

CONSTITUTIONAL CONTRACTS CLAUSE CHALLENGES IN PUBLIC PENSION LITIGATION

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Whether it be in the field of sports or the halls of the legislature it is not consonant with the American tradition of fairness and justice to change the ground rules in the middle of the game.¹

INTRODUCTION

Because of the economic impact of the global recession and the resulting loss in the value of public pension funds,² there has been increased scrutiny on the effect states' obligations to public pension funds are having on the ability of these same states to balance their budgets.³ A number of states believe that state pension deficits have run amok⁴ and that public employees are receiving much-too generous

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1. *Sylvestre v. Minnesota*, 214 N.W.2d 658, 665 (Minn. 1973) (quoting *Hickey v. Pension Bd. of City of Pittsburgh*, 106 A.2d 233, 238 (Pa. 1954)).

2. See Charles B. Stockdale, Douglas A. McIntyre & Michael B. Sauter, *The Sixteen States that are Killing Their Pensions*, 24/7 WALL STREET (Mar. 4, 2011, 6:11 AM), <http://247wallst.com/2011/03/04/the-sixteen-states-that-are-killing-their-pensions/> (“During a period like the market collapse of 2008, the value of many large pension funds plunged.”).

3. See William T. Payne & Stephen M. Pincus, *The Constitutional Limitations of Public Employee Pension Reform Legislation*, 19 PUB. LAW. 12, 12 (2011) (“The recent recession has refocused attention on the issue of underfunded government pensions in the United States.”); PEW CTR. ON THE STATES, *THE TRILLION DOLLAR GAP: UNFUNDED STATE RETIREMENT SYSTEMS AND THE ROADS TO REFORM* 1 (2010), available at http://downloads.pewcenteronthestates.org/The_Trillion_Dollar_Gap_final.pdf (“Of all of the bills coming due to states, perhaps the most daunting is the cost of pensions, health care and other retirement benefits promised to their public sector employees.”).

4. See PEW CTR. ON THE STATES, *supra* note 3, at 1 (“[A]t the end of the fiscal year 2008, there was a \$1 trillion gap between the \$2.35 trillion states and participating localities had set aside to pay for employees' retirement benefits and the \$3.35 trillion price tag of those promises.”). *But see* Florence Olsen, *At Actuaries Meeting, Speakers Debate Whether Public Pension Woes Are*

benefits and paying too little for these same benefits.⁵ Proponents of cutting public pension benefits have now sought to pass various forms of legislation seeking to cut back on public pension benefits available under various state employee retirement systems.⁶

Wisconsin provides a good example of one such battle. On February 11, 2011, newly-elected Republican Governor Scott Walker introduced his budget repair bill.⁷ The ostensible purpose of this

Overblown, BNA PENSION & BENEFITS DAILY, Mar. 31, 2011 (“[C]urrent debate about a public pension crisis overstates the problem The “pension crisis” is a direct consequence of a severe cyclical budgetary shortfall and not a pension crisis per se, said Elizabeth McNichol, a senior fellow specializing in state fiscal issues at [Center on Budget and Policy Priorities] CBPP.”)

5. See JEFFREY H. KEEFE, ECON. POLICY INST., BRIEFING PAPER #290, ARE WISCONSIN PUBLIC EMPLOYEES OVER COMPENSATED? 1, 6 (2011) [hereinafter KEEFE WISCONSIN PUBLIC EMPLOYEES], available at http://epi.3cdn.net/9e237c56096a8e4904_rkm6b9hm1.pdf; see also Press Release, U.S. Senate Comm. on Fin., Hatch Warns that Public Employee Pension Plans Will Bankrupt State & Local Government If Nothing Is Done (Mar. 17, 2011), available at <http://finance.senate.gov/newsroom/ranking/release/?id=75f6d894-76af-4e23-96f4-97199f056750> (“In a floor speech today, U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, warned of the fiscal dangers involved with expensive public employee pension programs, the budget-busting burdens they impose on state and local governments, and called for fundamental reforms that put states in charge.”).

6. See JEFFREY H. KEEFE, ECON. POLICY INST., ISSUE BRIEF #294, DESPERATE TECHNIQUES USED TO PRESERVE THE MYTH OF THE OVERCOMPENSATED PUBLIC EMPLOYEE 1 (2011) [hereinafter KEEFE, DESPERATE TECHNIQUES], available at http://epi.3cdn.net/1e05db309d0aa64571_rxm6bngw8.pdf (“[P]roponents claim[] that overpaid public sector workers are a drag on state budgets.”); see also Mary Williams Walsh, *The Burden of Pensions on States*, N.Y. TIMES, Mar. 10, 2011, http://www.nytimes.com/2011/03/11/business/11pension.html?_r=1&ref=pensionsandretirementplans (“More money, from employers and employees in some combination, will be needed, and perhaps much more in coming years.”); Randy Diamond, *Public Pension Plans Slash Benefits Due to Economy*, BUS. INS., <http://www.businessinsurance.com/article/20100711/ISSUE01/307119995> (last visited May 17, 2011) (“At least 24 public pension funds have cut benefits this year as fallout from the financial crisis continues to affect the plans’ stability.”).

7. Press Release, Office of the Governor Scott Walker, Governor Walker Introduces Budget Repair (Feb. 11, 2011), available at http://walker.wi.gov/journal_media_detail_print.asp?prid=5622&locid=177. As of the writing of this article, the status of the Budget Repair Bill is very much up in the air. On March 24, 2011, a Wisconsin appeals court panel declined to take formal action on a circuit court order that has temporarily halted implementation of the law, and kicked the issue to the state supreme court. See *Wisconsin v. Fitzgerald*, No. 2011AP 613-LV (Wis. Ct. App. Mar. 24, 2011), available at [http://op.bna.com/drcases.nsf/id/czon-8f9ulv/\\$File/wisconsin.pdf](http://op.bna.com/drcases.nsf/id/czon-8f9ulv/$File/wisconsin.pdf). Thereafter, on March 25, 2011, although the Secretary of State did not publish the bill so that it took legal effect, the Wisconsin Legislative Reference Bureau (“LRB”) did. Motion for Leave to Withdraw Petition, for Leave to Appeal, to Withdraw Petition for Temporary Relief, and to Withdraw Motion For Relief Pending Appeal at 3-4 *Wisconsin v. Fitzgerald*, No. 2011AP 613-LV (Wis. Ct. App. Mar. 24, 2011). The question that must now be decided is whether the “publication” by the LRB, without the Secretary of State’s approval, constitutes enactment of the law. In all events, this litigation is premised on the allegation that the enactment of the Budget Repair Bill violated of the Wisconsin Open Meetings

emergency piece of legislation was to overcome a \$150 million dollar deficit in the short-term and a \$3.6 billion budget deficit by the end of 2013.⁸ The budget repair bill also, and controversially, strips most collective bargaining rights from most public-sector employees in Wisconsin.⁹ The debate over the value of collective bargaining rights in the public sector has led to massive protests in Wisconsin and other states,¹⁰ and has drawn the attention of the international news media to labor relations in the United States.¹¹

But the collective bargaining issue is really only tangentially related to Governor Walker's efforts to cut public employee pensions in the state.¹² Indeed, collective bargaining rights have very little to do with pensions in most states, as pensions are set by statute.¹³ Additionally, there is much debate over whether the current financial state of the Wisconsin Retirement System ("WRS") is even a contributing cause to its current budgetary situation.¹⁴ In any event, the effort by Walker to

Law. WIS. STAT. §§ 19.81-19.89 (2010).

8. See A.G. Sulzberger & Monica Davey, *Union Bonds in Wisconsin Begin to Fray*, N.Y. TIMES, Feb. 21, 2011, <http://www.nytimes.com/2011/02/22/us/22union.html> ("Mr. Walker, the new Republican governor who has proposed the cuts to benefits and bargaining rights, argu[es] that he desperately needs to bridge a deficit expected to reach \$3.6 billion for the coming two-year budget.").

9. See *id.* Indeed, the "non-fiscal" version of the budget repair bill, signed by Governor Walker on March 25, 2011, eliminates almost all collective bargaining rights—except for allowing limited negotiation over wages—for almost all public employees, except police and firefighters. See Press Release, Office of the Governor Scott Walker, *supra* note 7.

10. See Richard A. Oppel Jr. & Timothy Williams, *Rallies for Labor, in Wisconsin and Beyond*, N.Y. TIMES, Feb. 21, 2011, <http://www.nytimes.com/2011/02/27/us/27rally.html>; Joe Newby, *Thousands Protest in Los Angeles in Support of Public Sector Unions*, EXAMINER.COM (Mar. 28, 2011 11:47AM), <http://www.examiner.com/conservative-in-spokane/thousands-protest-los-angeles-support-of-public-sector-unions>.

11. See, e.g., Roger Wilkinson, *Wisconsin Unions Rally for Rights*, AL JAZEERA ENGLISH (Feb. 20, 2011, 13:02 GMT), <http://english.aljazeera.net/video/americas/2011/02/2011220115031136309.html> ("In the state of Wisconsin, roughly 100,000 people turned up for a fifth straight day of protests. Public sector workers accuse the state's Republican governor of using the crisis as a reason to attack their union rights.").

12. See Walsh, *supra* note 6 ("Despite the furor in Wisconsin, collective bargaining does not appear to be the main factor driving pension costs higher.").

13. See Gerald W. McEntee, *Don't Blame Public Pensions*, U.S.A. TODAY, Jan. 17, 2011, http://www.usatoday.com/printedition/news/20110118/editorial18_st1.art.htm (noting that public employee pension systems "predated public employee bargaining rights, and few plans are subject to the bargaining process today"); see also IOWA CODE ANN. § 20.9 (West 2010) (excluding all retirement systems from the scope of collective bargaining negotiations).

14. See CENTER ON WISCONSIN STRATEGY, *THE WISCONSIN RETIREMENT SYSTEM IS ONE OF THE HEALTHIEST IN THE COUNTRY* (2011), available at <http://www.cows.org/pdf/bp-WRS.pdf>. For instance, a recent report on the financial health of the Wisconsin public pension system concluded

curtail public pension rights as part of the budget repair bill has already led to the threat of lawsuits based on both federal and state constitutional grounds.¹⁵ A potential lawsuit in Wisconsin based on curtailment of public pension rights would be part of an increasing number of state law suits where government efforts to cut back public pension rights are meeting with fierce resistance.

This contribution to the symposium focuses both on one of the constitutional challenges that is common to all of these suits and focuses on the Wisconsin public pension situation in particular. Specifically, does the proposed Wisconsin budget repair bill provision that prohibits public employers to pay their employees' pension contribution share constitute an unconstitutional impairment of contract rights under the federal and Wisconsin state constitution?¹⁶ The answer to this question is quite complicated for at least three reasons: (1) state and municipal employers in Wisconsin have different pension arrangements based on how they are municipally classified under state law (i.e., are they a city of the 1st class?); (2) the legislative history of the employment retirement system may be substantially different even within a state like Wisconsin as a result of constitutional and statutory home rule provisions unique to each municipality; and (3) past litigation over public pension rights in Wisconsin and subsequent court-enforced settlements may also play an important role in deciding what pension reform measures can be undertaken by the state.

This Article proceeds in four parts. Part I provides an overview of state and local pension systems in the United States and highlights similarities and differences between public plans and private-sector pension plans. Part II then considers the funding status of public pension funds in the United States and analyzes some of the challenges that the Wisconsin pension plan is currently facing. Part III considers pending public pension litigation in other states. Part IV concludes by

that, "Wisconsin's pension system is on excellent financial footing and among the healthiest in the nation, according to multiple independent reports and an analysis by COWS [Center on Wisconsin Strategy] and CEPR [Center for Economic and Policy Research]."¹⁵ *Id.*; see also PEW CTR. ON THE STATES, *supra* note 4, at 3 (finding that Wisconsin was a fully funded pension system before the recession).

15. See, e.g., Letter from Grant F. Langley, City Attorney of Milwaukee, to Alderman Joseph A. Dudzik (Feb. 28, 2011) [hereinafter Langley Letter], available at <http://lawprofessors.typepad.com/files/langleyletter.pdf> (maintaining that pension provisions of the Budget Repair Bill unconstitutional as applied to Milwaukee city employees on three grounds).

16. The Clause provides, in pertinent part, that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts . . ." U.S. CONST. art. I, § 10, cl. 1.

setting up the framework for a potential Contracts Clause legal challenge and specifically explores whether a Contracts Clause challenge by Milwaukee city employees could be successful if the pension provisions of Wisconsin's budget repair bill are enacted in their current form. Part IV also asks if any lessons can be drawn from this pension analysis for other municipalities in Wisconsin or for other public pension plans in other parts of the country. As will be established, the answer to this last question depends on whether vested rights, benefits, or terms and conditions associated with the public pension plan would be impacted by the particular state pension reform legislation under investigation.¹⁷

I. OVERVIEW OF STATE AND PUBLIC PENSIONS

When many people think about employee benefits law in the United States, they naturally think of the Employee Retiree Income Security Act of 1974 ("ERISA").¹⁸ Congress enacted ERISA to protect employees' retirement and welfare benefits.¹⁹ Nevertheless, by its express terms, ERISA does not apply to "governmental plans."²⁰ Consequently, public employee pension schemes are regulated by the federal government for federal employees,²¹ and by state and local governments for their

17. A word of caution: pension scholar and expert, Olivia S. Mitchell of the Pension Research Council at the Wharton School of Business at the University of Pennsylvania is wary of "how much can be learned from one state to another" when it comes to public pensions. See Jonathan Miltimore, *States Eye MN Pension Lawsuit*, WATCHDOG (Aug. 24, 2010), <http://watchdog.org/6322/states-eye-mn-pension-lawsuit/> [hereinafter Miltimore, *States Eye*].

18. Employment Retirement Income Security Act ("ERISA") of 1974 § 1, 29 U.S.C. § 1001 (2006).

19. See ERISA § 2(b). Section 2 of ERISA contains the Findings and Declarations of Policy. Specifically, it states: "It is hereby declared to be the policy of the Act to protect . . . the interests of participants in employee benefit plans and their beneficiaries . . ." *Id.*; see also *Massachusetts v. Morash*, 490 U.S. 107, 112 (1989) (citing *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 15 (1987)) ("ERISA was passed by Congress in 1974 to safeguard employees from the abuse and mismanagement of funds that had been accumulated to finance various types of employee benefits.").

20. ERISA § 4(b) ("The provisions of this title shall not apply to any employer benefit plan if—such plan is a governmental plan (as defined in Section 3(32))." In turn, ERISA § 3(32) reads: "The term 'governmental plan' means a plan established or maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing." *Id.* § 3(32).

21. *But see Federal Employees: Bill Would End Federal Defined Benefit Pension*, BNA DAILY LABOR REPORT 57 DLR A-11 (Mar. 24, 2011) ("The defined benefit pension currently available to federal employees under the Federal Employees Retirement System would be eliminated for new hires starting in 2013 under a bill (S. 644) introduced March 17 by Sens. Richard Burr (R-N.C.) and Tom Coburn (R-Okla).").

employees.

As far as state and local government pension plans in the United States, their history has evidenced an initial period when such public plans shared many of the same characteristics as employer-provided pension plans in the private sector. More recently, because of developments in how pensions have been structured in the private-sector in the United States, there has been significantly more variation between public and private pension plans in the United States.

This state of affairs between private and public pension plans has not always been the case in the United States. For most of their history, public-sector pension plans were substantially identical to private-sector pension offered by larger employers.²² More recently, however, public pensions and private pensions have begun to look substantially different. This is primarily because most public-sector plans are defined benefit plans,²³ while most private-sector plans, including almost all new private-sector plans, are of the defined contribution variety.²⁴ In short, state and local workers have much broader access to defined benefit plans than defined contribution pension plans.²⁵

This difference in pension plan structure is crucial. In defined benefit plans (“DBPs”), “the burden is placed on the employer to contribute funds to the pension plan on an actuarially sound basis so that sufficient funds exist to pay the worker when he or she retires.”²⁶ DBPs

22. See Stockdale, McIntyre & Sauter, *supra* note 2.

23. See Payne & Pincus, *supra* note 3, at 13 (“[D]efined benefit plans still make up the bulk of the retirement plans in the public sector.”). *But see Federal Employees: Bill Would End Federal Defined Benefit Pension*, *supra* note 21 on the precarious position of federal employee defined benefit plans.

24. See COLLEEN E. MEDILL, INTRODUCTION TO EMPLOYEE BENEFITS LAW: POLICY AND PRACTICE 121-22 (3d ed. 2011) (showing that in 2007 in the private-sector there were 48,982 defined benefit plans (“DBPs”) and 658,805 DCPs and that there were more than three times as many DCP participants than DBP ones).

25. Whereas 87% of state government workers and 83% of local workers had access to participate in defined benefit pension plans, only 43% of state workers and 24% of local workers had access to defined contribution plans. See U.S. BUREAU OF LABOR STATISTICS, U.S. DEP’T OF LABOR, STATE AND LOCAL GOVERNMENT EMPLOYEE BENEFITS, MARCH 2010 (Mar. 9, 2011), http://www.bls.gov/opub/ted/2011/ted_20110309.htm. With defined contribution plans, “employers are only responsible to contribute money to employee’s individual plan accounts under [this] model and that is where their responsibility ends.” See Paul M. Secunda, *The Forgotten Employee Benefit Crisis: Multiemployer Benefits Plan on the Brink*, 21 CORNELL J. L. & PUB. POL’Y (forthcoming 2011) (manuscript at 11) [hereinafter Secunda *The Forgotten Employee Benefit Crisis*], available at <http://ssrn.com/abstract=1656093>. Common examples of such plans in the public sector include Section 457 and Section 403(b) plans. See MEDILL, *supra* note 24, at 104.

26. See Secunda *The Forgotten Employee Benefit Crisis*, *supra* note 25, at 11.

place the risk on the employer to invest enough in the present to fund the ongoing pension expenses that largely involve pension payments to current retirees.²⁷ The required minimum funding of DBP plans is calculated based on a complex actuarial analysis revolving around factors such as age, length of service, projected future salary increases, and rate of return on plan investments.²⁸

On the other hand, defined contribution plans (“DCPs”) place all of the respective risk (i.e., risk of longevity, risk of investment return, and risk on inflation) on the employee.²⁹ In a typical 401(k) or 403(b) plan, the employer provides a suitable menu of investment options to the employee and then may or may not match whatever salary contribution the employee makes to their individual pension account.³⁰ After that contribution, the employer is completely off the hook; they have no additional pension funding responsibilities.³¹ Such consumer-driven investment devices have the advantages of portability and permitting employees to have more control over their pensions.³² At the same time, however, the disadvantage of placing the onus of retirement security on employees is that they may be financially illiterate or just not properly focused on their retirements early on in their careers.³³ In any event, the DCP conundrum is one that primarily haunts the private sector as the switch to DCPs for public-sector plans has been primarily restricted to a

27. *See id.*

28. See PUB. PLANS PRACTICES TASK FORCE OF THE AM. ACAD. OF ACTUARIES, RISK MANAGEMENT AND PUBLIC PLAN RETIREMENT SYSTEMS 1 (2010) [hereinafter, AM. ACAD. OF ACTUARIES], available at http://actuary.org/pdf/pension/PPPTF_Final_Report_c.pdf (“Our findings regarding public pension systems . . . are independent of the financial crisis and encompass risks unlikely to go away with economic recovery.”); CTR. FOR STATE & LOCAL GOV’T EXCELLENCE, STATE AND LOCAL PENSIONS: AN OVERVIEW OF FUNDING ISSUES AND CHALLENGES 2 (2011) (“Defined benefit pension plan funding is based on assumptions developed and certified by enrolled actuaries. There are two types of assumptions: demographic and economic. Demographic assumptions include projected behaviors such as salary growth, mortality, and length of service. Economic assumptions include inflation and investment returns.”).

29. *See generally* Paul M. Secunda, *401K Follies: A Proposal to Reinvigorate the United States Annuity Market*, 30 A.B.A SEC. TAX’N 13, 13-15 (2010) [hereinafter Secunda *401K Follies*] (arguing that the shift from DBPs to DCPs is troubling in that it increases the risk for employees, while decreases the risk for employers).

30. *See id.* at 13-14.

31. *See Payne & Pincus, supra* note 3, at 13 (“Underfunding is never an issue with 401(k) plans because the retiree receives only what has been contributed and any investment returns. The risk is squarely on the worker if his or her investment choices do not perform up to expectations.”).

32. *See Secunda 401K Follies, supra* note 29, at 13-14.

33. *See id.* at 13 (“[N]o guarantee exists that a participant will receive any specified amount of benefit at retirement and many baby boomers are waking up to this strange new world of being in charge of their future retirement.”).

policy debate at this point.³⁴

In addition to this difference in pension structure in the public and private sectors—and as discussed in a recent task force report by the American Academy of Actuaries—public pension plans have begun to also significantly diverge in design and operation from private-sector pension plans under ERISA in many other important ways.³⁵ For instance, the following significant differences exist:

- (1) Less federal oversight, and thus more discretion is left to state and local jurisdictions;³⁶
- (2) Differences in the budgeting process and the applicable accounting standards;³⁷
- (3) Design issues, such as (a) the need to make up for the lack of Social Security participation and coverage, (b) the ability to have tax deductible member contributions and (c) the earlier mandatory retirement ages for police and firefighters; and
- (4) The higher degree of public transparency that accompanies governmental decision making.³⁸

What all this means is that it is simply not possible to consider the exact same private-sector pension reform proposals and apply them, without more, to the public sector. This is especially so because public pensions, of course, involve the government as employer. Consequently,

34. Compare Alicia H. Munnell, Op-Ed., *High Risks, High Costs*, N.Y. TIMES, Feb. 27, 2011, <http://www.nytimes.com/roomfordebate/2011/02/27/why-not-401ks-for-public-employees/401ks-high-risks-high-costs> (arguing against public sector plans moving in the defined contribution plan direction), with Joshua D. Rauh, Op-Ed., *Start Paying or Stop Promising*, N.Y. TIMES, Feb. 27, 2011, <http://www.nytimes.com/roomfordebate/2011/02/27/why-not-401ks-for-public-employees/start-paying-or-stop-promising> (arguing in favor of transforming public sector pension plans into defined contribution plans).

35. See AM. ACAD. OF ACTUARIES, *supra* note 28, at 3.

36. *Id.* For instance, many states do not require their public-sector plans to pre-fund at any given level, like ERISA does. See Payne & Pincus, *supra* note 3, at 13. This state of affairs has led to many state and local pension plans to be significantly underfunded. *Id.* (“Unlike employers in the private sector, which must follow ERISA’s minimum funding requirements, most states are not required to pre-fund their plans at any level. This complete discretion has permitted some states to ‘kick the can down the road’ and put off making their required pension contributions year after year.”).

37. AM. ACAD. OF ACTUARIES, *supra* note 28, at 3.

38. *Id.*

every time that the state employer seeks to modify or amend the pension structure for employee pensions, there are a host of constitutional concerns that must be potentially considered.

For instance, under a Contracts Clause claim under the federal or state constitution, plaintiffs may obtain injunctive relief to bar the enforcement of pension reform which cuts back on already earned or vested pension rights and benefits.³⁹ Remedies are limited, however, to injunctive relief because of the operation of the Eleventh Amendment of the Constitution and the doctrine of sovereign immunity.⁴⁰ Nevertheless, the Takings Clause of the Fifth and Fourteenth Amendments of the Constitution may provide “just compensation,” because the cutting back of pensions may constitute an abridgement of a property right.⁴¹ Finally, because these claims are brought pursuant to the civil rights procedural vehicle of Section 1983,⁴² prevailing plaintiffs may also be entitled to their attorney fees and costs.⁴³

All of these constitutional considerations are absent when private employers seek to amend, modify, or terminate their pension benefits, because there is a lack of state action.⁴⁴ In short, a whole different set of legal considerations must be taken into account if a government employer wishes to cut back on public pension benefits in order to save

39. See Payne & Pincus, *supra* note 3, at 13.

40. See Paul M. Secunda, *Whither the Pickering Rights of Federal Employees?*, 79 U. COLO. L. REV. 1101, 1111 n.59 (2008) (“[S]tate employers may be able to avail themselves of sovereign immunity under the Eleventh Amendment, and responsible agents of the employers may be able to avoid individual damages liability if they show they are eligible for qualified immunity, though they may still be subject to injunctive relief.” (citing ERWIN CHERMERINSKY, *FEDERAL JURISDICTION* § 8.6.3, at 529 (4th ed. 2003))).

41. See U.S. CONST. amend. V; *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 122 (1978) (holding that Takings Clause “is made applicable to the states through Fourteenth Amendment” (citing *Chicago, B. & Q. R. Co. v. City of Chicago*, 166 U.S. 226, 239 (1837))); See also *Prof'l Firefighters Ass'n of Omaha, Local 385 v. City of Omaha*, No. 8:10CV198, 2010 WL 2426446, at *5 (D. Neb. June 10, 2010) (finding that cutting pension benefits can constitute an abridgement of a property right). Indeed, most states have found that pensions are a form of deferred compensation and constitute a property right. See Amy B. Monahan, *Public Pension Plan Reform: The Legal Framework*, 5 EDUC., FIN. & POLICY 617, 625 (2010).

42. 42 U.S.C. § 1983 (2006).

43. *Id.* § 1988(b). Nevertheless, in order for plaintiffs to prevail, they must actually win a judgment affixed with the court's imprimatur, and not simply win a favorable settlement against the state. See *Buckhannon Bd. & Care Home, Inc. v. West Virginia Dep't of Health & Human Res.*, 532 U.S. 598, 605 (2001).

44. See George Rutherglen, *State Action, Private Action, and the Thirteenth Amendment*, 94 VA. L. REV. 1367, 1370 (2008) (“All the . . . provisions of the Constitution regulate the structure and function of government, and if they confer individual rights, they protect only against ‘state action,’ in the broad sense of action by the federal government as well as by the states.”).

the state money. If such considerations are not taken into account, not only will the state not save money, but the state may well end up losing additional money in expensive and time-consuming constitutional litigation.

II. THE PUBLIC PENSION FUNDING CRISIS IN THE UNITED STATES AND THE CASE OF THE WISCONSIN RETIREMENT SYSTEM

A crucial way in which public and private pensions continue to differ is the extent to which these plans are currently underfunded. Private-sector pensions—these days mostly invested in self-directed 401k accounts—suffered greatly during the financial crisis from 2007-2009, as they held many securities subject to the vagaries of the equities market.⁴⁵ However, as those same markets begin to recover, there are signs that these private-sector plans will again return to health.⁴⁶

Of course, and as just discussed, a larger percentage of these private-sector pension plans are now defined contribution plans, meaning that employers are generally not responsible for having sufficient funds on hand when employees retire.⁴⁷ These employers simply make a one-time contribution (or none at all if the employer is dealing with a Section 401(k) deferral plan without a matching contribution) and there are no subsequent pension funding responsibilities. Simply put, employees in the defined benefit context are left with the responsibility of planning so that they have enough in their pension fund account when they retire.⁴⁸

Because most public pension plans are DBPs, employers are responsible for maintaining the financial health and actuarial soundness of these plans so that sufficient funds exist to pay their employees

45. See STEPHEN P. UTKUS & JEAN A. YOUNG, VANGUARD GRP. INC., THE GREAT RECESSION AND 401(K) PLAN PARTICIPANT BEHAVIOR 3 (2011), available at <https://institutional.vanguard.com/iam/pdf/CRRGR.pdf?cbdForceDomain=true>. (“DC plan participants endured a dramatic collapse in global stock prices from the market peak in October 2007 to its trough in March 2009, as well as a severe economic recession.”).

46. See *id.* at 1 (“Despite the substantial market and economic shock of 2008–2009, defined contribution (DC) retirement plan savings for most participants continued to grow over three- and five-year periods. Most metrics of participant saving and investing behavior returned to prerecession levels in 2010.”).

47. See *supra* note 23-34 and accompanying text.

48. See *Secunda 401K Follies*, *supra* note 29, at 14. I have argued elsewhere that this reliance on defined contribution plans in the private-sector is likely to go on to lead to a massive retirement income security problem in the United States. See *Id.*

pensions during their retirement.⁴⁹ Additionally, as with all defined benefit plans in the United States, the Pension Protection Act of 2006 (“PPA”)⁵⁰ now subjects these plans “to a 100% of current liability funding target, requiring higher funding of ‘at risk’ DB plans and imposing new benefit limits on underfunded DB plans.”⁵¹

The funded status of state and local government-sponsored pension plans is a major concern for millions of public sector workers, retirees, and their family members who are the beneficiaries of these plans.⁵² This is as a consequence of insufficient levels of state savings leading to a public pension funding gap of some \$731 billion projected over the next thirty years.⁵³ More problematically, only a third of American states have put aside sufficient money to fund their pensions, and some twenty states have funding levels below 80%, which is considered an unhealthy rate.⁵⁴ As will be discussed below, this underfunding of public pension plans has led some states to reduce promised pension payouts to retired plan members, which in turn, has led to a number of public pension lawsuits.⁵⁵

Actually, one of the more financially healthy public pension plans exists in Wisconsin.⁵⁶ Currently, the average public worker in Wisconsin gets about 57% of their pre-retirement salary replaced in retirement, the eighth most generous state as far as replacement ratios.⁵⁷ Most public-sector employees are able to retire at age fifty-seven with a

49. See Payne & Pincus, *supra* note 3, at 13.

50. Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780 (codified at 29 U.S.C. § 1001). President Bush signed the PPA into law on August 17, 2006. *Id.*

51. Chris Panteli, *Releasing the Pressure*, GLOBAL PENSIONS, Mar. 2011, at 20.

52. See CTR. FOR STATE & LOCAL GOV’T EXCELLENCE, *supra* note 28, at 4 (“According to the U.S. Census Bureau, public pension funds distribute more than \$175 billion in benefits annually to more than 7.7 million Americans, paying an average yearly benefit of some \$22,700.”).

53. See Chris Panteli, *Sad State of Affairs*, GLOBAL PENSIONS, Mar. 2011, at 22 [hereinafter Panteli, *Sad State of Affairs*]. The Pew Center on the States estimate that the total cost of providing pension benefits to all public employees in the United States will run exceed over \$2.73 trillion dollars and that the average total funding level is only at about 85% or \$2 trillion dollars right now. *Id.* Even worse, “[r]esearchers at Boston College’s Center for Retirement Research estimate that aggregate funding ratios will decline to 72 percent by 2013 under the most likely scenario.” CTR. FOR STATE & LOCAL GOV’T EXCELLENCE, *supra* note 28, at 4.

54. Panteli, *Sad State of Affairs*, *supra* note 53, at 22; See PEW CTR. ON THE STATES, *supra* note 3, at 4.

55. See *infra* Part III.

56. See Walsh, *supra* note 6 (“Wisconsin turned out to have the eighth-richest pensions of any state, replacing on average 57 percent of a worker’s pay in retirement.”).

57. See *id.*

full pension if they have at least thirty years of services.⁵⁸ For police and firefighters, they can retire at age fifty-three with a full pension if they have twenty-five years of service.⁵⁹

Yet, as generous as these pension benefits might appear, recent studies do not indicate that public-sector employees make more overall compensation (i.e., wage plus benefits) than their private-sector counterparts, as those who have argued against public employee pension rights have maintained.⁶⁰ Even if public employees have slightly more generous benefits (a common figure is about 5% more generous on average),⁶¹ public employees make less in wages.⁶²

For instance, a recent study by labor economist Jeffrey Keefe found that, “state and local government employees in Wisconsin are not overpaid.”⁶³ More specifically, when controlling for education, experience, organization size, gender, race, ethnicity, citizenship, and disability, public sector employees in Wisconsin earn anywhere from 4.8% to 8.2% less compensation than comparable private-sector employees.⁶⁴ The reason that these figures are important is that they play a prominent role in leading state officials to target public pensions as an unnecessary extravagance that state governments can no longer afford.⁶⁵ Not only are public employees not overpaid, but arguments that suggest that public employees represent a wasteful use of tax money do not consider that: (1) most pension benefits are set by statute,⁶⁶ (2) pension payments represent deferred compensation for which employees have bargained for in exchange for foregoing wages in the present,⁶⁷ and (3) without such benefits, there is evidence that there would be a mass exodus out of the public service and into the private sector.⁶⁸

58. *See id.*

59. *See id.*

60. *See* KEEFE WISCONSIN PUBLIC EMPLOYEES, *supra* note 5, at 1.

61. *See id.* at 2.

62. *See id.* at 9.

63. *Id.* at 1.

64. *See id.*

65. *See id.* at 2.

66. *See supra* note 13 and accompanying text.

67. *See* Lorraine A. Schmall, *Keeping Employer Promises When Relational Incentives No Longer Pertain: “Right Sizing” and Employee Benefits*, 68 GEO. WASH. L. REV. 276, 278 (2000) (“[E]mployees own their pension expectancies—what they thought they were promised in exchange for working at a rate of pay that reflects contributions to their deferred benefits.”).

68. *See* PEW CTR. ON THE STATES, *supra* note 3, at 3 (“Public sector retirement benefits provide a reliable source of post-employment income for government workers, and they help public employers retain qualified personnel to deliver essential public services.”); Schmall, *supra* note 67, at 283 (“Firms that sponsor plans clearly benefit from them—firms are assured a better and more

Yet, even in Wisconsin, where pension funding is considered a model for the rest of the country,⁶⁹ there is still a need to consider larger issues that face the state pension system. For instance, the state agency that operates public pensions in Wisconsin, the Department of Employee Trust Funds, prepared an analysis to see whether it had based its assumptions on investment gains that were too high.⁷⁰ In fact, “[t]he study prepared . . . was not expected to show, and did not show, that it has been relying on an unrealistic assumed rate of investment return.”⁷¹ This is certainly good news for the Wisconsin Retirement System, because even if investment return assumptions had to be lowered by as little as 1%, that could have translated into requiring a 12% pension contribution per employee.⁷² Nevertheless, even the “eighth richest pension plan” has problems that it still must address, including: “most retirees in the system have seen their pensions reduced 4.6% in the last three years, and some retirees have experienced a 40% decrease in the last three years due to the global economic crisis in 2008.”⁷³

The take-home point here is that even the best funded public pension plans, like Wisconsin’s, may have substantial challenges in the post-global recession environment. As a result of the current financial state of public pension funds, state officials will likely continue to look for ways to reduce pension payments as a way to reduce costs.⁷⁴ Because such state actions will interfere, in many cases, with public employees’ pension rights, there will inevitably be a continuing trend of public pension litigation in the United States for the foreseeable future.

The next section considers public pension litigation that has already commenced in the last few years as a consequence of states beginning to reduce public employee pension rights.

stable workforce, and both firms and employees receive tax advantages through the payment of deferred, rather than current, compensation.”).

69. PEW CTR. ON THE STATES, *supra* note 3, at 56 (giving the Wisconsin public pension system its highest grade of “solid performer” in 2010).

70. *See* Walsh, *supra* note 6. For instance, Illinois recently lowered its actuarial assumptions from 8.5% to 7.75%. *See* Pantelli *Sad State of Affairs*, *supra* note 53, at 23.

71. *See* Press Release, David A. Stella, Wisconsin Department of Employee Trust Funds, ETF Responds to New York Times (Mar. 11, 2011), *available at* http://etf.wi.gov/news/ht_20110311.htm.

72. *See* Walsh, *supra* note 6.

73. *See* Stella, *supra* note 71.

74. *See* PEW CTR. ON THE STATES, *supra* note 3, at 30 (“[S]tates’ pension systems will suffer from their recent investment losses for many years to come. These losses affected virtually every large state pension system in the country, sending assets plummeting and leading some policy makers and experts in the field to question longstanding assumptions about asset growth.”).

III. PENDING CONTRACTS CLAUSE CHALLENGES IN OTHER STATES

Although the reality of public pension litigation in Wisconsin has not yet occurred as of the writing of this article, public pension litigation is currently pending in Colorado, Minnesota, and South Dakota.⁷⁵ In these states, state legislation has sought to cut public pension expenses by lowering pension cost of living adjustments (“COLAs”) received by current retirees. The next sections consider the status of the pending public pension litigation in these three states.

A. Public Pension Litigation in Minnesota

In 2010, a group of Minnesota retirees filed a class action lawsuit, *Swanson v. Minnesota*,⁷⁶ against the State of Minnesota for an attempt to curtail pension cost-of-living adjustment increases for current state job retirees and their survivors.⁷⁷ More specifically, the Amended Complaint seeks: (1) declaratory relief providing that the Minnesota retirement legislation violates the Contract Clause of the Minnesota and Federal Constitutions; (2) a finding that the pension provisions violate the Takings Clause of the Minnesota and Federal Constitutions; and (3) an award seeking individual relief against the plaintiffs in their official capacities under Section 1983 for various federal constitutional

75. Additional pension litigation could also be forthcoming in New Mexico and New Hampshire, where the state has either passed—or is about to pass—legislation impacting public employee pension benefits. See William H. Carlisle, *Public Plans: New Mexico Legislature OKs Bill to Increase State Employees' Pension Contributions*, BNA PENSION AND BENEFITS DAILY, Mar. 25, 2011, http://news.bna.com/pdln/display/batch_print_display.adp?searchid=14226065 (“New Mexico state workers and educators will be required to pay more into their pensions while government payroll contributions will shrink correspondingly, under legislation (H.B. 628) that awaits action by Gov. Susana Martinez (R.)”); Jane Blume, *New Hampshire's Quiet Revolt Against Public Employees*, INT'L ASS'N OF FIRE FIGHTERS FRONTLINE BLOG (Mar. 24, 2011 12:25PM), <http://blog.iaff.org/post/2011/03/24/New-Hampshiree28099s-Quiet-Revolt-Against-Public-Employees.aspx> (“Public workers will now contribute more money to their pensions. Fire fighters are looking to pay 11.8 percent for their retirement contribution, up from 9.3 percent. In addition, any fire fighter who has worked less than 10 years will have to stay on the job for an extra five years.”).

76. See Amended Complaint at 5, *Swanson v. Minnesota*, No. 62-CV-10-5285 (Minn. Dist. Ct. July 2, 2010), available at http://minnesotapensions.com/yahoo_site_admin/assets/docs/2010-07_Amended_Complaint.236143205.pdf. There are approximately 130,000 retirees and their survivors in the class. *Id.* at 5-6.

77. See Amy Merrick, *Case Tests Retirees' Pension Cuts*, WALL ST. J., Sep. 15, 2010, <http://online.wsj.com/article/SB10001424052748704190704575489872547566554.html>.

violations.⁷⁸

The lawsuit was in response to Minnesota enacting a new pension COLA provision that either lowered the increase in benefits retirees received (which was originally set to increase at a flat rate of 2.5%) or completely abolished the increase altogether.⁷⁹ For the Teachers Retirement Association, for instance, there will be a freeze on any increases for two years.⁸⁰ The State intends to keep its new legislation in place until the pension plans are 90% funded, even though these plans had not been funded at this level between 1975 and 2009.⁸¹ This would mean that a current retiree who receives an annual pension of \$29,076⁸² would lose more than \$28,000 over a ten-year period if the new law were found valid.⁸³

The retirees have stated that in the past courts have only allowed benefits for current retirees to be reduced when the “employer funding the pension plans is on the brink of insolvency,”⁸⁴ and the retirees argue Minnesota is not anywhere close to going bankrupt.⁸⁵ The central theme to the retirees’ argument is that “[t]he retirement benefits from the Statewide Pension Plans that Plaintiffs and Class Members receive are an integral and significant part of their compensation for public service,”⁸⁶ and once they retired, they “acquired vested rights to their pensions, including the right to statutory postretirement adjustments to their pension benefits.”⁸⁷ Furthermore, the attorneys argue that there could be a Takings Clause issue because the State is taking private property for public use without just compensation.⁸⁸

78. See Amended Complaint, *supra* note 73, at 13-17.

79. See *id.* at 1, 9-13.

80. Miltimore, *States Eye*, *supra* note 17.

81. Amended Complaint, *supra* note 73, at 11.

82. This is the average annual pension benefit payout in 2008 for retirees with thirty years of service or more in one of the major pension funds. *Id.* at 12.

83. *Id.*

84. Merrick, *supra* note 77.

85. *Id.* The Center for Retirement Research at Boston College Public Plan Database shows that Minnesota’s State Employee public-sector plan was 85.9% funded in 2009, while the Teachers Retirement Fund was 77.4% funded in 2009. See *Public Plans Database Search Data*, CTR. FOR RETIREMENT RESEARCH AT BOSTON COLL., <http://pubplans.bc.edu/pls/htmldb/f?p=198:10:2817977085192158::NO:RP,10::> (last visited Apr. 25, 2011) (select “2009” as the year; then select “Minnesota” as the state; then select the variable group titled “Funding and ARC;” then click “Generate Table”).

86. See Amended Complaint, *supra* note 73, at 7.

87. *Id.* at 8.

88. See Timothy Inklebarger, *COLA Reduction Laws Under Fire in 3 States*, PENSIONS &

The State of Minnesota has responded that retirees have no legal right to any specific formula for benefit increases and that increases to future benefits are “subject to reasonable legislative actions that are intended to preserve the fiscal integrity and stability of Minnesota’s public employee pension plans.”⁸⁹ The State also maintains that the cases cited by the retirees have no bearing on the current case because Minnesota’s laws on worker rights are distinctively different from the states cited by the retirees since those cases involved states that have collective bargaining contracts.⁹⁰ The State further claims that the “legislature has clearly defined authority to adjust benefits to accommodate retirees, current employees and taxpayers.”⁹¹ In its objection to plaintiffs’ request for additional time for discovery, the State of Minnesota contended that its “case law made it clear the State had the right to modify benefits because no contract [implied or expressed] existed between the employees and the state.”⁹² The plaintiff retirees have now filed a motion for summary judgment.⁹³

As of the writing of this article, discovery has been completed and the court heard oral argument on cross motions for summary judgment on the Contracts Clause allegations on March 22, 2011,⁹⁴ and a decision is due on that motion within ninety days.⁹⁵

INVESTMENTS, Oct. 4, 2010,
<http://www.pionline.com/apps/pbcs.dll/article?AID=/20101004/PRINTSUB/310049980&crit=cola%20reduction%20laws>.

89. Joint Answer of Defendants to Amended Complaint at 2, *Swanson v. Minnesota*, No. 62-CV-10-05285 (Minn. Dist. Ct. July 30, 2010), available at http://minnesotapensions.com/yahoo_site_admin/assets/docs/2010-07-30_Joint_Answer_of_Ds_to_the_Amended_Complaint.236143313.pdf.

90. Jonathan Miltimore, *Minnesota Judge OK’s Discovery in Pension Suit*, WATCHDOG (Sept. 15, 2010 7:24AM), <http://watchdog.org/6571/Minnesota-judge-oks-discovery-in-pension-suit/> [hereinafter *Miltimore Discovery in Pension Suit*]. An interesting twist in this case is that the public employee unions supported the pension changes “because it protected [their] defined-benefit pensions by taking responsible actions to stabilize the pension funds,” though a union spokeswoman has admitted the support was given “reluctantly”. Merrick, *supra* note 74.

91. *Miltimore Discovery in Pension Suit*, *supra* note 90; see Joint Answer of Defendants to Amended Complaint, *supra* note 89, at 13-14.

92. *Miltimore Discovery in Pension Suit*, *supra* note 90.

93. Plaintiffs’ Memorandum in Support of Motion for Summary Judgment, *Swanson v. Minnesota*, No. 62-CV-10-05285 (Minn. Dist. Ct. Jan. 28, 2011), available at http://minnesotapensions.com/yahoo_site_admin/assets/docs/1-28-11_Ps_memo_in_sup_of_motion_for_sj.29194501.pdf.

94. See Halunen & Assocs. & Stember Feintein Doyle & Payne, LCC, *Minnesota Pensions Lawsuit*, MINNESOTA PENSIONS, <http://www.minnesotapensions.com> (last visited Apr. 25, 2011).

95. See MINN. STAT. § 546.27 (2010).

B. Public Pension Litigation in South Dakota

In Spring 2010, South Dakota passed a bill, SB 20, which reduced the annual cost of living adjustment increases for covered state employees from 3.1% to 2.1%.⁹⁶ This new law also put a cap on the amount that benefits could rise as a function of how much money is in the retirement system's market funds.⁹⁷

On June 11, 2010 four retirees—two retired judges, a professor, and a dean, all from Rapid City—filed a class action suit claiming the pension law was unconstitutional.⁹⁸ According to the plaintiffs, the change in cost of living adjustment increases could cause a retiree who receives \$36,000 in pension benefits a year to lose anywhere from \$40,000 to \$77,000 in benefits over the next twenty years.⁹⁹

The plaintiffs argue that the law violates the federal and South Dakota's Constitutions' Impairment of Contracts Clause by breaking its pension contract with the retirees.¹⁰⁰ The retirees contend that South Dakota's retirement system is one of the best funded in the country, so the system's strength is not the issue.¹⁰¹ Instead, the issue the retirees are concerned with is the "unilateral renegeing on that promise."¹⁰² Furthermore, the retirees argue that there could be a takings clause issue because the state is taking private property for public use without just compensation.¹⁰³

The state's counsel has responded to these contentions by arguing that South Dakota law allows the State to correct the system if the funding becomes too low, and that is what this new law does, because

96. See Complaint at 7-8, *Tice v. South Dakota*, Civ. No. 10-225 (S.D. Cir. Ct. June 11, 2010) (on file with author); David Montgomery, *State Pension Law Challenged in Court*, CAP. J. June 15, 2010, <http://www.capjournal.com/articles/2010/06/15/news/doc4c1718f0bad34188269589.txt> (last visited Mar. 17, 2011).

97. See Montgomery, *supra* note 96.

98. Complaint, *supra* note 96, at 2, 10-13.

99. *Id.* at 8-9; Montgomery, *supra* note 96.

100. Complaint, *supra* note 96, at 10-13; Montgomery, *supra* note 96.

101. Andrea J. Cook, *Former Rapid City Judge, Three Others Sue State Over Retirement Benefits Law*, RAPID CITY J., June 15, 2010, http://www.rapidcityjournal.com/news/article_dbc1f33a-78bc-11df-b4d8-001cc4c002e0.html. The Center for Retirement Research at Boston College Public Plan Database shows that the South Dakota public pension plan was 91.8% funded in 2009. See *Public Plans Database Search Data*, *supra* note 81 (select "2009" as the year; then select "South Dakota" as the state; then select the variable group titled "Funding and ARC;" then click "Generate Table").

102. Cook, *supra* note 101.

103. Complaint, *supra* note 91, at 12-14; Inklebarger, *supra* note 88.

the new law will save around \$368 million in thirty years.¹⁰⁴ As of April 2011, discovery and depositions have just begun in this case.

C. Public Pension Litigation in Colorado

In February 2010, the Colorado Legislature passed Senate Bill 10-001, and it was signed into law by Governor Ritter on February 23, 2010.¹⁰⁵ Designed to reduce the funding deficit of the public pension fund,¹⁰⁶ S.B. 10-001, among other things, reduced the COLA from a fixed rate of 3.5% to a rate that changes annually, but may not exceed 2%.¹⁰⁷

Even though only one-fourth of public-sector workers are granted collective bargaining powers in Colorado, the public pension benefits of Colorado are rated as the most generous in the country.¹⁰⁸ These pension benefits replace 90% of salary and have annual compounding that helps them keep up with the rate of inflation.¹⁰⁹ Although the State has tried to reduce this compounding of benefits, covered state workers have sued under the Contracts Clause to prevent this from happening.¹¹⁰

In any event, this new COLA rate is potentially in direct conflict with the benefits booklet handed out to retirees, which states that the pension fund will increase the retiree's benefit each year by 3.5% compounded annually.¹¹¹ The new law could cost a retiree who receives an annual pension of \$33,264 a loss of more than \$165,000 in benefits over twenty years.¹¹²

104. Cook, *supra* note 101.

105. Order Granting in Part and Denying in Part Defendants' Motion to Dismiss at 1, *Justus v. Colorado*, No. 2010 CV 1598 (Colo. Dist. Ct. Sept. 14, 2010), available at <http://saveperacola.files.wordpress.com/2010/10/judge-hyatt-defts.pdf>.

106. See *id.* The Center for Retirement Research at Boston College Public Plan Database shows that Colorado's public pension plans for "municipal" and "state" employees were significantly underfunded, at 76.2% and 67% funded, respectively, in 2009. See *Public Plans Database Search Data*, *supra* note 85 (select "2009" as the year; then select "Colorado" as the state; then select the variable group titled "Funding and ARC;" then click "Generate Table").

107. Jeannette Neumann, *Pension Cuts Face Test in Colorado, Minnesota*, WALL ST. J., June 12, 2010, <http://online.wsj.com/article/SB10001424052748704463504575301032631246898.html>.

108. See *Walsh*, *supra* note 6. *Part of the reason Colorado's public sector pension benefits are so generous is because public workers are not permitted to participate in Social Security, so that is the only pension they receive.* *Id.*

109. *Id.*

110. See *id.*; Second Amended Class Action Complaint at 11, *Justus v. Colorado*, No. 2010 CV 1598 (Colo. Dist. Ct. Sept. 14, 2010) (on file with author).

111. See Neumann, *supra* note 107.

112. *Id.*; Second Amended Class Action Complaint, *supra* note 105, at 9.

Three days after the State enacted this bill, a group of plaintiffs filed a class action lawsuit against the State to overturn the portion of the bill that decreases the COLA.¹¹³ The retirees rely on a 2004 opinion written by then-Attorney General Ken Salazar, that a retired public-sector workers' pension is a vested contractual obligation that is not subject to unilateral change of any type.¹¹⁴ The retirees argue that this makes the new law unconstitutional because it "impairs the retirees' contractual rights to receive pension benefits at the level promised" when the employees retired.¹¹⁵

The State responded to the retirees' arguments by contending that it would defy both law and logic to hold that the COLA could never be changed.¹¹⁶ It also stressed the fact that "preserving the solvency of the Public Employees' Retirement Association is a legitimate governmental interest."¹¹⁷ Of course, Colorado put itself in this funding mess in the first place by paying only between 50% and 70% of its actuarially required contribution between 2002 and 2008, resulting in an additional \$2.4 billion in plan underfunding.¹¹⁸

In May 2010, Colorado filed motions to dismiss six of the retirees' eight claims.¹¹⁹ The State maintained that the retirees' use of Colorado's Constitution for its Impairment of Contracts Clause was misplaced because that provision only applied to modifying obligations owed to the state, not obligations made by the state.¹²⁰ Last, the State contended in its motion that pension benefits are not a fundamental right protected by the U.S. Constitution, and that there was a rational basis for the State's actions.¹²¹

113. See Marianne Goodland, *Ruling on PERA Bill Expected Shortly*, COLO. STATESMAN, July 11, 2010, <http://www.coloradostatesman.com/content/991958-ruling-pera-bill-expected-shortly>.

114. See Changes to PERA Retirement Benefits and Contributions, Op. Att'y Gen. Colo. No. 04-4 (2004) available at http://saveperacola.files.wordpress.com/2010/01/changes_to_pera.pdf (maintaining that "actuarial[] necess[ity]" applies only to those PERA members who are "partially vested").

115. Goodland, *supra* note 113.

116. Neumann, *supra* note 107.

117. *Id.*

118. See Payne & Pincus, *supra* note 3, at 13.

119. Goodland, *supra* note 113.

120. See Goodland, *supra* note 113; see also COLO. CONST. art. II, § 11, art. V, § 38. The Colorado Constitution provides that "[n]o obligation or liability of any person, association, or corporation, held or owned by the state, or any municipal corporation therein, shall ever be exchanged, transferred, remitted, released, or postponed or in any way diminished by the general assembly." COLO. CONST. art. V, § 38. This provision is very similar to the Contracts Clause in the Federal Constitution. See U.S. CONST. art. I, § 10.

121. PERA Defendants' Reply in Support of Motion to Dismiss First Amended Class Action

On September 14, 2010, the court denied in part and granted in part Colorado's motion to dismiss. The court granted the motion to dismiss with regard to the requests for monetary damages under Section 1983 and for federal constitutional claims, but the parties stipulated to dismissal of those claims.¹²² On the other claims, including the impairment of contract claims under the Federal and Colorado State Constitution, the court denied Colorado's motion to dismiss.¹²³

On November 23, 2010, the plaintiff retirees filed a motion for partial summary judgment on the Colorado Constitution impairment of contract claim.¹²⁴ The retirees alleged that they had a contractual right to a particular cost of living adjustment formula, specifically the formula in place when they retired or became eligible to retire.¹²⁵ On February 23, 2011, the plaintiffs filed a second amended complaint, seeking class certification¹²⁶ and bringing claims seeking: (1) declaratory relief that the Colorado PERA COLA provisions violate the Colorado and Federal Constitution's Contract Clause; (2) that those provisions violate the Takings Clause of the Federal Constitution; (3) that those provisions violate the substantive component of the Due Process Clause under the Federal Constitution; and (4) seeking individual relief against defendants in their official capacities under Section 1983 for violation of the various federal constitutional provisions alleged in the previous accounts.¹²⁷ As of March 29, 2011, the parties have now both filed cross-motions for

Complaint at 2, *Justus v. State of Colo.*, 2010 CV 1589 (Colo. Dist. Ct. June 23, 2010), available at <http://saveperacola.files.wordpress.com/2011/04/2010-06-23-pera-defs-reply-in-support-of-motion-to-dismiss1.pdf>.

122. Order Granting in Part and Denying in Part Defendants' Motion to Dismiss at 3, *Justus v. State of Colo.*, 2010 CV 1589 (Colo. Dist. Ct. Sept. 14, 2010), available at <http://saveperacola.files.wordpress.com/2010/10/judge-hyatt-defs.pdf>.

123. *See id.*

124. Plaintiffs' Motion for Partial Summary Judgment at 4, *Justus v. State of Colo.*, 2010 CV 1589 (Colo. Dist. Ct. Nov. 23, 2010), available at <http://saveperacola.files.wordpress.com/2011/02/2010-11-23-plaintiffs-motion-for-partial-summary-judgment.pdf>.

125. *See id.* at 3.

126. *See* Plaintiffs' Second Amended Class Action Complaint at 3-4, *Justus v. State of Colo.*, 2010 CV 1589 (Colo. Dist. Ct. Feb. 23, 2011) (on file with author). The amended complaint seeks certification of two subclasses – one involving current retirees in the Denver Public School Division and the other subclass involving current retirees in all other covered public employment in Colorado. *Id.* at 4. The two sub-classes are estimated to contain about 100,000 members. *Id.*

127. *Id.* at 10-13. The allegations are very similar to the claims being advanced in the Minnesota and South Dakota public pension litigation because the same national law firm, Stember Feinstein Doyle & Payne (www.stemberfeinstein.com) of Pittsburgh filed all three public pension litigations. *See supra* Part III.A-B.

summary judgment.¹²⁸

IV. POTENTIAL WISCONSIN PUBLIC PENSION LITIGATION

In discussing likely Wisconsin pension litigation, it is important to keep in mind that what might be a crucial issue under one state's pension plan might be completely irrelevant to another. For instance, National Association of State Retirement Administrators Research Director Keith Brainard thinks that, "[t]he lessons of Minnesota and Colorado will be interesting, but they also won't be considered absolute guidance."¹²⁹ For his part, Ronald Snell, director of the state services division of the Denver office of the National Conference of State Legislatures, also shared the same sentiment, commenting that "regardless of the outcome of the three pending cases [in South Dakota, Minnesota, and Colorado], states could still move forward with their own plans to reduce COLAs because state courts are not bound by the decisions of other state courts."¹³⁰ On the other hand, other public pension officials believe that these public pension cases will "go a long way to lead other legislators in how they deal with pensions in the future."¹³¹

In any event, the relevant comparison in Wisconsin is not to reducing pension COLAs, but with regard to whether the Wisconsin Budget Repair Bill impermissibly impairs contractual obligations between certain Wisconsin public employees and the state under the Wisconsin and Federal Constitutions' Contracts Clause provisions.

A. Overview of Contracts Clause Legal Analysis

The federal version of the Contracts Clause, in pertinent part, provides that, "No State shall . . . pass any . . . Law impairing the

128. PERA Defendant's Motion for Summary Judgment, *Justus v. State of Colo.*, 2010 CV 1589 (Colo. Dist. Ct. Mar. 18, 2011) (on file with author); Plaintiffs' Reply Brief in Support of its Motion for Partial Summary Judgment, *Justus v. State of Colo.*, 2010 CV 1589 (Colo. Dist. Ct. Mar. 29, 2011) (on file with author).

129. Neumann, *supra* note 107.

130. Inklebarger, *supra* note 88.

131. Panteli, *supra* note 53, at 22 (quoting Dave Urbanik, Illinois Teachers Retirement System spokesman). The same article points out that some states, like Illinois, have a state constitutional provision that "protects pension benefits and does not allow the state to lower them once they've been set for an employee." *Id.* This is particularly problematic in Illinois where the state's retirement system is now at a funding level of about 35%. *Id.* at 23.

Obligation of Contracts.”¹³² Similarly, the Wisconsin State Constitution states, “[n]o . . . law impairing the obligation of contracts, shall ever be passed.”¹³³ Even though both of these Contracts Clauses are written in fairly unambiguous language, they “do[] not make unlawful every state law that conflicts with any contract.”¹³⁴ Instead, a court is tasked with “reconcil[ing] the strictures of the Contract Clause with the essential attributes of sovereign power necessarily reserved by the States to safeguard the welfare of their citizens.”¹³⁵

Based on this guidance, contract clause claims are analyzed under a two-pronged test.¹³⁶ The first question is “whether the state law has . . . operated as a substantial impairment of a contractual relationship.”¹³⁷ If the court concludes that the contract was substantially impaired, the court next considers whether the impairment was “reasonable and necessary to serve an important public purpose.”¹³⁸ Where the state is alleged to have impaired a public contract to which it is a party, “less deference to a legislative determination of reasonableness and necessity is required, because the State’s self-interest is at stake.”¹³⁹

Who has the burden of proof in this context is also a significant question and courts disagree over the proper standard. For instance, the First Circuit Court of Appeals in *UAW v. Fortuno*,¹⁴⁰ found that, “where plaintiffs sue a state . . . challenging the state’s impairment of a contract to which it is a party, the plaintiffs bear the burden on the

132. U.S. CONST. art. I, § 10, cl. 1.

133. WIS. CONST. art. I, § 12.

134. *Local Div. 589, Amalgamated Transit Union v. Massachusetts*, 666 F.2d 618, 638 (1st Cir. 1981).

135. *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 21 (1977) (quoting *Home Building & Loan Ass’n v. Blaisdell*, 290 U.S. 398 434-40 (1934); see also *Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 410 (1983).

136. See, e.g., *Parella v. Ret. Bd. of R.I. Emps. Ret. Sys.*, 173 F.3d 46, 59 (1st Cir. 1999). Some courts state this test as a three-part test. For example, in *Reserve Life Insurance Co. v. LaFollette*, the Wisconsin Court of Appeals adopted a three-part inquiry to determine whether a state law was unconstitutional under the Contracts Clause. See 323 N.W. 2d 173, 176 (Wis. Ct. App. 1982). In any event, the factors in each test are essentially the same. See *Chi. Bd. of Realtors, Inc. v. Chicago*, 819 F.2d 732, 736 (7th Cir. 1987) (“First, we must ask whether the Ordinance in fact operates as a substantial impairment of existing contractual relationships; second, we must inquire whether the city has a significant and legitimate public purpose justifying the Ordinance; and third, . . . whether the effect of the Ordinance on contracts is reasonable and appropriate given the public purpose behind the Ordinance.” (citing *Energy Reserves Group v. Kansas Power & Light Co.*, 459 U.S. at 411-12)).

137. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978).

138. U.S. Trust, 431 U.S. at 25.

139. *Parella*, 173 F.3d at 59 (quoting *Parker v. Wakelin*, 123 F.3d 1, 5 (1st Cir. 1997)).

140. 633 F.3d 37 (1st Cir. 2011).

reasonable/necessary prong of the Contract Clause analysis.”¹⁴¹ On the other hand, the Ninth Circuit, in two different cases, has advanced the notion that the context and posture in which a contract clause claim arises will dictate who bears the burden of showing reasonableness and necessity.¹⁴² In particular, the Ninth Circuit has held, in this vein, that “[t]he burden is placed on the party asserting the benefit of the statute *only when* that party is the state.”¹⁴³

Finally, there is some issue with how to style a contract clause claim. For instance, unlike other constitutional violations by actors acting under color of state law, there is currently some dispute over whether claims for contract clause violations are permitted to be brought under the Section 1983 civil rights procedural vehicle.¹⁴⁴ For instance, pointing to an 1885 United States Supreme Court precedent, the Fourth Circuit Court of Appeals has recently held that,

recourse to § 1983 for the deprivation of rights secured by the Contracts Clause is limited to the discrete instances where a state has denied a citizen the opportunity to seek adjudication through the courts as to whether a constitutional impairment of a contract has occurred, or has foreclosed the imposition of an adequate remedy for an established impairment. Section 1983 provides no basis to complain of an alleged impairment in the first instance.¹⁴⁵

141. *Id.* at 42.

142. See *Univ. of Haw. Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1106 (9th Cir. 1999) (quoting *Seltzer v. Cochrane*, 104 F.3d 234, 236 (9th Cir. 1996)).

143. *Seltzer*, 104 F.3d at 236.

144. See Civil Rights Act of 1871, 42 U.S.C. § 1983 (2006) (“Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State. . . subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress.”). Section 1983 is not substantive; it merely provides a procedural vehicle for plaintiffs to bring constitutional claims against state and local officials. See *Chapman v. Hous. Welfare Rights Org.*, 441 U.S. 600, 617 (1979). The purpose of such claims is to “vindicate constitutional rights and deter violations through suits brought by injured persons to stop government illegality and to obtain damages for injuries already suffered.” Michael L. Wells, *Section 1983, The First Amendment, and Public Employee Speech: Shaping the Right to Fit the Remedy (and Vice Versa)*, 35 GA. L. REV. 939, 944 (2001).

145. *Crosby v. Gastonia*, No. 10-1153, 2011 WL 818143, at *4 (4th Cir. Mar. 10, 2011) (citing *Carter v. Greenhow*, 114 U.S. 317, 322 (1885)). *But see* *S. Cal. Gas Co. v. Santa Ana*, 336 F.3d 885, 887 (9th Cir. 2003) (per curiam) (“The City’s argument that section 1983 provides no relief for a party deprived of its rights under the Contracts Clause is without merit.”). The disagreement between the courts apparently stems from a footnote by Justice White, in his decision in *Dennis v. Higgins*, in which he argued for a narrow reading of the *Carter* precedent. See *Dennis v. Higgins*,

Whether one construes an impairment of contract claim as a direct constitutional challenge to the actions taken by the state government or municipality or as complaining more indirectly that the government's contravention of the Constitution deprived the plaintiffs of one or more rights protected by Section 1983, the underlying law is basically the same. The threshold question is whether the acts of the state established nothing more than a mere breach of contract, as opposed to rising to the level of a constitutional impairment of obligation.¹⁴⁶

In this regard, the Seventh Circuit has commented that, "when a state repudiates a contract to which it is a party it is doing nothing different from what a private party does when the party repudiates a contract; it is committing a breach of contract," and "[i]t would be absurd to turn every breach of contract by a state or municipality into a violation of the Federal Constitution."¹⁴⁷ The crucial question becomes whether plaintiffs, bringing an impairment of contract claim, retain the right to recover damages for the breach. If the repudiation of the state obligation extinguishes the state's duty to pay damages, it then may be said to have impaired the obligation of contract.¹⁴⁸ In most of these public pension cases, this threshold issue would not appear to be an obstacle as plaintiffs could normally contend that they were barred from recovering damages from the State as the result of the State's amendment of their pension plan.

B. Wisconsin Legal Treatment of Contracts Clause Claims

Wisconsin courts interpret the Contract Clause in the Wisconsin Constitution according to the interpretation the United States Supreme Court has given its counterpart in the Federal Constitution.¹⁴⁹ As in all constitutional challenges, when a law is challenged under the Contract Clause, there is a strong presumption that the law is constitutional.¹⁵⁰ As far as burden of proof, Wisconsin courts hold that the challenging party

498 U.S. 439, 451 n.9 (1991). In any case, litigants would be well-advised to consider alternative forms of pleading when bringing an impairment of contract claim.

146. *See St. Paul Gaslight Co. v. St. Paul*, 181 U.S. 142, 149-51 (1901).

147. *Horwitz-Matthews, Inc. v. Chicago*, 78 F.3d 1248, 1250 (7th Cir. 1996).

148. *See id.* at 1250-51 ("The analogy is to the principle that government does not violate the takings clause if it stands ready to pay compensation for its takings should be evident." (citations omitted)).

149. *Chappy v. Labor & Indus. Review Comm'n*, 401 N.W.2d 568, 574 (Wis. 1987).

150. *E.g., id.* at 573.

has the burden to prove beyond a reasonable doubt that the law is unconstitutional.¹⁵¹

The language of the Contract Clause appears mandatory; however, it is not absolute and does not serve to completely prohibit *any* impairment of contract.¹⁵² The Contract Clause must sometimes yield to the police power, which is exercised for the compelling interest of the public.¹⁵³ Examples of goals the police power is used to achieve include “[p]ublic safety, public health, morality, peace and quiet, law and order.”¹⁵⁴ Use of the police power generally depends on the values the state seeks to preserve and whether there is a “reasonable relationship between the preservation of that value and the method the legislature has employed to preserve it.”¹⁵⁵

While the Contracts Clause is not absolute, it still imposes some limits on the ability of a state to interfere with existing contractual relationships despite its police power.¹⁵⁶ The United States Supreme Court has primarily used the Contracts Clause to limit states’ ability to modify contracts to which they are a party, but on a less frequent basis, also applies the Contract Clause to laws that impact private contracts.¹⁵⁷ As stated above, Wisconsin courts apply a multipart test which asks whether the law substantially impairs an existing contractual relationship and whether that impairment is justified.¹⁵⁸

For instance, in *Reserve Life Ins. Co. v. La Follette*,¹⁵⁹ a health insurer brought a claim arguing that a Wisconsin law violated the Contract Clause by requiring the insurer to add coverage for chiropractic services to existing policies.¹⁶⁰ The court found that the law requiring insurers to offer additional coverage under their existing policies did impair Reserve Life’s contractual relationships because it forced Reserve

151. *Id.* at 574. However, and as discussed previously, when the state is the party “asserting the benefit of the statute,” the state has the burden of “proving that the impairment was reasonable and necessary.” *Univ. of Haw. Prof’l Assembly v. Cayetano*, 183 F.3d 1096, 1106 (9th Cir. 1999); *see also supra* note 145 and accompanying text.

152. *Chappy*, 401 N.W.2d at 571.

153. *See State ex rel. Bldg. Owners and Managers Ass’n of Milwaukee v. Adamany*, 219 N.W.2d 274, 280 (Wis. 1974).

154. *Id.* at 281 (citing *Berman v. Parkery*, 348 U.S. 26, 32 (1954)).

155. *Id.* at 281.

156. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 242 (1978).

157. *Allstate Life Ins. Co. v. Hanson*, 200 F. Supp. 2d 1012, 1017 (E.D. Wis. 2002) (quoting *Wis. Cent. Ltd. v. Public Serv. Comm’n of Wis.*, 95 F.3d 1359, 1370 (7th Cir. 1996)).

158. *See supra* notes 132-35 and accompanying text.

159. 323 N.W.2d 173 (Wis. Ct. App. 1982).

160. *Id.* at 175.

to offer something additional and to undertake an obligation “beyond that to which it had agreed by contract.”¹⁶¹ Courts have also held that contractual rights conferred pursuant to a municipal pension system are subject to the Contract Clause, and that a state law that alters the contract is impairing an existing contractual relationship.¹⁶²

Next, courts consider whether the impairment is substantial.¹⁶³ A party must show that the law interferes with the parties’ “expectations” to prove a substantial impairment.¹⁶⁴ Therefore, a court considers whether the law was foreseeable, or even plausible, at the time the contract was made.¹⁶⁵ There is, therefore, a factual element to determining whether impairment is substantial.¹⁶⁶ Arguing that the new statutory obligation itself is a substantial impairment is not sufficient; rather, the party must provide evidence showing the effect of the impairment.¹⁶⁷ Although the *Reserve Life* Court found that the law impaired a contractual relationship, the court still upheld the law because the company failed to establish that the impairment was substantial.¹⁶⁸ If the alteration is minimal, the analysis may end at this stage and the law will be presumed constitutional.¹⁶⁹

Courts have found that a law substantially impairs a contractual obligation when it unilaterally reduced “contractually established, future state employee salary obligations.”¹⁷⁰ In this vein, courts have noted that interfering with employee pay creates a “financial hardship” and “is not an insubstantial impairment to one confronted with monthly debt payments and daily expenses for food and the other necessities of life.”¹⁷¹ Furthermore, when the state is faced with a budgetary deficit, the legislature has many alternatives available to it, such as reducing state services not governed by contract and raising taxes.¹⁷²

161. *Id.* at 178.

162. *See State ex rel. O’Neil v. Blied*, 206 N.W. 213, 214 (Wis. 1925).

163. *See Reserve Life*, 323 N.W.2d at 176.

164. *Allstate Life Ins. Co. v. Hanson*, 200 F. Supp. 2d 1012, 1018 (E.D. Wis. 2002).

165. *Id.*

166. *See Reserve Life*, 323 N.W.2d at 178.

167. *See id.*

168. *See id.* at 178-79.

169. *See Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 245 (1978).

170. *See Univ. of Haw. Prof’l Assembly v. Cayetano*, 183 F.3d 1096, 1104 (9th Cir. 1999) (quoting *Mass. Cmty. Coll. v. Massachusetts*, 649 N.E.2d 708, 712 (Mass. 1995)).

171. *See Univ. of Haw.*, 183 F.3d at 1105 (quoting *Ass’n of Surrogates & Supreme Court Reporters v. New York*, 588 N.E.2d 51, 54 (N.Y. 1992)).

172. *See id.* at 1106 (quoting *Op. of the Justices (Furlough)*, 609 A.2d 1204, 1210-11 (N.H. 1992)).

If the impairment is substantial, the court lastly examines the purpose of the state legislation to determine whether the impairment is justified.¹⁷³ To determine whether a law is unjustified, the court balances the extent of impairment against the public purpose the law purportedly serves.¹⁷⁴ In turn, the severity of impairment impacts the level of the court's scrutiny.¹⁷⁵

Whereas the court applies a low level of scrutiny when the impairment is not substantial, the hurdle for the state is higher when the impairment is more severe.¹⁷⁶ The different levels of scrutiny that courts use to interpret laws challenged under the Contract Clause has been described by the United States Supreme Court as a "sliding scale," in which the "level of scrutiny given a law varies directly in accordance with the severity of the impairment of existing contracts, and varies inversely in accordance with the degree of prior regulation in a particular field of activity."¹⁷⁷ Where the impairment is substantial, the state law at issue must serve a significant and legitimate public interest.¹⁷⁸

Additionally, as mentioned above, a law is even more stringently examined when the law impairs a contractual relationship that the state is a party to, as opposed to a contractual relationship between two private parties.¹⁷⁹ A state impairs a contractual obligation when it "prevents or materially limits the contractor's ability to enforce his contractual rights" perhaps by limiting remedies that would be available if both parties were private.¹⁸⁰ Moreover, a court also applies a relaxed level of scrutiny when the state has previously defined obligations in the challenged area of the law through prior regulations.¹⁸¹

1. Cases Where State Laws Upheld in Contracts Clause Challenges

A number of cases—not necessarily those involving pension rights—have upheld a state law despite a challenge under the Contracts

173. *Reserve Life*, 323 N.W.2d at 176.

174. *Univ. of Haw.*, 183 F.3d at 1107.

175. *See Chappy v. Labor & Indus. Review Comm'n*, 401 N.W.2d 568, 575 (Wis. 1987).

176. *See Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 245 (1978).

177. *Allstate Life Ins. Co. v. Hanson*, 200 F. Supp. 2d 1012, 1018 (E.D. Wis. 2002) (quoting *Chi. Bd. of Realtors, Inc. v. City of Chicago*, 819 F.2d 732, 736 (7th Cir. 1987)).

178. *Chappy*, 401 N.W.2d at 575.

179. *Spannaus*, 438 U.S. at 244 n.15.

180. *Univ. of Haw. Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1103 (9th Cir. 1999).

181. *See Chi. Bd. of Realtors*, 819 F.2d at 737.

Clause. In *Chappy v. Labor & Industry Review Commission*,¹⁸² an insurance carrier challenged the constitutionality of a retroactive state law that increased the amount of disability benefits injured employees could collect to account for inflation, arguing that application of the law impaired its contract.¹⁸³ However, because the carrier did not provide estimates of how much the law cost its company, the court did not find that the impairment was “substantial” and applied a lower standard of scrutiny.¹⁸⁴ Regardless, dicta by the court revealed that the law did have a significant and legitimate public purpose directed toward a broad and general economic problem, reasoning that those on a fixed income are severely impacted by inflation.¹⁸⁵

In another case, *Home Building & Loan Ass’n v. Blaisdell*,¹⁸⁶ the United States Supreme Court upheld a law challenged under the Contract Clause. In *Blaisdell*, the Minnesota legislature passed a law that altered a mortgagee’s remedy after a mortgagor defaulted on a home loan by extending the right of redemption.¹⁸⁷ Although the law conflicted with lenders’ contractual rights, the Court noted that states are able to enact laws pursuant to their police power to protect the interests of the people.¹⁸⁸

The *Spannaus* Court, reviewing the *Blaisdell* decision some forty years later, identified five unique factors that led the earlier Court to uphold the Minnesota law.¹⁸⁹ First, the legislature declared as a purpose for the Act that there was an emergency (namely the Great Depression) which required the state to protect homeowners due to great economic distress; second, the law applied to a basic society interest, rather than to a single narrow group; third, the relief was “appropriately tailored to the emergency;” fourth, the conditions of the extended redemption period were reasonable; and fifth, the law limited in duration and would

182. 401 N.W.2d 568 (Wis. 1987).

183. *See id.* at 570-71.

184. *See id.* at 575-76.

185. *See id.* at 576.

186. 290 U.S. 398 (1934).

187. *See id.* at 416.

188. *Id.* at 434-35 (“Not only is the [Contracts Clause] constitutional provision qualified by the measure of control which the State retains over remedial processes, but the State also continues to possess authority to safeguard the vital interests of its people. It does not matter that legislation appropriate to that end ‘has the result of modifying or abrogating contracts already in effect.’” (quoting *Stephenson v. Binford*, 287 U.S. 251, 276 (1932)).

189. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 242 (1978).

terminate once the economy stabilized.¹⁹⁰ Therefore, laws are more likely to survive a challenge under the Contracts Clause when they are expressly enacted to deal with a “broad, generalized economic or social problem.”¹⁹¹

Yet another law was upheld by the Wisconsin Supreme Court despite a challenge under the Contracts Clause in *Chicago & Northwestern Railway Co. v. La Follette*.¹⁹² There, the court upheld a law requiring a railroad to staff larger crews on its trains.¹⁹³ The railroad argued that the law impaired freedom to contract for the number of employees it wanted.¹⁹⁴ The court, however, upheld the legislature’s determination that additional crew members were necessary to ensure safety of the public pursuant to the state’s police power.¹⁹⁵

In yet a more recent Contracts Clause case, *Chicago Board of Realtors, Inc. v. City of Chicago*,¹⁹⁶ the Seventh Circuit upheld an Illinois law that altered the relationship between landlords and tenants in Chicago. The new law, which applied prospectively, contained a number of requirements landlords found objectionable, including a prohibition for charging more than ten dollars per month for late rent and requiring landlords to keep security deposits in a federally insured account in a bank located in Illinois.¹⁹⁷ The landlords brought suit under the Contracts Clause. Applying the sliding scale of scrutiny discussed above, the court analyzed the law under a lowered level of scrutiny due to heavy prior regulation by the legislature of landlord-tenant law and because the state was not a party to the contracts.¹⁹⁸ Under this lower level of scrutiny, the court upheld the new landlord-tenant law, finding that the law did not impair contractual obligations for constitutional purposes due to prior regulation in the area and because it was rational to believe the law would lead to improved public health and welfare.¹⁹⁹

Finally, foreseeability of future regulation was also a factor in the Contracts Clause case of *Allstate Life Insurance Co. v. Hanson*.²⁰⁰ In

190. *See id.*

191. *See id.* at 250.

192. 169 N.W.2d 441 (Wis. 1969).

193. *See id.* at 454.

194. *See id.* at 446.

195. *See id.* at 454.

196. 819 F.2d 732 (7th Cir. 1987).

197. *See id.* at 734.

198. *See id.* at 736-37.

199. *See id.*

200. 200 F. Supp. 2d 1012 (E.D. Wis. 2002).

Allstate Life, the Eastern District of Wisconsin upheld a new, retroactive law that created the presumption that divorce revokes beneficiary status for former spouses.²⁰¹ A former wife argued that the law was unconstitutional under the Contracts Clause because it interfered with her entitlement to benefits from her deceased ex-husband's life insurance policy.²⁰²

The court found that the law was not unconstitutional for a number of reasons. First, the law did not change the obligations under the contract between Allstate and the deceased ex-husband; it only impacted the interests of the beneficiary.²⁰³ Second, the court found it significant that a change in the law was foreseeable due to prior regulation by Wisconsin in asset transfers due to death.²⁰⁴ Furthermore, the law did not impose a severe restriction because it only established a default rule that the spouses could have opted out of through any affirmative act that showed the deceased's intent.²⁰⁵ Finally, the court found that the law served a significant and legitimate public purpose because it created uniformity within Wisconsin's estate law and made Wisconsin's law consistent with that of other states.²⁰⁶

2. Cases Where Law Found Unconstitutional Under Contract Clause

Of course, not all applicable federal and state cases uphold state laws challenged under the Contracts Clause. For instance, in *State ex rel. Building Owners & Managers Ass'n. of Milwaukee, Inc. v. Adamany*,²⁰⁷ the Wisconsin legislature enacted a law that required landlords to pass tax reduction savings on to their tenants.²⁰⁸ When landlords challenged the law under the Contracts Clause, the court found that the law impermissibly impaired the obligation of contracts because it was unclear what vital purpose the law served that justified depriving the landlords of rent for which they bargained.²⁰⁹

In *Allied Structural Steel Co. v. Spannaus*,²¹⁰ an Illinois corporation

201. *See id.* at 1021.

202. *See id.* at 1014.

203. *See id.* at 1020.

204. *Id.*

205. *Id.*

206. *See id.* at 1021.

207. 219 N.W.2d 274 (Wis. 1974).

208. *Id.* at 276.

209. *Id.* at 284-86.

210. 438 U.S. 234 (1978).

brought suit under the Contracts Clause when Minnesota enacted a law that had a substantial effect on the corporation's existing pension plan.²¹¹ The corporation's voluntary pension plan had length of service and age conditions for rights to vest, did not require the corporation to make contributions, and was subject to termination for any reason.²¹² The new Minnesota pension law provided for a "pension funding charge" if a company terminated a plan or closed an office.²¹³ When the corporation closed its Minnesota office a few months after the law was enacted, the State assessed a pension funding charge of \$185,000 against the corporation.²¹⁴

The Court held that the Minnesota pension law was unconstitutional under a Contracts Clause analysis because the law substantially impaired an existing contract by changing express terms and imposing unexpected liability.²¹⁵ Moreover, there was no evidence that the law was enacted to meet an important general social interest.²¹⁶ The law also only impacted an extremely narrow class—private corporations with voluntary pension plans who either closed an office or terminated their pension plans.²¹⁷ Finally, the U.S. Supreme Court also found it relevant that the State was regulating in an area that was not subject to regulation when the corporation created its contractual obligation by enacting a pension plan, which made its intrusion unforeseeable.²¹⁸

As will be discussed in the next section, the U.S. Supreme Court's decision in *Spannaus* provides a good model for analyzing pending Contracts Clause challenges to Wisconsin's controversial budget repair bill.

C. Potential Contract Clause Challenge to the Wisconsin Budget Repair Bill's Pension Provisions: The Case of Milwaukee City Employees

To determine whether a state law is unconstitutional pursuant to the

211. *See id.* at 238-40.

212. *Id.* at 237.

213. *Id.* at 238.

214. *Id.* at 239.

215. *See id.* at 247, 250-51.

216. *Id.* at 247.

217. *See id.* at 248.

218. *See id.* at 250.

Federal and State Contracts Clause, courts essentially ask: (1) is the contractual obligation impaired; (2) is the impairment substantial; and (3) is the impairment justified?²¹⁹ Courts also apply different levels of scrutiny depending on factors such as whether the state previously regulated the area of law at issue and whether the state is a party to the contract.²²⁰ Other relevant factors in determining whether a law should be upheld or struck down as unconstitutional include those discussed in *Spannaus*: (1) whether the legislature articulated a purpose for the law that applies generally, rather than just to a narrow group; (2) if the regulation was foreseeable; (3) if the law was created for public safety reasons, and (4) if the law was enacted pursuant to an emergency or if the law is temporary.²²¹

1. Application of Budget Repair Pension Provisions to City of Milwaukee Employee Retirement System

Just taking, for present purposes, the pension provision of the Budget Repair Bill that applies to Wisconsin cities of the first class (which only includes Milwaukee), it appears that the law may indeed run afoul of the federal and Wisconsin constitutional prohibition against impairment of contracts. That provision states:

62.623 Payment of contributions in an employee retirement system of a 1st class city. Beginning on the effective date of this section . . . in any employee retirement system of a 1st class city, . . . employees shall pay all employee required contributions for funding benefits under the retirement system. The employer may not pay on behalf of an employee any of the employee's share of the required contributions.²²²

The effect of this provision on the pension rights of Milwaukee city employees will likely be dramatic. For instance, a contribution requirement of 5.5% of "an employee's pay would be equivalent to

219. *Reserve Life Ins. Co. v. La Follette*, 323 N.W.2d 173, 176 (Wis. Ct. App. 1982) (citing *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244-45 (1978)).

220. *See Ass'n of Surrogates and Supreme Court Reporters v. New York*, 940 F.2d 766, 773-74 (2d Cir. 1991) ("When a State itself enters into a contract, it cannot simply walk away from its financial obligations. In almost every case, the Court has held a governmental unit to its contractual obligations when it enters financial or other markets." (quoting *Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 410 (1983))).

221. *See supra* note 191 and accompanying text.

222. Wisconsin Budget Repair Bill, 2011 Wis. Act 10, § 167 (to be codified at WIS. STAT. § 62.623).

114.4 hours of pay . . . [or] equivalent to [a] loss of 14.3 days of pay, assuming an eight-hour day.”²²³ So not only would such a requirement that the city cannot pay employee pension contributions be an impairment of the pension contract that the Milwaukee City employees have with the state,²²⁴ but it would be quite a substantial impairment.²²⁵ Indeed, other cases from other courts stand for the proposition that state legislation that has the effect of reducing the pension rights of public employees to this magnitude would satisfy the requirement that the contractual impairment in question is substantial.²²⁶

Under the Contracts Clause analysis described above, that leaves the important question of whether this substantial impairment is justified.²²⁷ One would speculate that the reason that the Governor of Wisconsin, Scott Walker, would give for the need for these new pension provisions is that the state is facing a budget emergency, with the state being in the red over \$150 million in the short-term and \$3.6 billion dollars through 2013.²²⁸

Yet, state legislation that substantially impairs contracts right is usually not upheld because the test for constitutionality in the Seventh Circuit is a difficult one:

[A] court should uphold a challenged statute if it “reasonabl[y] and appropriate[ly]” serves “a significant and legitimate public purpose”

223. Langley Letter, *supra* note 15, at 11.

224. *See State ex rel. Bartlet v. Thompson*, 16 N.W.2d 420, 421 (Wis. 1944) (holding that municipal pension systems that confer contractual rights upon member-beneficiaries are subject to the strictures of the Federal and State Contracts Clause against impairment by subsequent legislation); *see also State ex rel. O’Neil v. Blied*, 206 N.W. 213, 214 (Wis. 1925); *Benson v. Gates*, 525 N.W.2d 278, 285-86 (Wis. Ct. App. 1994) (citing *Blied*, 206 N.W. at 214). Milwaukee City Attorney Langley concluded in this regard that “[t]he session laws, charter ordinances, court opinions, and the [Global Pension Settlement (“GPS”)] . . . strongly support the proposition that any employee whose share of pension contributions is currently paid by the City has a vested contractual right to a continuation of this practice.”). *See Langley Letter, supra* note 15, at 11.

225. *See, e.g., Langley Letter, supra* note 15, at 11 (“The imposition of a pension contribution requirement of 5.5 or 7 percent of salary would almost certainly be deemed a substantial impairment of members’ vested rights.”).

226. *See, e.g., Univ. of Haw. Prof’l Assembly v. Cayetano*, 183 F.3d 1096, 1099, 1104 (9th Cir. 1999) (finding that a statute delaying payment of wages for six day period constituted a substantial impairment); *Ass’n of Surrogates and Supreme Court Reporters v. New York*, 940 F.2d 766, 772 (2d Cir. 1991) (holding that statute that provided for withholding of 10-days’ pay prior to retirement constituted substantial impairment); *Mass. Cmty. Coll. v. Massachusetts*, 649 N.E.2d 708, 712 (Mass. 1995) (finding that between two and fifteen day furloughs of public employees constituted a substantial impairment).

227. *See supra* text accompanying note 223.

228. *See supra* note 8.

when balanced against the severity of the impairment. “[T]he Supreme Court has suggested that a sort of sliding scale is appropriate [whereby] . . . the level of scrutiny given a law varies directly in accordance with the severity of the impairment of existing contracts, and varies inversely in accordance with the degree of prior regulation in a particular field of activity.”²²⁹

In short, a court would balance the substantiality of the contract impairment against the interest the state is seeking to serve by passing the legislation.²³⁰

As already noted, the impairment on the vested pension rights of Milwaukee City employees would be quite severe; in the range of about two weeks of pay. Wisconsin would argue that such pension provisions are required given its current state budget emergency. Yet, that budget emergency claim does not appear legitimate upon closer examination. As already discussed, the Wisconsin Retirement System is one of the healthiest in the country and has not been significantly underfunded in the last twenty-five years.²³¹ Moreover, pension plans are not funded by general tax revenue, but by compensation commitments to employees in the form of deferred compensation.²³² So, it is far from clear how imposing these additional pension contribution requirements on Milwaukee city employees will reduce the structural deficit that Wisconsin now faces.

Furthermore, some of the other relevant factors discussed earlier in this section will likely favor public employees in this constitutional balancing test. For instance, the law was not created for public safety reasons, the law does not appear to be enacted pursuant to an emergency, and the law is not temporary.²³³ Moreover, the Wisconsin legislature has given individual municipalities, like Milwaukee, the authority to decide local pension issues under its state-based, constitutional home rule authority.²³⁴ And because it is the state, and not the city, that is seeking this pension contract change, a court might give additional scrutiny to the need for such a change. Finally, a court would more closely

229. See *Allstate Life Ins. Co. v. Hanson*, 200 F. Supp. 2d 1012, 1018 (E.D. Wis. 2002) (quoting *Chi. Bd. of Realtors, Inc. v. City of Chicago*, 819 F.2d 732, 736 (7th Cir. 1987).

230. See *State ex rel. Cannon v. Moran*, 331 N.W.2d 369, 376-78 (Wis. 1983).

231. See *supra* notes 14 and 66.

232. See Schmall, *supra* note 64, at 279.

233. See *supra* note 187 and accompanying text.

234. See Langley Letter, *supra* note 15, at 2-3 (citing Wis. CONST. art. XI, § 3(1) (establishing a municipal home rule in 1924)).

scrutinize a law impairing a contractual obligation between the City of Milwaukee and its employees because Wisconsin is a party to the contract.²³⁵

In any event, Wisconsin courts have limited the acceptable reasons for substantially impairing a pension contract to those dealing with the financial stability of the plan and do not consider other reasons, such as the need of the state to balance its budget.²³⁶ In short, most courts to have considered Contracts Clause challenges regarding pension obligations have concluded that even rather minor impairments of employee contract rights involving compensation are legally unjustified.²³⁷ Thus, in the particular situations involving the application of the pension provisions of the budget repair bill to the City of Milwaukee's retirement system, a Contracts Clause violation is likely to be found.

2. The Uncertain Meaning of the Milwaukee Pension Analysis to Other Public Pension Plans in Wisconsin and Elsewhere

The above analysis of how the budget repair bill applies to the Milwaukee city employees' pension rights does not mean, however, that public pension litigation involving other municipalities in Wisconsin, or other states and municipalities in the United States, will come out the same way. This is because of a crucial distinction in how Milwaukee city employees are treated under applicable public pension law and how public employees may fair as far as their pension rights in other parts of

235. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 n.15 (1978).

236. *See Ass'n of State Prosecutors v. Milwaukee Cnty.*, 544 N.W.2d 888, 893 (Wis. 1996) (“[L]egislature[s] should retain a limited power to adjust or amend a retirement plan in certain situations, such as when it is necessary to preserve the actuarial soundness of a plan or to salvage financially troubled funds.”); *Milwaukee Police Ass'n v. City of Milwaukee*, 588 N.W.2d 636, 639 (Wis. Ct. App. 1998) (“[A]lthough the state has ‘a limited power to adjust or amend a retirement plan in certain situations,’ and may intervene to ‘preserve the actuarial soundness of a plan or to salvage’ it if it is financially strapped, it may not raid it, even by a little bit.” (citing *Ass'n of State Prosecutors*, 544 N.W.2d at 893)).

237. *See, e.g., Ass'n of Surrogates & Supreme Court Reporters v. New York*, 940 F.2d 766, 773-74 (2d Cir. 1991). The Contract Clause “is especially vigilant when a state takes liberties with its own obligations.” *Id.* at 773 (citing *Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 412 n.14 (1983)). “When a State itself enters into a contract, it cannot simply walk away from its financial obligations. In almost every case, the Court has held a governmental unit to its contractual obligations when it enters financial or other markets.” *Id.* at 774 (quoting *Energy Reserves Grp.*, 459 U.S. at 412 n.14).

Wisconsin or other parts of the country.

In short, a large number of Milwaukee city employees work under collective bargaining agreements where the city has agreed to pay for the employee share of pension contributions and such employees have been found to have a vested right in City-paid contributions.²³⁸ The vested nature of these rights stem from a unique and long history surrounding the provision of public pensions in Milwaukee. For instance, the 1947 session law that transferred control of the Milwaukee Employees' Retirement System to the City "declared that cities of the first class are entitled to the largest measure of self-government over their pension plans."²³⁹ Under this same 1947 session law, Section 30 stated in pertinent part:

Every such member and beneficiary shall be deemed to have accepted the provisions of this act and shall thereby have a benefit contract in said retirement system of which he is such member or beneficiary The annuities and all other benefits . . . shall be obligations of such benefit contract . . . and each member and beneficiary having such a benefit contract shall have a *vested right to such annuities and other benefits and they shall not be diminished or impaired by subsequent legislation or by any other means without his consent.*²⁴⁰

Perhaps, even more significantly, the Milwaukee Home Rule Charter fixes the vested and contractual rights of city employees as of the date of the member's initial employment.²⁴¹ These provisions have been interpreted to mean that the retirement benefits in effect when a Milwaukee city employee becomes a member of the city pension system are vested and cannot be changed unless the employee agrees.²⁴² In other words, vested pension benefit rights include the city paying the employee's share of pension contributions.²⁴³

Finally, the Milwaukee pension system is distinct because of its past litigation history. A number of plaintiffs sued Milwaukee in a

238. See Langley Letter, *supra* note 15, at 2, n.1.

239. See *id.* at 4 (citing Milwaukee City Charter, § 36-14 (Oct. 12, 2010), available at http://cctv25.milwaukee.gov/netit-code81/charter_/ch36/CH36.pdf).

240. Milwaukee City Charter, § 36-13-2-a (emphasis added).

241. Milwaukee City Charter § 36-13-2-c; see also Milwaukee City Charter § 36-08-7-a-1 ("[C]ommencing with the first pay period of 1970, the city shall contribute on behalf of general city employees 5.5% of such member's earnable compensation.").

242. Langley Letter, *supra* note 15, at 8 (citing Milwaukee Police Ass'n v. City of Milwaukee, 588 N.W.2d 636 (Wis. Ct. App. 1998)).

243. *Id.*

number of different cases in the years prior to 2000 because of its governance of the city pension plan.²⁴⁴ As a consequence of this litigation, the City entered into a Global Pension Settlement (“GPS”) with almost all of its public employees.²⁴⁵ In pertinent part, the GPS states: “Every member [of the Employees’ Retirement System] . . . shall have a vested and contractual right to the benefits in the amount and on the terms and conditions as provided in the law on the date the combined [city pension] fund is created.”²⁴⁶ The city paying for the city employees’ pension contributions is considered one such pension term and condition under the GPS.

Thus, only through obtaining voluntary consents could employee contributions to the state pension plan be required by city employees.²⁴⁷ Indeed, the only way that such increased contributions have been possible in the past, and the way it worked under the GPS, is by the city offering enhanced pension benefits to covered employees in exchange for individual waivers.²⁴⁸

So, although Milwaukee city employees may have vested contractual rights to have the city pay their share of pension contributions, it is unclear whether other municipalities in Wisconsin, or elsewhere in the country for that matter, have similar vesting language in their pension statutes, ordinances, court opinions, and/or case settlements. Each public pension plan must be considered on its own to determine whether public pension provisions provide an argument that some vested contractual right, benefit, or pension term and condition has been unilaterally eliminated or reduced through enactment of state pension reform legislation. Only under these conditions, will a constitutional Contracts Clause challenge be potentially successful when such legislation seeks to curtail public employee pension rights.

CONCLUSION

The recent spate of high profile efforts by state governors to roll back public employee pension rights in light of recent budgetary challenges has shone the light directly on the importance to public employees of the Contracts Clause provisions of the Federal and State

244. *Id.* at 10.

245. *See id.*

246. Milwaukee City Charter § 36-13-2-g.

247. *See* Langley Letter, *supra* note 15, at 2.

248. *Id.*

Constitutions. Using as an example the controversial budget repair bill in Wisconsin and the application of the bill's pension provisions to Milwaukee City employee pension rights, this article has sought to show how, under certain specified circumstances, such legislative attempts may be constitutionally impermissible if such laws substantially impair employee contracts with the state without the necessary legal justification.

Although such Contracts Clause litigation might be successful in a suit brought by the City of Milwaukee on behalf of its employees, it is unclear whether such arguments will be successful in other parts of Wisconsin or in other states. As the examination of pending pension litigation in other states underscores, there will also be different types of state legislation that may run afoul of pension rights under the particular provisions of states' pension laws. Because of the lack of legal uniformity in public pension regulation from one state to the next, the only possible way to determine whether state curtailment of public employee pension rights will be constitutional is by undertaking an in-depth legal analysis of the applicable pension laws, regulations, ordinances, court opinions, and prior settlements.