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## **Stroock: Protecting Pensions And Contract Rights For Public Sector Employees.**

A look at how, in the current economic climate, some cities and states have attempted to impair contracts and pensions and how the public sector labor force has and can protect against those efforts.

### **INTRODUCTION**

Recently, in an important decision for public employees, the Illinois Supreme Court rejected an attempt by Illinois lawmakers to impair the State's public pension system. The proposed legislative changes would have, among other items, curtailed future cost-of-living adjustments for workers, raised the age of retirement for some, and imposed a cap on pensions for those with the highest salaries. Though no one could reasonably dispute the gravity of Illinois' budgetary difficulties, the court recognized that "economic conditions are cyclical and expected," and "fiscal difficulties have confronted the State before."<sup>1</sup> The Legislature could not attempt to cure budgetary shortfalls on the backs of public employees, even in dire circumstances, because the Illinois constitution provides that benefits promised as part of a pension system for public workers "shall not be diminished or impaired." To the court, "crisis [was] not an excuse to abandon the Rule of law....it [was] a summons to defend it." Thus, the Legislature could not unilaterally diminish the fundamentally and constitutionally preserved retirement benefits of public workers.<sup>2</sup>

The Illinois Supreme Court's decision is one of several recent decisions nation-wide dealing with the constitutionality of a state's seeking to impair contractually bargained-for pension rights of public employees. Yet, the decisions have not all been decided the same way and have had mixed results for public employees.

Even more recently, in a lawsuit filed by a number of New Jersey public employee unions, New Jersey Superior Court Judge Mary Jacobson initially ruled that Governor Chris Christie's attempt unilaterally to withhold \$1.6 billion of contributions from the public pension system to cure New Jersey's budgetary shortfall was unlawful.

The court held that reneging on the State's financial obligations to public sector workers violated the contract rights of the employees under the New Jersey and Federal Constitutions.

The court concluded that because the State "failed to present any real evidence of an emergency situation or of its having considered any alternatives to cutting out the [pension payments] entirely to balance the budget," the action was unconstitutional.<sup>3</sup> Governor Christie was ordered to make the \$1.6 billion payment to the public pension system because the State had "substantially impaired plaintiff's contractual rights without justification."<sup>4</sup>

However, the New Jersey Supreme Court reversed the lower court ruling. In a lengthy opinion, the court held that the New Jersey legislation that created the annual obligation to fund the severely underfunded pension system ran afoul of the State Constitution's Debt Limitation Clause, a unique New Jersey constitutional mandate prohibiting the Legislature from incurring debts, either by

contract or by statute (i.e., without voter approval), exceeding one percent of the annual budget. The court, in its first full paragraph, made absolutely clear that whether New Jersey's "men and women must be paid their pension benefits when due [was] not in question." Instead, the issue was whether the funding legislation in question, Chapter 78, could create a valid and legally enforceable contractual right to an annual contribution from the State into the pension funds in the absence of voter approval. Because of the New Jersey-specific constitutional debt limitation provision, under state law it could not. There was no enforceable contract.

Importantly, on this strictly legal question pertaining to a statutory financing scheme, the court had no occasion to consider whether the State's commitment to pay retirement benefits when due is a valid and binding contract and whether its failure to pay would constitute a violation of the federal or State Contracts Clause. The language of the decision, and the court's repeated emphasis on the narrow question before it, suggests that it remains, at the very least, an open question. Indeed, the court recognized the importance of New Jersey fulfilling its obligations and noted that the State "must get its financial house in order" to "honor its compensation commitment to retired employees." It further emphasized that "the State repeatedly asserted at oral argument that it is not walking away from its obligations to the pensions and to pay benefits due to retirees." Thus, while the decision ostensibly appears to be a victory for the Christie administration, no overly broad conclusions about its substance or applicability of the decision to other jurisdictions should be drawn.

For over a decade, New Jersey has, on average, made less than half of its required annual contributions to its state pension fund and, as in many states like Illinois, with politicians loathe to propose tax increases or to make the budgetary cuts needed to fund shortfalls, attention has now turned to the once believed to be inviolable public sector pensions.

The recent Illinois decision and the New Jersey lawsuit, captioned *Burgos v. New Jersey*,<sup>5</sup> despite their ultimate differing outcomes, provide a path for how public sector unions can utilize state and federal constitutional provisions to protect the safety net that their members have for so long counted on for their retirements. New Jersey's and Illinois' budgetary imbalance and consequent fiscal difficulties are not uncommon. Although the U.S. economy is improving, as evidenced by lower unemployment rates, drastically reduced gas prices, and surging stock markets,<sup>6</sup> fiscal concerns remain for some of the nation's largest cities and states. Recovering from the recession has been harder for certain U.S. municipalities, in part because despite the improved housing and labor markets, tax revenues – the largest source of government funds – have not universally rebounded as quickly. Many American cities are still struggling to adjust to the shrunken revenue streams that resulted from the recession,<sup>7</sup> the decline in federal and state aid, and the decline in property tax revenue.<sup>8</sup> In some recent, well-known severe cases – Detroit, Michigan, San Bernadino, California, and Stockton, California – the impact of the recession, combined with the unwillingness of governments to make hard choices, has pressed municipalities into bankruptcy.<sup>9</sup> Aside from cities and smaller localities, some state governments, are also facing difficult choices in today's challenging economic climate.<sup>10</sup>

Under the guise of these budgetary constraints, policymakers have taken aim at public sector pensions and contracts in an attempt to stabilize finances. Such unilateral attempts to reduce or eliminate altogether contractually bargained-for rights, have been met with challenges across the country, based on both state and federal constitutional grounds. Under numerous state constitutions, including Illinois', New Jersey's, and New York's, public sector employee pensions are accorded the status of contracts, "the benefits of which shall not be diminished or impaired," under a provision colloquially referred to as the "Non-Impairment Clause."<sup>11</sup> Similarly, under Article I, Section X of the Federal Constitution, states are prohibited from impairing contractual obligations,

under a provision known as the “Contracts Clause.”<sup>12</sup> The federal Contracts Clause and state non-impairment clauses safeguard the legitimate expectations of employees who devote their lives to public service and ensure that the promises made to municipal workers when they began their careers are ultimately fulfilled. As they have historically, many public sector workers take lower paying jobs precisely for the security and predictability of seniority and a pension. Yet, these protections are not absolute. In truly dire economic circumstances, governments exercising their constitutionally recognized police power may trump these protections and modify or breach labor contracts. Importantly, however, they may only legally so act as a last and necessary resort.

The first part of this article outlines the contours of state non-impairment clauses and the federal Contracts Clause (and state analogs), focusing on how courts analyze challenges made on those constitutional bases. The second part of this article discusses recent legislative and judicial impairments of public sector pensions in both Detroit and Illinois. Last, we examine the state of the law in New York, using recent national developments to inform the analysis.

## **METHODS FOR PROTECTING PENSIONS AND CONTRACT RIGHTS<sup>13</sup>**

### **The Non-Impairment Clause - Protecting Pensions**

Public sector employees in certain states can use the non-impairment clause to protect their pension rights from unilateral reductions imposed by a state or local government. Under many state constitutions, including New York’s, pensions are granted contractual status. Article V § 7 of the New York State Constitution declares that, “membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired.”<sup>14</sup> Notably, there is no qualification. Thus, any judicial or legislative action that seeks to impair pension rights is arguably a violation of New York’s Non-Impairment Clause.<sup>15</sup>

Case law and the legislative history confirms that the purpose of New York’s Non-Impairment Clause was “to fix the rights of the employees at the time of commencement of membership in the [pension] system, rather than as previously at retirement.”<sup>16</sup> The clause prohibits unilateral action by either the Legislature or the employer that would diminish or impair the rights employees have gained through their membership in the system.<sup>17</sup>

### **The Contracts Clause - Protecting Contract Rights**

In addition to non-impairment clauses, the federal Contracts Clause and its more well-developed caselaw protects all citizens nationwide from having their contract rights modified or impaired by government officials. It applies commonly to labor contracts between government employers and public employee unions. Wage freezes or furloughs, for example, which typically abrogate the collectively bargained-for wage increases of municipal workers, fit neatly within the constitutionally contemplated paradigm of a state impairing a citizens’ contractual rights. To challenge the imposition of a wage freeze or furlough, employees have argued that by imposing the freeze, the state is violating its obligations under the federal Contracts Clause, which provides that “[n]o state shall . . . pass any . . . law impairing the obligation of contracts.” (Most states have a contracts clause analog that mirrors the federal provision.) In addition to challenging wage freezes or other diminution of contract rights, the Contracts Clause may also be used to challenge a unilateral impairment of public sector pensions in states that recognize pensions as contractual obligations. In New York and other states, through the Non-Impairment Clause, the constitution not only prohibits the impairment of pensions but expressly recognizes pensions as contracts. Other states have afforded pensions contractual constitutional protection via court rulings.<sup>18</sup>

To establish a viable Contracts Clause claim, employees must show there has been a “substantial impairment of a contractual relationship.”<sup>19</sup> Courts will assess, whether a contractual impairment is constitutional: “(1) whether the contractual impairment is in fact substantial; if so, (2) whether the law serves a significant public purpose, such as remedying a general social or economic problem; and, if such a public purpose is demonstrated, (3) whether the means chosen to accomplish this purpose are reasonable and appropriate.”<sup>20</sup> When a state is impairing its own contracts, as is often the case with municipal and state workers, the impairment is scrutinized more closely than if a state is impairing private contracts.<sup>21</sup> “Courts are less deferential to a state’s judgment of reasonableness and necessity when a state’s legislation is self-serving and impairs the obligations of its own contracts.”<sup>22</sup> Further, the level of review is heightened if the impairment is severe. The United States Supreme Court has recognized “[t]he severity of the impairment is said to increase the level of scrutiny to which the legislation will be subjected.”<sup>23</sup>

The most significant hurdle in prevailing on a Contracts Clause claim from a labor perspective is demonstrating that the impairment did not “serve a significant public purpose” or that the impairment was not “reasonable and appropriate” to accomplish that purpose. In *Buffalo Teachers Fed’n v. Tobe* (“Buffalo Teachers”), the Second Circuit analyzed whether legislation establishing a wage freeze to deal with Buffalo’s fiscal crisis was a violation of the Contracts Clause.<sup>24</sup> There, the court found that the wage freeze did not violate the contracts clause because the freeze was “reasonable and necessary”<sup>25</sup> during an extreme economic crisis in the city of Buffalo during 2003.<sup>26</sup> Buffalo’s population was declining, its poverty rate was above 20% and its credit rating was near junk status. Importantly, the court emphasized that the wage freeze was utilized as a “last resort measure,” imposed “only after other alternatives had been considered and tried,” including, among other things, a tax increase and a city-wide hiring freeze.<sup>27</sup> Other factors the court considered in determining the reasonableness of the wage freeze was that the freeze was temporary, and applied prospectively to future wages, not to past wages already earned.<sup>28</sup> The Buffalo Teachers precedent clarifies that though a government’s interest in addressing a dire fiscal emergency may constitute a legitimate public interest, the existence of revenue shortfalls or other budgetary problems alone does not satisfy the significant public purpose inquiry.<sup>29</sup> Relief from the obligation to pay its workers is useful from a budgetary perspective to any government. But a wage freeze or other unilateral contract impairment is not just another tool for balancing municipal budgets; it is a tool that must only be used as a last resort. <sup>30</sup>

In the case of the New Jersey appellate court, Judge Jacobson began her analysis by stating that New Jersey’s Non-Impairment Clause created a contractual right for pensions between public employees and their employers.<sup>31</sup> While recognizing that the constitutional prohibition is not absolute, the court held that the State’s decision to eliminate \$1.57 billion of its \$2.25 billion obligation to the pension system reflected a substantial impairment “by any measure.”<sup>32</sup> Moreover, because “a State is not completely free to consider impairing the obligations on par with other policy alternatives,” New Jersey’s Governor could not unilaterally cut pensions, more than a year before the end of the fiscal year, before even considering other budgetary alternatives.<sup>33</sup> The court afforded less deference to the State in its analysis of whether the Governor’s actions were reasonable and necessary because the State’s own economic self-interest was at stake. Quoting the Supreme Court’s seminal decision in *U.S. Trust*, the court stated that “[i]f a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contracts Clause would provide no protection at all.”<sup>34</sup>

Though the New Jersey Supreme Court reversed the decision on other grounds, the lower court’s decision (and Justice Albin’s dissent in the Supreme Court decision) is critical as it used the Contracts Clause analytical framework of *U.S. Trust* and *Buffalo Teachers* and applied it to the impairment of state employee pensions. A future challenge in New Jersey to the actual reduction of

pension payments should pick up on Judge Jacobson's reasoning in this regard. As the Supreme Court found, New Jersey must get its "financial house in order," but to withstand scrutiny, impairing pensions must be a last, not a first resort.

### **Comparing the Non-Impairments Clause and the Contracts Clause**

Since its adoption, the Non-Impairment Clause in New York has most often been used to prohibit the Legislature from altering the formula by which the amount of retirement benefits is determined.<sup>35</sup> In both *Kleinfeldt v. New York City Employees' Retirement System* and *Birnbaum v. New York State Teachers Retirement System*, the New York Court of Appeals explained that even if their decisions invalidating the Legislature's attempt to alter the retirement benefits formula would "plunge[]" the retirement system "into bankruptcy," the court was "not at liberty to hold otherwise" as the constitutional amendment prohibits – without qualification – official action which "adversely affects the amount of retirement benefits payable to the members under [the] laws and conditions existing at the time of his entrance into retirement system membership." <sup>36</sup> In *Kleinfeldt*, the court further emphasized that "[a]lthough fiscal relief is a current imperative, an unconstitutional method may not be blinked." <sup>37</sup>

This reasoning suggests that the Non-Impairment Clause may actually be stronger than the Contracts Clause and a first and threshold line of defense, as the Non-Impairment Clause – unlike the Contracts Clause – may protect pensions even in the event of a fiscal crisis. These New York cases, along with the Illinois decision discussed below, support the position that the Non-Impairment Clause may provide an absolute protection against pension reductions. However, the inviolability of New York's and other state's non-impairment clauses may come into question. Some judges in states with similar non-impairment clauses have found that the pension protection provision is not ironclad. These judges hew more closely to the Contracts Clause "last resort" analysis in determining whether pensions may be impaired.

### **LEGISLATIVE AND JUDICIAL IMPAIRMENTS IN TODAY'S ECONOMIC CLIMATE**

The contours of non-impairment clause jurisprudence can be seen in the recent examples of both Detroit and Illinois. Both illustrate what circumstances may allow for a successful constitutional challenge.

#### **Detroit's Bankruptcy and Public Sector Pensions**

Detroit's bankruptcy filing in 2013 underscores the vulnerability of pensions amidst tough financial times. Detroit's bankruptcy filing was not surprising, as the city had reached rock bottom following "decades of decline" and the "flight of residents and businesses to the suburbs."<sup>38</sup> It stands as the biggest municipal bankruptcy filing in the country's history, a true low for the "hollowed-out relic that once was hub for the U.S. automotive industry."<sup>39</sup> Detroit, like Buffalo in 2003, was in dire economic straits, experiencing significant decreases in population, employment, and revenue. These decreases caused the city's infrastructure to decay, its crime rates to rise, and its borrowing to become excessive.<sup>40</sup> Detroit's debt, upon filing, was estimated to be \$18 billion.<sup>41</sup>

In the face of Detroit's challenging financial circumstances, its public sector employees sought to protect the pensions they were promised. Michigan, like New York, has a constitutional non-impairment clause protecting them. Article IX, § 24 of the Michigan Constitution reads, "[t]he accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired." Several public sector employee unions challenged Detroit's eligibility to file for bankruptcy and its attempt to diminish their pensions. The unions argued that "the city filed for bankruptcy with the

sole intention of diminishing pension benefits, and that the filing violates state and federal constitutions.”<sup>42</sup> However, the court explained that although the “the State of Michigan cannot legally provide for the adjustment of the pension debts of the City of Detroit” due to the “prohibition against the State of Michigan impairing contracts in both the United States Constitution and Michigan Constitution . . . [t]he federal bankruptcy court, however, is not so constrained.”<sup>43</sup> The court reasoned that because the Bankruptcy Clause of the U.S. Constitution, and the corresponding Bankruptcy Code, empower the Bankruptcy Court to impair contract rights, pensions – though armed with constitutional contractual status, could be impaired in bankruptcy.<sup>44</sup> The court stated, “[i]t has long been understood that bankruptcy law entails impairment of contracts.”<sup>45</sup> Thus, despite the seemingly absolute language of the Michigan Non-Impairment Clause, Bankruptcy Judge Steven Rhodes found that Detroit pensions could be impaired in order to settle the bankruptcy.<sup>46</sup>

Importantly, the linchpin of Judge Rhode’s ruling was that (1) the situation in Detroit was so dire that municipal bankruptcy was necessary and (2) within that municipal bankruptcy context, impairment of bargained-for rights was permissible.

As a result of the court’s decision, a settlement with the unions, which reduced the pensions of retirees by 4.5% and eliminated their cost-of-living adjustments,<sup>47</sup> was reached by the parties and confirmed by the court on November 7, 2014.<sup>48</sup> Clearly, Detroit’s bankruptcy significantly impacted the lives of the hard working people of Detroit, altering their expectations of retirement.

### **Illinois Workers Fight Back**

Like Detroit and New Jersey, the State of Illinois is enduring persistent economic and budgetary difficulties. Despite the national economic recovery and a recent increase in state income taxes, Illinois is “in a deeper financial hole than ever,” according to a recent state financial report.<sup>49</sup> Illinois has “both atypically large debts and structural budgetary imbalances” that threaten to rapidly expand the State’s already growing debts and deficits. <sup>50</sup> It has the lowest credit rating of any state, and it now faces future credit downgrades, which will further increase the state’s high cost of borrowing.<sup>51</sup> To combat its rising deficits, Illinois, like other governments, turned to legislation to overhaul its pension system. Unlike Judge Rhodes’ decision in Detroit however, the Illinois courts have been unwilling to allow the government to dishonor its pension commitments.

In December 2013, Illinois passed legislation in an effort to close the gap of \$100 billion of unfunded liabilities in the State’s retirement system.<sup>52</sup> This legislation attempted to restore fiscal balance “by raising the retirement age for government employees and cutting cost-of-living adjustments.”<sup>53</sup> Plaintiff public sector unions brought suit to enjoin enforcement of the law on the grounds that it unconstitutionally impaired public employee pension rights under the Illinois Non-Impairment Clause.<sup>54</sup> The State argued that the act was justified as an exercise of its police powers.<sup>55</sup> By order dated November 21, 2014, Illinois Judge John Belz struck down the legislation ruling that “[b]ecause the Act diminishes and impairs pension benefits and there is no legally cognizable affirmative defense, the Court must conclude that the Act violates the Pension Protection Clause of the Illinois Constitution.”<sup>56</sup> Judge Belz “rejected Illinois’ argument that pensions could be cut to protect the public welfare in an emergency, including the state’s precarious financial situation.”<sup>57</sup> He explained that the Illinois “Pension Protection Clause contains no exception, restriction, or limitation for an exercise of the State’s police powers or reserved sovereign powers.”<sup>58</sup>

The Attorney General of Illinois filed a motion to appeal Judge Belz’s ruling.<sup>59</sup> The Illinois Supreme Court heard oral arguments on March 11, 2015 and on May 8, 2015 the Court unanimously affirmed, finding that state politicians had attempted to correct Illinois’ fiscal problems on the backs of public sector retirees without a meaningful effort to distribute the burden among all Illinoisans. Other means, such as increasing state income taxes, had not been considered and even a budgetary crisis

was not an excuse to override the clearly stated absolute protection of pensions.<sup>60</sup>

Following Judge Belz's ruling in the lower court, public sector employees of Illinois took the offensive, seeking to challenge additional pension-impairing legislation passed by the State directed towards municipal employees in Chicago. Public Act 98-0641, which came into law in June 2014, "demands increased pension contributions from [Chicago] employees and limits their cost-of-living adjustments" in an effort to "cover a funding shortfall of as much as \$9.4 billion in two city pension funds supporting more than 60,000 workers and retirees."<sup>61</sup> In December 2014, a coalition of unions and city employees filed suit to strike down the legislation. In their complaint, the coalition stated "[u]nless this court strikes down and enjoins implementation of the act, plaintiffs and thousands of other current and retired city of Chicago and Chicago Board of Education employees will be harmed, and the trust that all Illinois citizens place in the inviolability of their constitution will be breached."<sup>62</sup> The outcome of this new litigation should shed further light on the viability of challenges to unilateral pension-impairing legislation in states with non-impairment clauses.

### **Lessons To Be Drawn From Detroit, Illinois and New Jersey**

New York public sector employees can learn from the cases in Detroit, Illinois, and New Jersey despite the still unsettled state of the law. These experiences provide a sense of the circumstances under which a court may permit the abridgement of public worker pensions and when it might resist unilateral legislative or executive action. They also provide useful information on the effectiveness of the two primary legal challenges available to public sector unions to thwart pension and benefit reductions: one based on state non-impairment clauses, as was the case in Illinois, and one, as in New Jersey and Buffalo, based on state and federal contracts clause claims.

In Detroit, the court permitted the impairment of pensions because of the city's bankruptcy and the federal court's perceived ability to invalidate public contracts without violating the Contracts Clause. Detroit's decision rested on the city's dire financial crisis and the federal court's analysis that federal bankruptcy law trumps both the State Non-Impairment Clause as well as the federal Contracts Clause.

In Illinois, despite the State's precarious financial situation, the court did not permit pensions to be impaired. There, the public sector unions pointed to the Non-Impairment Clause, and the court interpreted the clause as an absolute protection against any reduction the state legislature wished to impose upon the public employee pension system. By contrast, in New Jersey, the Supreme Court, assured by counsel that the State "is not walking away from its obligations to the pensions systems and to pay benefits due to retirees" found that a unique New Jersey constitutional provision, prevented the formation of a contract requiring certain pension funding levels. No such constitutional provision exists in New York.

The takeaway is that at the very least in New York – because of the Buffalo decision and the fact that pensions are constitutionally protected contracts – pensions may only be impaired when a municipality is suffering a severe fiscal crisis as in Detroit or Buffalo, and, even then, absent bankruptcy only once all other reasonable alternatives have been tried. However, an unprecedented situation akin to Detroit's bankruptcy is unlikely to occur in the foreseeable future in New York. So long as New York State and its municipalities are not on the verge of dire fiscal crisis, public employees here should find comfort in the state and federal constitutional arguments, which succeeded in Illinois and, at least initially, New Jersey, to bar any attempted pension reduction. A challenge to pension or contract infringing governmental acts should focus first on the unambiguous constitutional language of the Non-Impairment Clause ("benefits... shall not be diminished or impaired") and second on whether the government action to abrogate contractual rights or pensions is truly a measure of last resort.

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**Last Updated: August 4 2015**

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**Footnotes**

1 In re Pension Reform Litigation, No. 118585, 2015 IL 118585, 2015 Ill. LEXIS 499 (Ill. May 8, 2015)

2 Id. at \*68.

3 James L. Bromley and Hugh K. Murtagh, Some Pension Promises May be Too Strong To Break, LAW360, (Mar. 10, 2015), <http://www.law360.com/articles/629964/some-pension-promises-may-be-too-strong-to-break>.

4 Id.

5 Burgos v. New Jersey, No. MER-L-1267-14 (N.J. Super. Ct. Law Div. Feb. 23, 2015).

6 Alejandro Chafuen, The U.S. Economy In 2015: Challenges And Opportunities, FORBES (Jan. 1, 2015, 7:00 AM), <http://www.forbes.com/sites/alejandrochafuen/2015/01/01/the-u-s-economy-in-2015-challenges-and-opportunities/>. See also Nick Timiraos, U.S. Economy's Promises, and Perils, of 2015, THE WALL STREET JOURNAL (Jan. 4, 2015, 6:09PM), <http://www.wsj.com/articles/can-u-s-economy-keep-powering-ahead-1420399994/> ("Economists often disagree, but they share a broad consensus on one point: The U.S. economy is among the world's best off as 2015 begins.").

7 Katherine Peralta, U.S. Cities Aren't Out of the Woods Yet, U.S. NEWS (Nov. 11, 2014, 4:03PM), <http://www.usnews.com/news/articles/2014/11/11/fiscal-hangover-the-crisis-fiscal-impact-on-us-cities> ("The combination of declines in state aid and a slump in returns from property taxes - which is the largest source of revenue for a city - is to blame for the fiscal drain, the report found. Those two revenue sources declined an average of 4 percent across all cities.").

8 Id.

9 Bankrupt Cities, Municipalities List and Map, GOVERNING (Nov. 7, 2014), <http://www.governing.com/gov-data/municipal-cities-counties-bankruptcies-and-defaults.html>.

10 See Illinois Public Employee Benefits Act, Public Act 098-0599 § 1(June 1, 2014).

11 N.Y. CONST. art. V, § 7; see also Ill. CONST. art. XIII, § 5; Mich. CONST. art IX, § 24.

12 U.S. CONST. art. I § 10, cl. 1.

13 These arguments do not apply to bilateral negotiations between government officials and public



sector employees in efforts to curb contract or pension rights; rather, these arguments apply when government officials unilaterally attempt to alter pension rights. Further, these arguments do not apply to employees who enter the pension system after pension rights have been impaired. There is no claim of pension impairment if it occurred prior to an employee's entrance into the pension system.

14 N.Y. CONST. art. V, § 7. (emphasis added).

15 Barnes et al. v. Arizona State Retirement System et. al., No. CV. 2011-011638 (Sup. Ct. AZ, Maricopa Cnty., 2012) (invalidating act that sought to increase employee contributions to Arizona's retirement system under the Arizona and federal Contracts Clause and under Arizona's Non-Impairment Clause).

16 Guzman v. New York City Emp. Ret. Sys., 45 N.Y.2d 186, 190-91 (1978).

17 Ballentine v. Koch, 89 N.Y.2d at 56.

18 Madden v. Contributory Ret. Appeal Bd., 431 Mass. 697, 701 (2000) ("The State retirement system creates a contractual relationship between its members and the State.") (citing Opinion of the Justices, 364 Mass. 847, 860 (1973)).

19 General Motors Corp v. Romein, 503 U.S. 181, 186 (1992).

20 Sanitation & Recycling Indus., Inc. v. City of New York, 107 F.3d 985, 993 (2d Cir. 1997).

21 Condell v. Bress, 983 F.2d 415, 418 (2d Cir. 1993).

22 Id; U.S. Trust Co. of New York v. New Jersey, 431 U.S. 1, 26 (1977) ("[C]omplete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake. A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all.")

23 Energy Reserves Grp., Inc. v. Kansas Power & Light Co., 459 U.S. 400, 411 (1983).

24 464 F.3d 362 (2d Cir. 2006).

25 Id. at 371. ("Ultimately, for impairment to be reasonable and necessary under less deference scrutiny, it must be shown that the state did not (1) 'consider impairing the ... contracts on par with other policy alternatives' or (2) 'impose a drastic impairment when an evident and more moderate course would serve its purpose equally well,' nor (3) act unreasonably 'in light of the surrounding circumstances'") (quoting U.S. Trust Co., 431 U.S. at 30-31).

26 Id.

27 Id.

28 Id. at 371-72.

29 Donahue v. Paterson, 715 F. Supp. 2d 306, 319-21 (N.D.N.Y. 2010).

30 As discussed in further detail supra at 6-7, a Contracts Clause argument faces additional challenges if the impairment has been imposed in the context of municipal bankruptcy. Certain

courts have found that the Contracts Clause does not constrain the federal government and that bankruptcy law “explicitly empower[s] bankruptcy court[s] to impair contracts.” See *In re City of Detroit*, Mich., 504 B.R. 191, 244 (Bankr. E.D. Mich. 2013). Moreover, if a municipality is in a fiscal situation as dire as bankruptcy, the necessity of impairment may be more pronounced.

31 *Burgos v. New Jersey*, *supra* note 3.

32 *Id.*

33 *Id.* (quoting *U.S. Trust Co. of New York v. New Jersey*, 431 U.S. 1, 31 (1977)).

34 *U.S. Trust Co.*, 431 U.S. at 26.

35 *Kleinfeldt v. New York City Employees’ Retirement System*, 36 N.Y. 2d 95, 99-100 (1976).

36 *Id.* at 102; *Birnbaum*, 5 N.Y.2d 1, 11 (1958).

37 *Kleinfeldt*, 36 N.Y. 2d at 101.

38 Matthew Dolan, *Record Bankruptcy for Detroit*, *WSJ*, (Jul. 19, 2013), <http://www.wsj.com/articles/SB10001424127887323993804578614144173709204>.

39 Karen Pierog and Lisa Shumaker, *Factbox: Detroit Bankruptcy was Years in the Making*, *REUTERS*, (Jul. 18, 2013), <http://www.reuters.com/article/2013/07/19/us-usa-detroit-bankruptcy-factbox-idUSBRE96H1J820130719>.

40 *Id.* at 193.

41 *Id.* at 194.

42 Emily Atkin, *Unions Say Detroit Can’t Show It’s Insolvent*, *LAW360*, (Oct. 18, 2013), <http://www.law360.com/articles/481300/unions-say-detroit-can-t-show-it-s-insolvent>.

43 *Id.* at 244.

44 *Id.*

45 *Id.* (internal citations omitted). In examining the legislative intent behind the Non-Impairment Clause in the Michigan Constitution, the court explained that the Non-Impairment Clause in Michigan is no stronger than the Contracts Clause, and thus pensions could be impaired in bankruptcy just like contracts are impaired in bankruptcy. The court stated, the “constitution could have given pensions protection from impairment in bankruptcy in several ways.” *Id.* at 247. The court then explained that the drafters of the Michigan Constitution could have protected pensions further by prohibiting Michigan municipalities from filing bankruptcy, or by creating a property interest in pensions that bankruptcy courts would be required to respect under state law, or by establishing a secured interest in a municipality’s property, or finally, the drafters could have “explicitly required the State to guaranty pension benefits.” *Id.* (emphasis added). The court concluded that since the drafters took none of these precautions, pensions, because they enjoy merely a contractual status, are vulnerable to impairment in bankruptcy. *Id.*

46 *Id.* at 243-248.

47 *Detroit’s bankruptcy plan: A phoenix emerges*, *THE ECONOMIST*, (Nov. 7, 2014),

<http://www.economist.com/blogs/democracyinamerica/2014/11/detroits-bankruptcy-plan>.

48 In re City of Detroit, (Bankr. E.D. Mich. Nov. 7, 2014).

49 Greg Hinz, State in deepest financial hole ever, CRAIN'S CHICAGO BUSINESS, (Mar. 13, 2014), <http://www.chicagobusiness.com/article/20140313/BLOGS02/140319866/state-in-deepest-financial-hole-ever>.

50 Illinois Public Employee Benefits Act, Public Act 098-0599 § 1 (June 1, 2014).

51 Id.

52 Illinois Public Employee Benefits Act, *supra* note 41.

53 Brandon Lowrey, Judge Strikes Down \$100B Ill. Public Worker Pension Reform, LAW360, (Nov. 21, 2014), <http://www.law360.com/articles/598731/print?section=employment>.

54 In re Pension Litigation, No. 2014 MR 1, (Ill. Cir. Ct. Sangamon Cnty., Nov. 21, 2014).

55 Id.

56 Id. (emphasis added).

57 Karen Pierog and Lisa Shumaker, Illinois asks high court for pension law hearing as soon as January, (Dec. 4, 2014), <http://www.reuters.com/article/2014/12/05/us-usa-illinois-pensions-idUSKCN0JJ04I20141205/>. See also In re Pension Litigation, *supra* note 46. ("Pension Protection Clause contains no exception, restriction, or limitation for an exercise of the State's police powers or reserved sovereign powers. Illinois courts, therefore, have rejected the argument that the State retains an implied or reserved power to diminish or impair pension benefits.").

58 In re Pension Litigation, *supra* note 46. Judge Belz's ruling tends to support the argument that the Non-Impairment Clause is stronger than the Contracts Clause. Belz explained that the Illinois Non-Impairment Clause is absolute, and will still be violated even if the state is in severe financial distress. In contrast, the Contracts Clause, will not be violated if there is a significant public purpose for the impairment.

59 Citation to that article re: AG's swift appeal

60 Rick Pearson, Monique Garcia, and Bob Sexter, Illinois pension law greeted with court skepticism, CHICAGO TRIBUNE, (Mar. 11, 2015, 8:05PM), <http://www.chicagotribune.com/news/local/politics/ct-illinois-pension-supreme-court-met-0312-20150311-story.html#page=1>.

61 Lance Daroni, Chicago Pension Reform Bill Unconstitutional, Unions Say, LAW360, (Dec. 17, 2014, 2:29PM), <http://www.law360.com/articles/605332/chicago-pension-reform-bill-unconstitutional-unions-say>.

62 Id.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

