

Clients & Friends Memo

A Looming Crisis: Illinois Supreme Court Strikes Down Statute Reducing Benefits

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On May 8, 2015, the Supreme Court of the State of Illinois struck down recently enacted state public pension reform legislation on the grounds that the legislation violated the “pension protection clause” of the Illinois constitution. The legislation had sought to reduce Illinois’s pension liabilities by reducing annuity benefits to some members of the State’s public pension systems. The Illinois Supreme Court’s ruling limits the options that Illinois now has for dealing with its deepening fiscal crisis and, in turn, may force Illinois to propose additional legislative measures, possibly including legislation authorizing its municipalities to file for protection under chapter 9 of the United States Bankruptcy Code. In re Pension Reform Litig., 2015 IL 118585 (May 8, 2015).

The Challenge to the Pension Reform Act

Illinois has five State-funded retirement systems, which have been chronically underfunded almost since their inception. Following downgrades in Illinois’s credit rating, the State General Assembly passed Public Act 98-599 (“the Act”) in the fall of 2013, and then-Governor Pat Quinn signed the Act into law on December 5, 2013. The Act primarily affected four of the five State-funded retirement systems and contained provisions designed to reduce annuity benefits for the members of those systems who had previously been entitled to the highest level of benefits. Among other things, the Act provided for decreased annual annuity adjustments and increased retirement ages for the affected members.

Almost immediately after the Act was signed into law, members of the Illinois retirement systems brought five separate actions challenging the Act’s validity, among other things on the grounds that the Act violated the Illinois constitution’s “pension protection clause.” The pension protection clause provides, “Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.” Illinois Const. art. XIII, sect. 5. The five actions were ultimately consolidated in the circuit court of Sangamon County, which found the Act to be unconstitutional in its entirety as a violation of the pension

protection clause. Because the circuit court's judgment invalidated a State statute, appeal lay directly to the Illinois Supreme Court.

Illinois Supreme Court Strikes Down the Act

The Illinois Supreme Court affirmed the circuit court's ruling that the Act was an unconstitutional violation of the Illinois constitution's pension protection clause. The Court characterized the issue of whether the Act violated the pension protection clause as "easily resolved," because the pension protection clause expressly provides that State pension benefits "shall not be diminished or impaired." The Court had already held in earlier cases that the protections of this clause attach as soon as an individual first embarks upon employment in a position covered by a public retirement system, and not when the employee ultimately retires. Accordingly, once an individual begins work and becomes a member of a public retirement system, any subsequent changes to the Illinois Pension Code that would diminish the benefits conferred by membership in the retirement system cannot be applied to that individual.

The Court rejected the State's major affirmative defense, which was that State finances had become so dire that the General Assembly was compelled to invoke the State's police power to override the pension protection clause. The Court concluded that the circumstances surrounding the enactment of the Act were not sufficiently unique to justify an invocation of the State's police power. Furthermore, Illinois Supreme Court precedents reaching back to the Great Depression hold that exigent circumstances alone are not sufficient to justify a deviation from "plain and unequivocal" provisions of the Illinois constitution.

The State attempted to buttress its police power argument by citing to cases permitting the police power to override the "contracts" clauses of the State and federal constitutions (as opposed to the more specific pension protection clause), but the Court noted that the judicially-recognized "police power" exception to the State and federal contracts clauses is actually quite narrow, and that attempts by a state to impair contracts to which the state itself is a party are subject to particular scrutiny. Specifically, a state's impairment of its own contracts is generally viewed as appropriate only where the relevant contractual provisions had effects that were "unforeseen and unintended" by the legislature and where the state was unable to achieve its purpose through less drastic measures. The Court concluded that it was impossible for the State to make these necessary showings.

The Court also noted that the drafters of the pension protection clause could have, but chose not to, make that clause subject to the State's police power. It cited its own precedents to the effect that the General Assembly cannot enact legislation that conflicts with provisions of the Illinois constitution unless the constitution specifically grants it such authority. The Court also cited

numerous examples of provisions in the Illinois constitution where the drafters specifically made particular constitutional guarantees subject to the State's police power.

The Court also agreed with the circuit court that the unconstitutional annuity reduction provisions of the Act were not severable from the remainder of the statute, meaning that the Act was invalid in its entirety. The Court noted that the Act's own severability provision lists 39 specific sections that are "inseverable" from each other, including some of the provisions that impermissibly reduce retirement annuity benefits. Thus, invalidation of the annuity reduction provisions also required elimination of the other "inseverable" provisions, with the end effect being that the Act effectively "evaporates." In any event, the Court noted that severability provisions are not conclusive, and that an entire statute will be held unconstitutional if "the legislature would not have passed the law without the provisions deemed invalid," as the Court concluded was the case with the Act.

Conclusion

Illinois's inability to restructure its pensions directly through state legislation now leaves the State with one less option for dealing with its fiscal crisis. Furthermore, because the Illinois constitution's pension protection clause protects municipal as well as State-funded pensions, the Court's ruling could severely limit the options of Illinois municipalities, such as the City of Chicago, as they seek to deal with their own substantial unfunded pension liabilities.

As one possible solution, the current Illinois governor, Bruce Rauner, has proposed a constitutional amendment under which the State constitution's pension protection clause would protect only benefits already earned by current members and, unlike the existing version, would no longer protect current members' unearned future benefits. In addition, Governor Rauner has also discussed legislation authorizing Illinois municipalities to file for protection under chapter 9 of the Bankruptcy Code. Such legislation might provide a means of circumventing state constitutional restrictions on the ability to impair public pension benefits. Bankruptcy courts, including in the Detroit, Michigan and Stockton, California chapter 9 cases, have ruled that the federal Bankruptcy Code overrides state law protections for pensions.

Within four days of being rendered, the Illinois Supreme Court's decision resulted in the plummet of Chicago's credit rating to junk status, making Chicago reportedly the only U.S. city with a population over 500,000 people, other than Detroit, to have such low ratings.¹ With optimism as to the ability to formulate a plan to deal with the looming debt crisis and significant pension liabilities now dwindling, it remains to be seen whether the political will exists in Illinois to enact a chapter 9

¹ See Hal Dardick & Heather Gillers, *Chicago Credit Rating Plummet to Junk Status Following Pension Ruling*, [Chicago Tribune](#), May 12, 2015.

authorization statute or other reforms, and if so, which State and municipal pension systems might be affected. With focus shifting from Detroit, it seems that all eyes are now turning to Illinois.

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