No. 118585

IN THE
SUPREME COURT OF ILLINOIS

IN RE: PENSION REFORM LITIGATION	Appeal from the Circuit Court for the Seventh Judicial Circuit, Sangamon County, Illinois, Sangamon County Case Nos. 2014 MR 1, SH 3, and 2014 CH 48; Cook County Case No. 2013 CH 28406; and Champaign County Case No. 2014 MR 207 (consolidated pursuant to Supreme Court Rule 384) The Honorable JOHN W. BELZ, Judge Presiding

MOTION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF OF INTERESTED PARTIES IN SUPPORT OF APPELLANT PAT QUINN, GOVERNOR OF ILLINOIS

Under Illinois Supreme Court Rule 345, *amici* contracts professors respectfully move for leave to file a brief as *amici curiae* in support of the position of the Appellant Pat Quinn, Governor of Illinois. Specifically, *amici* wish to address an analytic gap in the circuit court's reasoning regarding contract principles as they relate to the Pension Protection Clause. The interaction between familiar contract principles and established Illinois law sheds light on this important issue. The proposed *amicus* brief is attached hereto.

Amici are a group of Illinois law professors who teach and write in the area of contract law. Katharine Baker is a Professor of Law at Chicago-Kent College of Law.

(10)

Wendy Epstein is an Assistant Professor of Law at DePaul University College of Law and focuses her research on contract and commercial law. Adrian Walters is the Ralph L. Brill Professor of Law at Chicago-Kent College of Law and focuses his research interests on bankruptcy and general corporate and commercial law. As members of the Illinois legal community, *amici* have a significant interest in the consistent interpretation of Illinois contract and constitutional law, and in faithful adherence to the law as articulated by the Illinois legislature and the Illinois Supreme Court.

As the Court is aware, the circuit court granted summary judgment and declared Public Act 98-0599 unconstitutional and void in its entirety. An important issue at the circuit court level was whether the State's police power justified the impairment to pension benefits caused by Public Act 98-0599. The proper resolution of this issue turns on the interaction between common law contract principles, constitutional doctrine, and constitutional interpretation. *Amici* believe that the trial court's treatment of this complicated issue gave short shrift to the contract principles portion of this analysis.

Amici believe that the circuit court ignored that the Pension Code should be treated as a contract and the attendant implications thereof. This Court has consistently interpreted the Pension Code as a "contractual relationship." *Kanerva v. Weems*, 2014 IL 115811, ¶48; *People ex rel. Sklodowski v. Illinois*, 182 Ill. 2d 220, 228-29 (1998) ("The plain language of the pension protection clause makes participation in a public pension plan an enforceable contractual relationship . . . ."). And, as a contract, familiar common law doctrinal and interpretive principles apply. Some of these doctrines operate to imply terms or law that the parties did not expressly include in their agreement. In public contracts, a longstanding principle of Illinois law is that the State's responsibility to

exercise its police power in appropriate circumstances is implied. *Felt v. Board of Trustees*, 107 Ill. 2d 158 (1985); *Allied Steel v. Spannaus*, 438 U.S. 234, 241 (1978). Since the State retains the ability to exercise its police power as a matter of contract law, the Pension Protection Clause's protection of pensions is not absolute. *Amici* seek leave to file an *amicus curiae* brief in order to explain in detail the interaction and application of contract principles to the constitutional issues the Court now confronts.

Aside from the obvious direct impact on the State and its constituents, the issues presented in this appeal have far-reaching consequences on the development of Illinois law as it relates to the intersection of basic contract principles and State Constitutional law. As *amici*, we are able to focus on these important legal issues in more detail than the parties, who are necessarily focused on the numerous issues raised on appeal. *Amici* also have no stake in the present controversy and are therefore able to offer a detached perspective different than that of the parties in the case.

Amici therefore seek to submit the attached brief to provide a carefully focused analysis in order to assist the Court in deciding these important issues.

Dated: January 12, 2015

Respectfully submitted,

Contracts Professors, Katharine Baker, Wendy Epstein, and Adrian Walters

By: _____
One of Their Attorneys

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	)	The Honorable JOHN W. BELZ, Judge Presiding

ORDER

The motion of Contract Professor's for leave to file a brief as *amicus curiae* in support of Appellant Pat Quinn, Governor of Illinois is:

☐ **GRANTED** ☐ **DENIED**

Dated: _____, 2015

_____
Justice

Certificate of Service

The undersigned hereby certifies that he is one of the attorneys for *amici curiae* and that he caused copies of the foregoing **MOTION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF OF INTERESTED PARTIES IN SUPPORT OF APPELLANT PAT QUINN, GOVERNOR OF ILLINOIS** to be served upon all counsel of record by causing them to be deposited in the United States mail, postage prepaid, on January 12, 2015, addressed to:

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AMICUS CURIAE BRIEF OF INTERESTED PARTIES IN SUPPORT OF APPELLANT PAT QUINN, GOVERNOR OF ILLINOIS

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TABLE OF POINTS AND AUTHORITIES

TABLE OF POINTS AND AUTHORITIES
(continued)

Page

TABLE OF POINTS AND AUTHORITIES
(continued)

Page

TABLE OF POINTS AND AUTHORITIES
(continued)

Page

TABLE OF POINTS AND AUTHORITIES
(continued)

Page

The undersigned contracts professors respectfully submit this brief as *amici curiae* and request that this Court reverse the November 21, 2014 order of the Circuit Court for the Seventh Judicial Circuit, as supplemented by the Circuit Court's November 25, 2014 findings. The circuit court entered judgment in favor of the plaintiffs' in the consolidated cases on their claims that certain provisions of Public Act 98-599 (the "Pension Code") violate the Pension Clause of the Illinois Constitution (Article XIII, § 5) The court declared the Pension Code void in its entirety.

STATEMENT OF INTEREST

Amici are a group of Illinois law professors who teach and write in the area of contract law. Katharine Baker is a Professor of Law at Chicago-Kent College of Law. Wendy Epstein is an Assistant Professor of Law at DePaul University College of Law and focuses her research on contract and commercial law. Adrian Walters is the Ralph L. Brill Professor of Law at Chicago-Kent College of Law and focuses his research interests on bankruptcy and general corporate and commercial law. As members of the Illinois legal community, *amici* have a significant interest in the consistent interpretation of Illinois contract and constitutional law, and in faithful adherence to the law as articulated by the Illinois legislature and this Court.

ARGUMENT

The Pension Protection Clause of the Illinois Constitution states that membership in the Illinois pension and retirement system is a "contractual relationship." For this reason, a court must interpret these relationships as contracts. Contract law recognizes multiple doctrines pursuant to which absolute, strict performance of a contract according to its terms is not always required, and a party's performance maybe suspended or modified in specific circumstances. *Amici* invoke this well-established aspect of contract law to argue that the "contractual relationship" established by the Pension Code is subject to long recognized legal doctrines that operate as implied terms of the relationship. Among those doctrines is the sovereign's inalienable right to exercise its police powers for the general welfare -- a reserved right present in all contracts, including the Pension Code, and crucial to the sovereign's ability to maintain a well-functioning polity.

I. The Circuit Court Erred in Failing to Treat the Pension Code as a Contract

A. The Code is Properly Interpreted as a Contract

The Pension Protection Clause of the Illinois Constitution explicitly defines membership in the public pension system as a "contractual relationship." (Article XIII, § 5.) The constitution accordingly requires courts to interpret pension legislation as a contractual relationship, and this Court has consistently followed that directive. *Kanerva v. Weems*, 2014 IL 115811 ¶48 (2014); *People ex rel. Sklodowski v. Illinois*, 182 Ill. 2d 220, 228-29 (1998) ("The plain language of the pension protection clause makes participation in a public pension plan an enforceable contractual relationship . . . ."); *Buddell v. Bd. Of Trs., State Univ. Ret. Sys. of Ill.*, 118 Ill. 2d 99, 102 (1987).

It is axiomatic that courts interpret contractual relationships according to contract law principles. Because membership in the state pension and retirement systems is a contractual relationship, it is subject to interpretation according to contract law. *See Buddell*, 118 Ill. 2d at 102 ("[The Pension Protection Clause] guarantees that all pension benefits will be determined under a contractual theory . . . .").

B. The Pension Code, Like Other Contracts, Has Implied Terms

Courts regularly take account of implied terms and other legal doctrines when interpreting contracts. "The primary objective in construing a contract is to give legal effect to the intent of the parties." *Gallagher v. Lenart*, 226 Ill. 2d 208, 232 (2007). In order to determine the parties' intent, the court may be required to imply terms not expressly contained in the agreement. *Schiro v. W.E. Gould & Co.*, 18 Ill. 2d 538, 544 (1960). Any terms implied in a contract are as much a part of the contract as what is expressed. *See Barnes v. Am. Brake-Beam Co.*, 238 Ill. 582, 591 (1909) ("The law supplies the want of express agreements by necessary implications, and a contract includes not only what the parties say in it, but all those things which the law implies as a part of it"); *William W. Brauer Steamship Co. v. Plano Mfg. Co.*, 135 Ill. App. 100, 108 (1st Dist. 1907) (implying terms where the details of the contract were not clearly expressed in the written instruments, but were nevertheless clearly implied).

Both statutes and common law doctrines operate to imply terms in a contract. *See Barnes*, 238 Ill. at 591; *Nevin v. Pullman Palace Car Co.*, 106 Ill. 222, 223 (1883); *see also In re Doctors Hosp. of Hyde Park, Inc.*, 337 F.3d 951, 955 (7th Cir. 2003) (("[S]tatutes are a source of implied contractual terms-the Uniform Commercial Code being the most common such source-just like common law doctrines, such as the duty of

good faith, which in Illinois is read into all contracts.") (quoting *Selcke v. New England Ins. Co.*, 995 F.2d 688, 689 (7th Cir. 1993) (internal citations omitted)).

Chief among the implied terms is that a contract is subject to existing law. Courts presume that parties contract with reference to existing law, whether or not expressly stated within the contract. *George v. Haas*, 311 Ill. 382, 386 (1924). "Thus, contractual language must be interpreted in light of existing law, the provisions of which are regarded as implied terms of the contract, regardless of whether the agreement refers to the governing law." 11 R. Lord, Williston on Contracts § 30:19 (4th ed.); *Ill. Bankers' Life Ass'n v. Collins*, 341 Ill. 548, 552 (1930). Existing law includes laws which affect the validity, construction, discharge, and enforcement of contracts. *Ill. Bankers'*, 341 Ill. at 548.

Established legal doctrines are incorporated into contracts both to avoid requiring parties to include them in their agreements, and because parties are not free to exclude from their agreements various legal principles, including principles grounded in public policy. In Illinois, as everywhere else in America and throughout the common law world, it is presupposed that parties cannot anticipate every contingency that may affect performance. Illinois courts have long incorporated legal doctrines into private contracts to address exceptional circumstances that excuse performance of a contract. *See Leonard v. Autocar Sales & Service*, 392 Ill. 182, 187 (1945) (recognizing the doctrine of impossibility as an excuse for nonperformance of a contract); *Smith v. Roberts*, 54 Ill. App. 3d 910, 913 (4th Dist. 1977) (stating that "commercial frustration is a viable doctrine in Illinois"); *see also Pielet v. Pielet*, 2012 IL 112064, ¶ 51-53 (addressing the defense of novation).

For example, the doctrines of impossibility, commercial frustration, and novation apply to all Illinois contracts through implication. These doctrines provide escape valves when the facts and circumstances warrant. *See Smith*, 54 Ill. App. 3d at 912. Impossibility generally applies where performance becomes impossible after a contract is made. *Chicago, M. & St. P. Ry. Co. v. Hoyt*, 149 U.S. 1 (1893); *Leonard*, 392 Ill. at 187. The doctrine includes not only strict impossibility, but impracticability because of extreme and unreasonable difficulty. *Fisher v. U.S. Fidelity & Guaranty Co.*, 313 Ill. App. 66, 72-73 (1st Dist. 1942).

Frustration of purpose, or commercial frustration, is a related doctrine that "rests on the view that where . . . the parties when entering into the contract must have known that it could not be performed unless some particular condition or state of things would continue to exist, the parties must be deemed...to have made their bargain on the footing that such particular condition or state of things would continue to exist." *Smith*, 54 Ill. App. 3d at 912-13 (citing *Leonard*, 392 Ill. at 187-88). The defense of commercial frustration will be applied when: (1) the frustrating event was unforeseeable; and (2) the value of the counterperformance of the other party was rendered nearly destroyed by the frustrating event. *Id.*

The affirmative defense of novation arises "when a valid new contract is created and a valid existing contract or obligation is extinguished," or where there is a substitution of a new debt for an existing debt. *U.S. Fidelity and Guar. Co. v. Klein Corp.*, 190 Ill. App. 3d 250, 256 (1st Dist. 1989); *Pielet*, 2012 IL 112064 at ¶52. In order to prove novation, a party must show: (1) a prior, valid obligation; (2) a subsequent agreement of all parties to the new contract; (3) the extinguishment of the old contract;

and (4) a valid new contract. *Pielet*, 2012 IL 112064 at ¶52. While novation may not be presumed, the intention of the parties may be inferred from the circumstances. *Alton Banking & Trust Co. v. Schweitzer*, 121 Ill. App. 3d 629, 634 (5th Dist. 1984). (*Amici* mention impossibility, frustration of purpose, and novation solely as examples of run-of-the-mine implied contractual terms. The material implied contract term *here* is none of these, but rather the State's police powers.)

The circuit court did not consider any implied terms of the Pension Code, nor did it address established legal doctrines. Instead, the court held the Pension Code to its express terms only. That is not the proper approach to contract law. Contract law requires consideration of the intent of the parties and the express and implied terms, including existing law and implied legal doctrines inherent in all contracts. The circuit court ignored the requirements of contract law because it failed to treat the Pension Code as a "contractual relationship." That failure subverts both the directive of the constitution and the intention of the legislature. For these reasons, the circuit court's Order should be reversed.

C. Parties to a Standard Commercial Contract Have Incentives to Voluntarily Modify the Terms of Their Agreement in Light of Extreme Economic Conditions

Various legal devices encourage parties to voluntarily modify their agreements in the face of unforeseen dire circumstances. In the commercial sphere, one such device is bankruptcy. Bankruptcy encourages voluntary modification by providing a reciprocal benefit. A reasonable modification allows the party facing bankruptcy to avoid that outcome and the other contracting party likely receives a greater return than they would have received had bankruptcy occurred. *See e.g., Lindsay v. Ass'n of Prof'l Flight*

Attendants, 581 F.3d 47 (2d Cir. 2009) (American Airlines sought and received concessions from flight attendants union due to the union's opinion that there was a legitimate threat of bankruptcy).

The bankruptcy process itself encourages voluntary modification by requiring commercial entities and unions to attempt to reach agreements. *See In re Maxwell Newspapers, Inc.*, 981 F.2d 85, 89 (2d Cir. 1992) (The Bankruptcy Code "requires unions to face those changed circumstances that occur when a company becomes insolvent, and it requires all affected parties to compromise in the face of financial hardship. At the same time, [it] also imposes requirements on the debtor to prevent it from using bankruptcy as a judicial hammer to break the union"). This process accordingly balances the unforeseen dire financial circumstances and the contractual rights previously negotiated.

Similar incentives exist with respect to municipal entities. *See e.g., In re City of Bridgeport*, 129 B.R. 332, 336-37 (Bankr. D. Conn. 1991) (("Chapter 9 [of the Bankruptcy Code] is intended to enable a financially distressed city to continue to provide its residents with essential services such as police protection, fire protection, sewage and garbage removal, and schools . . . while it works out a plan to adjust its debts and obligations.") (citations omitted) (internal quotation marks omitted)).

States, however, lack the option of bankruptcy under current federal law. Without the potential for a reduction in benefits obligations and without an actual restructuring process, there exists no incentive to voluntarily negotiate with the state, even in the face of dire circumstances. The lack of incentive illustrates the importance of the state's ability to modify contracts in exceptional circumstances. The state's ability is present in

its police power reserved to all the states by the United States Constitution. *United States v. Morrison*, 529 U.S. 598, 618 (2000); *Mem'l Gardens Ass'n, Inc. v. Smith*, 16 Ill. 2d 116, 123 (1959) (citing *Union Cemetery Ass'n of City of Lincoln v. Cooper*, 414 Ill. 23, 31-32 (1953)).

II. The Pension Code Remains Subject to the Police Power

A. The State's Ability to Exercise its Police Power in Appropriate Circumstances is Implicit in Every Public Contract, Including the Pension Code

This Court and the United States Supreme Court have long recognized that – notwithstanding constitutional language stating that certain contracts shall not be "diminished or impaired" – contracts remain subject to the State's police power. *See Felt v. Board of Trustees*, 107 Ill. 2d 158, 165-67 (1985); *Sanelli v. Glenview State Bank*, 108 Ill. 2d 1, 47 (1985); *George D. Hardin, Inc. v. Village of Mount Prospect*, 99 Ill. 2d 96, 103 (1983); *Meegan v. Village of Tinley Park*, 52 Ill. 2d 354, 357-58 (1972); *People ex rel. Lyle v. City of Chicago*, 360 Ill. 25, 29 (1935); *Hite v. Cincinnati Indianapolis RR*, 284 Ill. 297, 299-300 (1918); *City of Chi. v. Chi. Union Traction Co.*, 199 Ill. 259, 270 (1902); *Mills v. Cnty. of St. Clair*, 7 Ill. 197, 228 (1845); *Allied Steel v. Spannaus*, 438 U.S. 234, 241 (1978); *U.S. Trust v. N.J.*, 431 U.S. 1, 23 (1977); *City of El Paso v. Simmons*, 379 U.S. 497, 509 (1965); *E. N.Y. Savings Bank v. Hahn*, 326 U.S. 230, 232 (1945); *U.S. v. Winstar Corp.*, 518 U.S. 839, 872 (1996) (plurality); *Faitoute Iron & Steel v. City of Asbury Park*, 316 U.S. 502, 513 (1942); *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 436 (1934).

"Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also

read into contracts as a postulate of the legal order." *Home Bldg. & Loan*, 290 U.S. at 239. The police power is an essential attribute of the sovereign power of each state reserved by the Constitution of the United States. *Mem'l Gardens*, 16 Ill. 2d at 123 (citations omitted). The state may exercise its police powers in order to protect the public health, safety, morals, and general welfare or convenience. *Vill. of Chatham v. Cnty. of Sangamon*, 216 Ill. 2d 402, 424-25 (2005) (quoting *City of Carbondale v. Brewster*, 78 Ill. 2d 111, 114-15 (1979)).

Certainly the State may appropriately invoke its police powers to respond to dire economic conditions. *See Home Bldg. & Loan,* 290 U.S. at 434 (upholding a Minnesota statute which imposed a moratorium on mortgage foreclosures in light of the dire events of the Great Depression); *Faitoute Iron & Steel*, 316 U.S. at 506 (upholding state legislation authorizing the modifications of public bonds, "[t]he necessity compelled by unexpected financial conditions to modify an original arrangement for discharging a city's debt is implied in every such obligation"); *Town of Cheney's Grove v. VanScoyoc*, 357 Ill. 52, 55, 61-62 (1934) (state law limiting the recovery on publicly issued bonds did not violate the Contracts Clause of the Illinois or United States Constitution because it "was intended to meet a distressed financial condition prevalent throughout the state"); *City of Chicago v. Chicago and Northwestern Ry. Co.*, 4 Ill. 2d 307, 317-18 (1954) (statute altering the allocation of a contractual debt obligation did not violate the Contracts Clause because the Clause "does not prevent a proper exercise by the State of its police power of enacting regulations reasonably necessary to secure the health, safety morals, or general welfare of the community, even though contracts may thereby be

affected, for such matters cannot be placed by contract beyond the power of the State to regulate and control them").

B. The Pension Protection Clause is not a Limit on the Police Power

The State's right to exercise its police powers is an implied condition of every contract. *Hahn*, 326 U.S. at 232; *Energy Reserves Group v. Kansas Power & Light Co.*, 459 U.S. 400, 410 (1983); *see also Hite*, 284 Ill. at 299; *Hardin*, 99 Ill. 2d at 103. The sovereign's right to exercise police powers is as much a part of a public contract as thought it were written expressly into the contract. *See Barnes*, 238 Ill. at 591; *William W. Brauer Steamship Co. v. Plano Mfg. Co.*, 135 Ill. App. 100, 108 (1st Dist. 1907).

The law has been well established, since the time of the Constitutional Convention through the present, that the state retains its police powers even if provisions of the Constitution mandate that certain contract rights not be diminished. *See Atlantic Coast Line R.R. Co. v. City of Goldsboro*, 232 U.S. 548, 558 (1914) (("[T]he power of the State to establish all regulations that are reasonably necessary to secure the health, safety, good order, comfort, or general welfare of the community can neither be abdicated nor bargained away, *it is inalienable even by express grant.*") (emphasis added)); *Kanerva*, 2014 IL 115811 at ¶41 ("[T]he drafters of a constitutional provision are presumed to know about existing laws and constitutional provisions and to have drafted their provision accordingly."). As such, the state retains its police powers in the face of constitutional provisions, like the Pension Protection Clause, that contracts cannot be diminished or impaired.

A state's police powers fall squarely within the Reserved Powers Doctrine. According that doctrine, certain powers are so integral to the sovereign that they may not be contracted away under any circumstance. *Winstar*, 518 U.S. at 888 (1996); *U.S. Trust*, 431 U.S. at 23. The classic example of this limitation is where a party attempts to avoid actions of the state made pursuant to its police powers. *See Winstar*, 518 U.S. at 888; *Stone v. Mississippi*, 101 U.S. 814, 815-16 (1880); *see also N. Park Pub. Water Dist. v. Vill. of Machesney Park*, 216 Ill. App. 3d 936, 940 (2d Dist. 1990) ; *Peoples Gas Light Coke Co. v. City of Chicago*, 413 Ill. 457, 473-74 (1952) (holding that the city could not grant an easement in derogation of its police power over public streets). "It is fundamental...that the police power is inalienable; neither a State nor its municipalities may surrender or limit such power." *N. Park Pub. Water Dist.*, 216 Ill. App. at 940 (citing *State Public Utilities Comm'n v. City of Quincy*, 290 Ill. 360, 363 (1919)); *Chi. Union Traction*, 199 Ill. at 270 (("'No contract can be made which assumes to surrender or alienate a strictly governmental power which is required to continue in existence for the welfare of the public. This is especially true of the police power, for it is incapable of alienation.'") (internal citation omitted)).

For these reasons, it is clear that the Pension Code is subject to the police powers of the sovereign under established contract principles and, as well, under the doctrine of reserved powers. In its Order, the circuit court engaged in little discussion or analysis of the state's right to exercise its police power. Instead, the court merely stated its finding as a matter of law that "the defendants' affirmative matter provides no legally valid defense." The court's approach failed to consider the police powers principles long recognized by this Court and the United States Supreme Court.

C. The State's Ability to Exercise its Police Powers to Protect the Health and Welfare of All Citizens is Essential to the Maintenance of a Well-Functioning Polity

The State's responsibility to protect the health and welfare of all citizens exists regardless of the State's contractual obligations. *See W.B. Worthen Co. v. Thomas*, 292 U.S. 426, 433 (1934) ("[L]iteralism in the construction of the Contract Clause...would make it destructive of the public interest by depriving the state of its self-protection"); *Chi Union Traction*, 199 Ill. at 270; *Felt*, 107 Ill. at 165-67. This responsibility should not be compromised by holding that the State's pension obligations are absolute.

CONCLUSION

For all of the reasons stated herein, the Contracts Professors respectfully request that this Court reverse the Order of the Circuit Court granting summary judgment and declaring the Act void to allow for interpretation of the Act under the principles of contract law.

Dated: January 12, 2015

Respectfully submitted,

Contracts Professors, Katharine Baker,
Wendy Epstein, and Adrian Walters

By: _____
One of Their Attorneys

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Certificate of Compliance

I certify that this brief conforms to the requirements of Rules 341(a) and (b). The length of this brief, excluding pages containing the Rule 341(d) cover, the Rule 341(h)(1) Statement of Points and Authorities, the Rule 341(c) Certificate of Compliance, and the Certificate of Service, is 13 pages.

Charles H. R. Peters

Certificate of Service

The undersigned hereby certifies that he is one of the attorneys for *amici curiae* and that he caused copies of the foregoing ***AMICUS CURIAE*** **BRIEF OF INTERESTED PARTIES IN SUPPORT OF APPELLANT PAT QUINN, GOVERNOR OF ILLINOIS** to be served upon all counsel of record by causing them to be deposited in the United States mail, postage prepaid, on January 12, 2015, addressed to:

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