

MEMORANDUM

To: Dan M. Slack
From: Albert J. Lee
Date: April 9, 2004
Re: Pension Protection Clause of the 1970 Illinois Constitution

I. Question Presented

Whether amendments to the Illinois Pension Code that reduce pension benefits are permissible under Art. 13, Sec. 5 of the 1970 Illinois Constitution (“the pension protection clause”).

II. Short Answer

No. The pension protection clause prohibits direct changes to fixed variables in the statutory pension formula that reduce a member’s vested benefits. However, changes that only incidentally affect pension calculations are constitutionally permissible.

III. Legal Background

A. General Rules

The pension protection clause of the 1970 Illinois Constitution 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.¹

The Illinois Supreme Court stated that “[t]he plain language of the pension protection clause makes participation in a public plan an enforceable contractual relationship and also demands that the ‘benefits’ of that relationship ‘shall not be diminished or impaired.’”² Furthermore, the Court has held that “the contractual relationship is governed by the actual terms of the Pension Code at the time the employee becomes a member of the pension system.”³ The legal contract vests with an employee upon entrance into the system, i.e. upon payment of employee contributions, or in 1971, whichever is later.⁴ This contractual “vesting” is distinguished from “vesting” in terms of

¹Ill. Const. 1970, art. XIII, § 5.

² People ex rel. Sklodowski v. State, 182 Ill.2d 220, 228-29 (1998).

³ *Id.* See also Di Falco v. Bd. of Trustees of the Firemen’s Pension Fund of the Wood Dale Fire Protection District No. One, 122 Ill.2d 22, 26 (1988); Kerner v. State Employees’ Retirement System, 72 Ill.2d 507, 514 (1978).

⁴ See Carr v. Bd. of Trustees of the Police Pension Fund of Peoria, 158 Ill.App.3d 7, 8 (3d Dist. 1987); Schroeder v. Morton Grove Police Pension Bd., 219 Ill.App.3d 697, 700 (1st Dist. 1991); .

rights under the plan upon fulfillment of special qualifying conditions, such as minimum terms of service.⁵

Historically, the pension protection clause was enacted to “eliminate any uncertainty as to whether state and local governments were obligated to pay pension benefits to their employees.”⁶ At the time of the clause’s enactment, Illinois pensions were either “mandatory” or “optional.” On one hand, state employees’ contractual relationship under a mandatory plan was considered in the nature of a gratuity that could be revoked at will.⁷ On the other hand, only those employees participating in an optional plan enjoyed enforceable contractual rights associated with the plan.⁸ The pension protection clause eliminated the uncertainty created by the distinction and made all State pensions contractual obligations.⁹

The contractual obligation not only binds State pension administrators, but also extends to actions by the State legislature. A majority of cases concerning the clause have held that the pension protection clause “prohibits subsequent amendments to the law from decreasing a party’s pension benefits, but allows pension benefits to be enhanced by subsequent amendment on the theory that a new contract with the increased vested benefits is formed if the party provides additional consideration in the form of continued contributions.”¹⁰

Attempts to use the pension protection clause to hold the State to its statutory pension funding obligations have been unsuccessful.¹¹ In the most recent case on the issue, *People ex rel. Sklodowski v. State*, the Illinois Supreme Court held that the pension protection clause did not convey rights to beneficiaries to enforce the level of state contributions mandated by statute.¹² The Court concluded, “The framers of the Illinois Constitution were careful to craft in the pension protection clause an amendment that would create a contractual right to benefits, while not freezing the politically sensitive area of pension financing.”¹³

B. Cases Examining Constitutionality of Legislative Acts under the Pension Protection Clause

1. Illinois Supreme Court Cases

Buddell v. State Universities Retirement System,¹⁴ decided in 1987, is the most recent Illinois Supreme Court case finding a legislative amendment to have impaired a member’s vested rights under the pension protection clause. There, an amendment to the

⁵ *Kraus v. Bd. of Trustees of the Police Pension of Fund of the Village of Niles*, 72 Ill.App.3d 833, 836 (1st Dist. 1979).

⁶ *Sklodowski*, 182 Ill.2d at 228.

⁷ *Id.*

⁸ *Id.*

⁹ *See id.*

¹⁰ *Miller v. Retirement Bd. of Policemen’s Annuity and Benefit Fund of the City of Chicago*, 329 Ill.App.3d 589, 597 (1st Dist. 2001) (citing *Hannigan v. Hoffmeister*, 608 N.E.2d 396, 402 (1992)).

¹¹ *See, e.g., McNamee v. State of Illinois*, 173 Ill.2d 433 (1996); *People ex rel. Illinois Federation of Teachers v. Lindberg*, 60 Ill.2d 266 (1975).

¹² *Sklodowski*, 182 Ill.2d at 233.

¹³ *Id.*

¹⁴ 118 Ill.2d 99 (1987).

Pension Code required a member to apply for military service credit before a certain deadline, where no such requirement existed when the member entered the system. The Court held that plaintiff's contractual right to purchase military service credit without a time restriction, as specifically provided in the pre-amended statute, could not be divested by the legislature in violation of the pension protection clause.¹⁵

Felt v. Board of Trustees of the Judges Retirement System,¹⁶ decided in 1985, addressed an amendment that changed the base salary used in benefit computations. Prior to the amendment, judges' retirement benefits were computed on a salary base taken from the judge's salary on the last day of judicial service.¹⁷ The amendment changed the salary base formula to take into account the average salary in the final year of judicial service, resulting in a reduction to plaintiff's annuity by \$3,187.44.¹⁸ The defendants argued that the amendments were enacted to discourage judges from retiring upon obtaining salary increases, and hence, enjoying higher benefits without having contributed to the system.¹⁹ The Court rejected the argument saying that the impairment of retirement benefits was not defensible as a reasonable exercise of the State's police powers and was, therefore, unconstitutional.²⁰

Peters v. City of Springfield,²¹ decided in 1974, was the first Illinois Supreme Court case considering the extent of the "enforceable contractual right" under the pension protection clause. There, the City enacted a municipal ordinance reducing the mandatory retirement age of its policemen and firemen from 63 to 60.²² The plaintiff firemen contended that the ordinance impaired and diminished their pension benefits in contravention of the pension protection clause.²³ They argued that the pension protection clause must be construed to include within pension rights the minimum retirement age provided by the law at the time one enters the system.²⁴ The Court disagreed, holding that "the purpose and intent of the constitutional provision was to insure that the pension rights or public employees which had been earned should not be 'diminished or impaired' but that it was not intended, and did not serve, to prevent the defendant City from reducing the maximum retirement age, even though the reduction might affect the pensions which plaintiffs would ultimately would have recovered."²⁵ Although the pension fund formula was based on salary and length of service, the Court observed that "municipal employment is not static and a number of factors might require that a public position be abolished, its functions changed, or the terms of employment modified."²⁶ Important to its consideration was that the City's exercise of its "home-rule" power affected plaintiff's pension benefit "only indirectly" because the mandatory retirement age did not fall within the scope of the pension statutes.²⁷

¹⁵ *Id.* at

¹⁶ 107 Ill.2d 158 (1985).

¹⁷ *Id.* at 160-61.

¹⁸ *Id.* at 161, 166.

¹⁹ *Id.* at 166.

²⁰ *Id.* at 167.

²¹ 57 Ill.2d 142 (1974).

²² *Id.* at 144.

²³ *Id.* at 149.

²⁴ *Id.* at 150.

²⁵ *Id.* at 152.

²⁶ *Id.*

²⁷ *See id.* at 151.

2. Illinois Appellate Cases

Miller v. Retirement Board of Policemen's Annuity,²⁸ decided in 2001 by the 1st Appellate District of Illinois, is the most recent Appellate case on the issue. There, the Pension Code had fixed retirement benefits for police officers at age 63.²⁹ Those officers working past the age of 63 enjoyed an annual statutory increase of 3% over the fixed base annuity for the subsequent years until retirement.³⁰ An amendment to the Pension Code, effective Jan. 1, 1988, reinstated the mandatory retirement age at 63 years, retroactively forcing those who have worked beyond that age to retire by March 1988.³¹ Furthermore, the amendment required that retirement benefits for those officers working beyond age 63 be fixed at the age of actual withdrawal from service.³² According to the plaintiff class representatives, although this created an increased base annuity, the calculations still resulted in a lower overall monthly benefit for many in the class.³³ The 1st District held that the application of the amendment to the plaintiffs was an unconstitutional impairment of contract because it “amounted to a change in the terms of the [plaintiffs’] contract with the pension system and directly diminished their benefits under the contract.”³⁴ Central to its holding was the distinction between indirect effects (like those in the *Peters* case) and direct ones: “Unlike *Peters*, the amendment in this case did not create a mere incidental effect on pension calculations but, rather, directly changed a fixed variable in the pension formula.”³⁵

Schroeder v. Morton Grove Police Pension Board,³⁶ decided in 1991 by the 1st District, found the reinstatement of a Workers’ Compensation offset provision after its repeal unconstitutional under the pension protection clause when applied to members who had paid contributions before, during, and after the repeal.³⁷ The court took the position that “where a pension system increases an employee’s benefits, the employee can take advantage of a beneficial pension change where he provides consideration for the contractual modification, most often taking the form of new or continued contributions to the pension system.”³⁸ The court rejected the position in *Sellards v. Board of Trustees of the Rolling Meadows Firemen’s Pension Fund*,³⁹ holding that the Constitution “does not provide that a person has a vested right in any beneficial changes in a pension system.”⁴⁰ The court, instead, opted to follow the appellate majority, namely, *Fenton v. Board of Trustees of the City of Murphysboro*,⁴¹ *Gualano v. City of*

²⁸ 329 Ill.App.3d 589 (1st Dist. 2001).

²⁹ *Id.* at 593.

³⁰ *Id.*

³¹ *Id.* at 593-94.

³² *Id.* at 593.

³³ *Id.* at 594.

³⁴ *Id.* at 600.

³⁵ *Id.* at 601.

³⁶ 219 Ill.App.3d 697 (1st Dist. 1991).

³⁷ *Id.* at 702.

³⁸ *Id.* at 701 (quoting *Taft v. Board of Trustees*, 133 Ill.App.3d 566, 572 (2d Dist. 1985)).

³⁹ 133 Ill.App.3d 415 (1st Dist. 1985).

⁴⁰ *Id.* at 417.

⁴¹ 203 Ill.App.3d 714 (5th Dist. 1990).

Des Plaines,⁴² *Carr v. Board of Trustees of the Police Pension Fund of Peoria*,⁴³ and *Taft v. Board of Trustees of the Police Pension Fund of the Village of Winthrop Harbor*,⁴⁴ all similarly allowing contractual enforcement of beneficial amendments upon payment of further consideration.⁴⁵

Kraus v. Board of Trustees of the Police Pension Fund,⁴⁶ an often-cited case from the 1st District, was decided in 1979. The plaintiff was a police officer whose retirement plan allowed an officer on disability to retire at regular pension equal to one-half of the salary attached to his rank the year preceding retirement.⁴⁷ An amendment reduced the amount to one-half of the salary attached to his rank at the date of disability.⁴⁸ The defendant board argued, “the legislature has power, as necessity requires, to enact Pension Code modifications which directly diminish the benefits to be received by preexisting members of the pension system, so long as they do not affect the rights of those who are already eligible to retire or have retired.”⁴⁹

The *Kraus* court rejected the defendant’s argument and held that the reduction directly diminished plaintiff’s benefits in contravention of the pension protection clause.⁵⁰ The court noted that the Illinois Constitution adopted the intent and the basic thrust of the New York constitutional provision.⁵¹ Where other states, including Alaska, Hawaii, and Michigan, had used the term “accrued benefits” under their respective protection clauses, the court found the conspicuous absence of the word “accrued” from the Illinois and New York clauses to strongly rebut the premise that the pension rights do not vest until retirement.⁵² Rather, the court emphasized that its holding “prohibits legislative action which directly diminishes the benefits to be received by those who became members of the pension system prior to the enactment of legislation, though they are not yet eligible to retire. Legislative action directed toward another aim, but which has an incidental effect on the pensions which the employees would ultimately receive, is not prohibited.”⁵³ As a result, the court held that mandatory retirement ages, work hours, and salaries could be reduced, even if they indirectly impact benefits.⁵⁴

IV. Conclusion

The above case law can be summarized into the following points:

1. The pension protection clause freezes the terms of the plan for the employee to the statutes in effect in 1971 or at the time of entry into the system, whichever is later.

⁴² 139 Ill.App.3d 456 (1st Dist. 1985).

⁴³ 158 Ill.App.3d 7 (3d Dist. 1987).

⁴⁴ 133 Ill.App.3d 566, 572 (2d Dist. 1985).

⁴⁵ *Schroeder*, 219 Ill.App.3d at 702.

⁴⁶ 72 Ill.App.3d 833 (1st Dist. 1979)

⁴⁷ *Id.* at 835.

⁴⁸ *Id.* at 836.

⁴⁹ *Id.*

⁵⁰ *Id.* at 844.

⁵¹ *Id.* at 846.

⁵² *Id.* at 847.

⁵³ *Id.* at 849.

⁵⁴ *Id.*

2. Subsequent amendments may not reduce or diminish the overall pension benefits received by directly altering a fixed variable of the formula used to calculate pension benefits. Nor may they seek to reinstate statutes which repeal was beneficial to members paying contributions before, during, and after the repeal.
3. Subsequent amendments may, however, create mere incidental effects on pension calculations that serve to reduce the overall pension benefit, i.e. changing the mandatory retirement age where the formula is merely worded in general terms of salary and length of service.
4. According to a majority of appellate decisions, subsequent amendments may increase a member's benefit in the order of a modified contract for which future contributions serve as consideration.
5. The pension protection clause does not create contractual rights to secure system funding.