Madiar (that is widely shared), but it has no relevance to the constitutional issues that would now be presented under the Pension Clause.

The reality is that the General Assembly has behaved in the manner that the Pension Clause authorized. In the Pension Clause, the delegates authorized a type of "pay as you go system" in which the General Assembly could indefinitely defer actuarially required funding of the systems and provide funding "just in time" to pay benefits due in each future year. By refusing to impose a requirement of actuarially adequate funding, the framers of the Illinois Constitution permitted the regime in which the ability of the State to pay annuities (based on work performed years or decades earlier) would depend on the financial conditions that the State faced in the years when the annuities payments were due (not the earlier years when they were earned). Under this system, benefits earned years earlier would inherently be in jeopardy when, as now, the State has insufficient revenues both to provide essential services and pay all pension costs due under current formulas. While this may have been horrendous public policy, it was permitted by the Pension Clause.

Accordingly, because the present unfunded liabilities of the pension system were authorized by the Pension Clause, they were not a violation of any rights that the Pension Clause

conferred on state employees. As the Illinois Supreme Court has now stated on three separate occasions, the only enforceable contract right that state employees have under the Pension Clause is to require payment of annuities when they are due. *Lindberg,* 60 Ill. 2d at 271 (debates established that "members of the pension plans" have a right to receive the "money due them at the time of retirement"); *McNamee,* 173 Ill. 2d at 446 (same); *Sklodowski,* 182 Ill.2d at 229-31. This right (like claims of all the State's current creditors) is subject to the State's ability to make payments at the time the payments are due and would not be worth one hundred cents on the dollar in a bankruptcy situation.

For the same reason, by enabling the funding of the pension benefits that current state employees have earned to date, the comprehensive pension reform legislation would confer benefits on state employees that exceed those that the Pension Clause itself requires. These include the new enforceable rights to compel specific levels of funding that employees were held not to have in the three earlier Illinois Supreme Court decisions.

**The Delegates Recognized That The Pension Clause Would Not Result In Full Payments In Bankruptcy Situations.** The last major premise of Mr. Madiar's article is that he claims that the Convention debates establish that the Pension Clause is an absolute unconditional guarantee that employees will earn benefits throughout their career under whatever formula was in effect on their first day of employment and receive 100% of those benefits upon their retirement.[19] Madiar 66-69. In particular, in the event that the pension systems have insufficient

[19] Mr. Madiar also argues that the Pension Code itself constitutes a "guarantee" that the State will pay 100% of all pension benefits, regardless of circumstances. Madiar 47**.** This issue has no pertinence to the issue of the constitutionality of the comprehensive pension benefit reform legislation. Like the Pension Code's other funding provisions, the statutory provisions on which Mr. Madiar relies do not create "vested rights" in employees and therefore could be prospectively changed even if they constituted guarantees. *See Sklodowski,* 182 Ill. 2d at 231.

Further, for reasons more fully explained in our December 7 Opinion and in a separate memorandum that we will prepare on this issue, we do not believe that there is any statutory guarantee. To argue otherwise, Mr. Madiar relies on the "Obligations of State" clauses that appear in the five separate Pension Code Articles that govern the five state

funds to make these payments, he appears to contend that the State is constitutionally required to do so, regardless of the financial condition of the State and regardless of the effect on the State's ability to discharge essential governmental responsibilities. *Id.* He believes that is the import of Mrs. Kinney's statement that "the word 'impaired' is meant to imply and to intend that if a pension fund would be on the verge of default or imminent bankruptcy, a group action *could* be taken to show that these rights *should* be preserved." *Id.* at 2929 (emphasis added).

In our opinion, this argument is incorrect. To say that a judicial action could be brought in a certain situation is not to say that the court would be required to grant 100% of the relief sought, regardless of the circumstances. Also, Mrs. Kinney was addressing the rights of employees in the event of the imminent insolvency of state pension funds, not that of the State, and her statement patently does not provide that the Pension Clause would require the State to fund 100% of benefits in conditions in which that could be done only if the State curtailed essential health, educational, and public safety services. That the State might ever occupy its current financial situation appears to have been entirely outside the contemplation of the framers of the Pension Clause.

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pension plans. Four of these clauses provide for the payment by the State of "all benefits granted under this system *to the extent specified in this Article*." Each of these Articles "specifie[s]" that the State is to establish and make contributions to a pension fund, and that that pension fund is to pay pension benefits. No provision in any of these Articles "specifie[s]" that the State will pay pension benefits if the pension fund cannot. Therefore, there is no statutory guarantee for these four plans.

In the Fifth Article (applicable to the Teachers' Retirement System), the "Obligations of State" clause provides for the payment by the State of "all benefits granted under this system." This clause does not create a guarantorship that does not exist in the other four plans. Like the "Obligations of State" clause in the other four plans, the clause was enacted at time when these pension benefits were gratuities, so it could not have created a contractual guarantee of the payment of benefits. Further, in the cases on which Mr. Madiar relies, this clause has been construed to enable parties to bring suits against the Teachers' Retirement System in the Court of Claims. *Shields v. State Employees' Retirement Sys.*, 363 Ill. App.3d 999, 1004, 844 N.E.2nd 438, 442 (1st Dist. 2006) and *Jones v. Jones-Blythe Construction Co.*, 150 Ill. App. 53, 55, 501 NE.2d 374, 375 (4th Dis. 1986). These suits are therefore subject to the jurisdictional and damages limits applicable to the Court of Claims, so the clause is plainly not a State guarantee of pensions under the Teachers' Retirement System.

However, both Mrs. Kinney's other statements and the statements of other delegates establish that the framers understood that the Pension Clause would provide no priority to state and municipal employees in a bankruptcy situation. A delegate who ended up opposing the Clause stated that, in a bankruptcy, the Clause would weaken the rights of employees because the Clause grants contractual rights to pension benefits, rather than (as prior cases had held) treating the employees as having property rights. *Id.* At 2929 (Mr. Whalen). In bankruptcy, the difference between a contract right and a property right is fundamental, for holders of contract rights are unsecured creditors and holders of property rights are entitled to the moneys or assets in question.

Neither Mrs. Kinney nor any other sponsor or delegate denied that the Clause would operate in that way in a bankruptcy and that contractual pension rights (even for previously earned benefits) could be reduced in that event. Several delegates opposed the Pension Clause because it provided contract rights and not property rights; these delegates agreed with Mr. Whalen that the Clause could actually weaken pension rights in a bankruptcy. *Id.* at 2930-31 (statements of Delegates Davis, Borek, and Bottino).

Similarly, Mrs. Kinney and supporters of the Clause otherwise made statements that indicated the purpose of the Pension Clause was far more modest than Mr. Madiar argues. A major theme of the debates was that the Clause would overrule the prior rule in which benefits under "mandatory" plans were gratuities that the State and municipalities had no obligation to pay. Mrs. Kinney stated that the Clause was adopted to address concerns of participants in "mandatory plans" that their benefits could be nullified by home rule municipalities, and that the Clause "would simply be a means of giving them assurances that these benefits will not at some future date be eliminated." *Id.* 2926. Another delegate supported the measure because he

wanted to ensure that "irrespective of the financial condition of a municipality or even the state government, that those persons who have worked for often substandard wages over a long period of time could at least expect to live in some kind of dignity during their golden years." *Id*. at 2926 (comments of Delegate Kemp). In a bankruptcy situation, these statements suggest that the purposes of the Clause would be achieved, so long as employees ended up receiving adequate retirement income from the State, even if it were less than the benefits that they would have received if the State had been able to fully fund the systems. As explained above, the reform legislation is designed to assure adequate retirement income to current state employees.

In short, the Convention Proceedings establish that the Pension Clause was intended to do no more than establish that state and municipal employees have contractual rights to pension benefits. The delegates believed that in a bankruptcy situation, employees would have the same rights as general unsecured contract creditors to make a claim for payment and that the Clause would then only bar a claim that the pension benefits are a gratuity and that nothing needs to be paid. In all events, there is no basis for Mr. Madiar's statements that the Clause is a guarantee that the State would make full payment of pension claims when the State has insufficient revenues to do so and still provide essential government services.

**The Voters Who Approved The Clause Did Not Share Mr. Madiar's Understanding Of It.** Also, the Pension Clause was approved and made effective by the voters, and the ultimate question is what they understood the Clause to mean. They were not told that the Clause meant that the pension claims of state employees must be paid in full when, as here, that would deprive the State of moneys required to provide essential health, education, transportation, and public safety services. In its official explanation of the Pension Clause to the voters, the Convention stated that the Pension Clause is "self-explanatory." VII Proceedings 2747. There is nothing in

the text of the Act that supports such a position, and it is implausible in the extreme to suppose that the voters of the State would support a measure that would prevent the State from providing essential services in order to guarantee that state employees received pensions that are substantially higher than those available in the private sector for comparable work.

### F. There Is No Merit To Mr. Madiar's Attempts To Marginalize *Felt*, And The Other Illinois Supreme Court Decisions On Which He Relies Are Irrelevant.

For the reasons stated above, it is our opinion that the comprehensive pension reform legislation is constitutional under the balancing test that the Illinois Supreme Court set forth in *Felt* (which followed well settled U.S. Supreme Court and other precedents). In addition to other factors discussed in more detail above, *Felt* states that "the legislature has an undeniable interest and responsibility in ensuring the adequate funding of State pension systems." 107 Ill.2d at 166. The comprehensive pension legislation would eliminate current unfunded liabilities, enable funding of these systems, and give State employees new rights to enforce funding requirements. For this reason alone, the legislation is constitutional.

To avoid this conclusion, Mr. Madiar argues that *Felt's* statement is wrong and has been disapproved *sub silento* by more recent decisions. He further argues that the relevant cases are not *Felt* and the many like decisions, but Illinois Supreme Court decisions that have enforced the express legislative prohibition on prospective reductions in judicial salaries. In our opinion, these arguments are incorrect.

First, Mr. Madiar admits that *Felt* stated that fostering adequate funding of the pension systems is a legitimate state interest and that it invalidated the statute at issue in that case *solely* because it would not have materially advanced that interest. Mr. Madiar tries to marginalize *Felt* by contending that, despite what the decision said, its true meaning was that the legislature has a legitimate interest in funding only because the Clause was purportedly "'intended to force the

funding of benefits indirectly, by putting the state and municipal governments on notice that they are responsible for the benefits.'" Madiar 57 (quoting *dictum* in *McNamee,* 173 Ill. 2d at 442, 444). But that makes no sense. As the facts of both *Felt* and *McNamee* establish, if assuring funding of the Pension System had been the underlying objective of the Pension Clause, the Pension Clause has failed, for the General Assembly has not remotely provided the actuarially-required levels of funding. Further, notwithstanding the decades-long failure of the General Assembly to provide adequate funding, *McNamee* held that employees could not bring judicial actions to force any levels of funding under the Pension Clause. That is why *Felt* recognized that legislation that *in fact* enables greatly improved pension funding serves a legitimate and important government interest.

Mr. Madiar suggests that this interest nonetheless is not a legitimate one because state employees putatively do not benefit from adequate funding of pension systems. That assertion is contradicted by Mr. Madiar's policy arguments that the legislature was at fault for failing to provide this funding. Madiar 1-2. That assertion is also contradicted by the fact that state employees have, on three separate occasions, unsuccessfully brought lawsuits seeking to compel funding of the systems. The employees understood that funding of pension systems benefits them. The obvious reason is that even if they have a contractual right to obtain payment from the State when the pension systems cannot make them – *as dictum* in these three Illinois Supreme Court decisions suggests – that right has no priority over other claims to state money and can be compromised in a bankruptcy situation like that now facing the State.

In short, *Felt* is correct. Accordingly, the facts that the comprehensive pension reform legislation would eliminate unfunded pension liabilities, allow adequate funding of new and previously earned benefits, and give state employees the new right to enforce funding

requirements are all factors that demonstrate the legislation does not unconstitutionally impair or diminish the benefits of membership in state pension systems.

Second, there is also no substance to Mr. Madiar's contention that the most relevant Illinois Supreme Court decision is not *Felt*, but earlier decisions interpreting the Illinois Constitution's prohibition on reduction in the salaries of judges during their terms of office (and similar provisions applicable to a handful of other public employees). Madiar 4 & n.3. For example, he relies on *People ex. rel. Lyle v. City of Chicago*, 360 Ill. 25 (1935), which held that the prohibition on the diminution of judicial salaries applied even in the Great Depression because this constitutional provision does not contain an exception for emergencies or other exigent circumstances.

In our opinion, these decisions are irrelevant. They rest on the interpretation of constitutional provisions that have different terms and purposes than the Pension Clause. As explained above, the Pension Clause extended the protections of the Contract Clause to "mandatory" pensions by making membership in pension systems "enforceable contractual relationships" and barring impairment or diminution of the benefits of these contractual relationships. That is why Contract Clause principles are properly applied in assessing Pension Clause claims.

By contrast, the constitutional prohibition at issue in *Lyle* applies to diminution of salaries, not the benefits of contractual relationships. For the reasons stated above, while it is a straightforward matter to determine if salaries have been reduced, a determination whether legislation impairs or diminishes the benefits of membership in a pension system is considerably more complicated because it requires assessments of the overall effect of legislation on not just future benefits, but also the funding and payment of previously-earned benefits. Also, the

Illinois Supreme Court has held that the constitutional ban on legislative diminution of judicial salaries implicates the doctrine of "separation of powers," which places "judicial salaries in a qualitatively different legal posture" than the compensation "paid to other state officers and employees." *Jorgensen*, 211 Ill. 2d 286 at 309. The Pension Clause does not implicate separation of powers,

In addition, in arguing the relevance of the judicial and other "salary" cases, Mr. Madiar has misconceived our grounds for concluding that the comprehensive pension reform legislation is constitutional under the Pension Clause and the Contract Clause. Our opinion is not that there is an "exigent circumstances" exception to the Pension Clause. Our opinion is that the comprehensive pension reform legislation is constitutional because it does not "impair" or "diminish" the "benefits" of "membership" in state pension systems within the meaning of the Pension Clause. In our view, there is no impairment or diminution of those benefits because under the comprehensive pension reform legislation, it can reasonably be concluded that state employees will be better off than they were in the absence of the legislation and certainly not materially worse off. The legislation benefits current employees by enabling the funding of the pension benefits that they have earned to date (and also the funding of the somewhat reduced benefits that they will earn in the future) and by providing far greater certainty that current employees will in fact have adequate retirement income than would exist in the absence of legislation. The comprehensive pension reform legislation also benefits them because it will allow the State to continue to provide essential health, education, and public safety services, and without those services, the "benefits" of "membership" in the pension system could be meaningless and assuredly would be far less valuable than they are today. No comparable

arguments could have been made – or were made – in any of the cases involving the ban on reductions in judicial salaries.

In short, in our opinion, *Felt* properly relied on Contract Clause principles in assessing claims under the Pension Clause, and the constitutionality of the comprehensive reform legislation is established by *Felt* and the many similar cases cited in this memorandum. By contrast, it is our view that the judicial salary and similar other decisions on which Mr. Madiar has relied are inapposite.

### G. For These Reasons, Affirmative Assent Of Each State Employee Is Not Required Before Comprehensive Pension Legislation Will Be Valid.

Mr. Madiar's article also includes a discussion of the conditions under which there would be a valid novation or modification of the pension contracts between the pension systems and each of the covered employees. Madiar 60-65. Mr. Madiar's position is that, under principles of contract law, that would require both that the comprehensive pension legislation provided new rights and benefits to employees and that each employee affirmatively consented to the modification of his or her individual contract with the relevant state pension system. *Id.* While Mr. Madiar's arguments appear to be internally inconsistent (*see* p. 13 n.12, *supra*), we have not thoroughly analyzed this portion of Mr. Madiar's article, because we believe that the legislation is constitutional in any event.

Formal modifications of the individual employee contracts would not be required unless the comprehensive pension legislation would otherwise violate the Pension Clause. For the reasons stated above, it is our opinion that it would not. We believe that the Pension Clause only protects previously earned benefits. But even if it also protects benefits that will be earned in the future, it is our opinion that the comprehensive pension legislation does not violate the Pension Clause (or the Contract Clause) because it does not "diminish" or "impair" the benefits of the

pension contracts. In this circumstance, it is irrelevant whether each individual employee assents to future modifications of his or her future benefits, for the amendment to the Pension Code would be constitutional, with or without each employee's assent.

## CONCLUSION

In this memorandum, we have not endeavored to respond to each argument made in Mr. Madiar's article, but have confined our analysis to the basic reasons why we are unpersuaded by Mr. Madiar's analysis and continue to believe that the pension reform legislation would be constitutional.

For all the reasons stated, it is our opinion that the comprehensive pension reform legislation that is discussed in this memorandum is constitutional because (1) the Pension Clause protects only previously-earned benefits and (2) even if the Pension Clause protected expectations that particular levels of benefits will be earned in the future, the comprehensive pension reform legislation does not "impair" or "diminish" the benefits of membership in state pension systems within the meaning of the Pension Clause.

Finally, we emphasize that we do not presume to predict how the Illinois Supreme Court will rule on these constitutional issues. Our opinion is that there are compelling arguments that the comprehensive pension reform legislation would be constitutional and that it is very likely that the Illinois Supreme Court will accept them. The only way to know, with certainty, whether comprehensive pension reform legislation would be upheld is to enact the legislation and see what the Court decides.

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