

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, 2014 CH 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 OF THE CIVIC COMMITTEE
OF THE COMMERCIAL CLUB OF CHICAGO
FOR LEAVE TO FILE A BRIEF *AMICUS CURIAE*
SUPPORTING DEFENDANTS-APPELLANTS**

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The Civic Committee of the Commercial Club of Chicago (“Civic Committee”) respectfully moves pursuant to Illinois Supreme Court Rule 345 for leave to file a brief *amicus curiae* in support of the defendants-appellants.

The issue in this case is the constitutionality of Public Act 98-599, which reforms the four State pension systems that apply to State legislators, State university employees, other non-judicial State employees, and K-12 public school teachers outside of Chicago. The Civic Committee has a longstanding and acute interest in the issues raised in this litigation and has expertise and experience that will assist the Court in its resolution of this very important case.

The Civic Committee is an affiliate organization of the Commercial Club of Chicago, which is a private, not-for-profit organization composed of senior executives from the largest employers in the metropolitan area of Chicago. The purpose of the Commercial Club of Chicago is to promote the social and economic vitality of the Chicago metropolitan area. The Civic Committee is a separate not-for-profit corporation that is made up of some of the chief executive officer and managing partner members of the Commercial Club. The Civic Committee addresses public policy issues and works hand-in-hand with public officials and other civic organizations for the social and economic well-being of our region.

The Civic Committee has historically worked on an array of projects to improve the operations of state and city government, expand the economy, improve ground and air transportation facilities, rationalize land use and environmental planning, and improve the schools. Over the years, it has become increasingly apparent that the fiscal and budgetary challenges faced by the State of Illinois are major impediments to all these initiatives, and

that the State's continued ability to perform important and essential governmental services depends on reform of the four state pension systems addressed in Public Act 98-599.

In 2006, the Civic Committee established a State Finance Task Force, which was charged with evaluating the State's finances, and in December of that year, the Task Force published a pamphlet entitled *Facing Facts*, which contained a thorough analysis of the State's finances and the need for prompt action.¹ The Great Recession of 2008 then caused dramatic increases in the State's unfunded pension liabilities and future pension costs. It further then became apparent that there have been structural changes in the State's economy that have reduced the State's capacity to raise revenues at a time when the State's non-pension expenses were already increasing far more rapidly than State revenues. By 2009, it had become clear that the State's fiscal position had deteriorated rapidly, that the growing pension debt and unfunded pension liabilities of the four pension systems had created a burden on the State's finances that is unsustainable, and that the State would not be able to perform its most important functions and effectively address the State's many other pressing needs unless measures were adopted to reduce the State's pension costs and provide greater security for members of pension systems. The Civic Committee discussed this issue in detail in an updated report, *Facing Facts 2009*.² In subsequent years, there has been a steady further deterioration in the State's finances, despite dramatic budget cuts and tax increases.

¹ The report is available at <http://www.civiccommittee.org/Media/Default/pdf/FacingFacts2006.pdf>.

² The updated report is available at <http://www.civiccommittee.org/Media/Default/pdf/FacingFacts2009.pdf>.

Since 2009, members of the Civic Committee have led the public efforts to promote reform of the State's pension systems. The Civic Committee arranged for actuarial and other financial experts to provide analysis of the State's pension and other costs and of various options for pension reform, to testify at legislative hearings, and otherwise to work closely with legislators and their staffs. The Civic Committee similarly arranged for attorneys and law firms to draft legislative language, analyze the constitutional and other issues raised by pension reform, testify at legislative hearings, and otherwise discuss the issues with legislators and their staffs. These efforts culminated in the Civic Committee's support of Senate Bill 1, which was passed in December 2013 and was signed by Governor Quinn and enacted into law as Public Act 98-599.

For these reasons, the Civic Committee has a special and unique interest in the outcome of these consolidated challenges to Public Act 98-599. Moreover, because of its expertise in the State's finances and deep knowledge of the factual conditions that led to the specific provisions of the Act, the Civic Committee is well positioned to provide the Court with an understanding of the consequences for the State, its economy, its businesses, and its citizens of a decision invalidating the Act.

In the proposed Brief *Amicus Curiae*, the Civic Committee has endeavored not to duplicate the presentations that the State Defendants and any other *amici* will make. Instead, the Civic Committee primarily seeks to provide the Court with a thorough understanding of the facts and events that made the enactment of Public Act 98-599 a matter of paramount necessity in the Civic Committee's judgment and that mean that invalidation of the Act would have severe adverse consequences for this State's economy

and future. The Civic Committee has also sought to develop and present aspects of the legal issues that go beyond the presentation of the State Defendants.

For the foregoing reasons, the Civic Committee respectfully submits that its motion for leave to file the attached Brief *Amicus Curiae* in support of Appellants should be granted.

Respectfully submitted,

Dated: January 12, 2015

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ORDER

This matter having come before the Court on the motion of the Civic Committee of the Commercial Club of Chicago under Rule 345 for leave to file a brief *amicus curiae* in support of Defendants-Appellants,

It is hereby ordered that the motion is ALLOWED / DENIED.

Date: _____

CERTIFICATE OF SERVICE

I, David W. Carpenter, certify that on January 12, 2015, three (3) true and correct copies of the foregoing MOTION OF THE CIVIC COMMITTEE OF THE COMMERCIAL CLUB OF CHICAGO FOR LEAVE TO FILE A BRIEF *AMICUS CURIAE* SUPPORTING DEFENDANTS-APPELLANTS and proposed BRIEF OF *AMICUS CURIAE* THE CIVIC COMMITTEE OF THE COMMERCIAL CLUB OF CHICAGO SUPPORTING DEFENDANTS-APPELLANTS were served upon all counsel of record listed below by FedEx with postage fully prepaid, in properly-addressed envelopes.

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CERTIFICATE OF ELECTRONIC FILING

I, David W. Carpenter, certify that on January 12, 2015, the foregoing MOTION OF THE CIVIC COMMITTEE OF THE COMMERCIAL CLUB OF CHICAGO FOR LEAVE TO FILE A BRIEF AMICUS CURIAE SUPPORTING DEFENDANTS-APPELLANTS was served and filed by electronic means on the Clerk's office of the Illinois Supreme Court. Upon acceptance, an original and one copy of the file-stamped version will be delivered to the Clerk's office within 5 days.

I further certify that on January 12, 2015, the proposed BRIEF OF *AMICUS CURIAE* THE CIVIC COMMITTEE OF THE COMMERCIAL CLUB OF CHICAGO SUPPORTING DEFENDANTS-APPELLANTS was served by electronic means on the Clerk's office of the Illinois Supreme Court. Once the Brief has been accepted and filed, the original and 12 copies will be delivered to the Clerk's office within 5 days.

/s/ David W. Carpenter
David W. Carpenter

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INTRODUCTION AND SUMMARY

The decision of this appeal will have momentous importance for the State of Illinois, its economy, and all its citizens. Quite simply, the decision will determine whether there is any prospect that our State can have a reasonable economic future.

This specific issue in this case is the constitutionality of Public Act 98-599. In it, the General Assembly amended the provisions of the four Illinois pension systems that apply to the State's non-judicial employees (including the members of the General Assembly itself) and to public school teachers outside Chicago. This Act was passed in response to structural changes in the State's economy and other events in the past 15 years that manifestly had not been foreseen either when pension rights were defined in the 1970s and 1980s or when the current system of pension funding was adopted in 1994.

These unforeseen events are crippling our State government. Of most direct relevance to this case, the unanticipated developments resulted in an immediate \$70 billion increase in the unfunded pension liabilities of the four systems and would cause wholly unanticipated multi-billion-dollar increases in the State's annual pension costs for the next three decades. Further, the increases in the State's pension costs will occur after related changes in the economy reduced the State's capacity to raise revenues, caused the State's non-pension-related expenses to increase at a much faster rate than the State's revenues, and mean that the State faces chronic and rapidly increasing deficits even apart from its pension costs.

The General Assembly previously responded to these events with deep cuts to the State's budget, tax increases, and reductions in benefits for employees hired after January 1, 2011. But as the Institute of Government and Public Affairs of the University of

Illinois concluded in October 2013, these measures were woefully insufficient. It stated that unless pension reforms and other aggressive actions are adopted, the State will face chronic budget deficits for the foreseeable future—with the deficit increasing from as much as \$4 billion in 2015 to as much as \$14 billion in 2025. The inevitable result would then be that rapidly growing pension costs would increasingly “crowd out”—and prevent—expenditures on governmental functions essential to the State’s viability.

In Public Act 98-599, the General Assembly formally found that it could not eliminate this structural deficit without making some changes to the four pension systems, and the General Assembly made extraordinary efforts to minimize the impact on members of those pension systems and to assure that the State provides them adequate retirement income. The Act maintains the core of the pension benefits and has modified only three specific aspects of the pension formulas that had conferred windfalls on system members or that otherwise did not create reasonable expectations or substantial reliance interests. And the Act enhances the remaining core benefits by requiring—for the first time in the State’s history—full actuarially adequate funding of them.

The net effect of the Act’s provisions will be to reduce the State’s costs by over \$2 billion annually for the next 25 years. As the Institute For Government and Public Affairs of the University Of Illinois concluded in January 2014 and as the Civic Committee will demonstrate in more detail below, these pension cost savings are an essential first step in addressing the State’s structural budgetary deficit, will themselves enable essential services to be provided more broadly, and will pave the way for other actions that are equally required to secure the State’s future.

In the circuit court, the State Defendants made detailed evidentiary showings that, if credited, would establish that the Act is necessary to achieve fiscal stability and enable

vital government functions, that the State reasonably determined that there is no alternative to the Act, that the Act's provisions are reasonable in all other respects, and that the Act, on balance, thus does not unconstitutionally diminish or otherwise impair the benefits of membership in the four pension systems.

But the circuit court refused to consider the State's evidentiary showing, holding that it is legally irrelevant. It concluded that the Pension Clause is an absolute and categorical prohibition on any reduction in pension benefits, regardless of the consequences of the modification for the State and its citizens. Under this holding, parties to pension contracts enjoy greater protections than the Contract Clauses gives others who contract with the State, and the Pension Clause even then gives pension contracts priority over the State's fundamental constitutional responsibility of promoting the general welfare for the benefit of all its citizens.

As detailed below, this decision is contrary to this Court's prior decisions under the Pension Clause, is contrary to settled rules of constitutional interpretation, and is contrary to the terms and history of the Pension Clause itself. But above all else, the decision is contrary to basic linguistics, logic, and common sense. The benefits of membership in a pension system—like all constitutional rights—have their value only because of other protections and opportunities provided by government, and determinations whether a law has “impaired” the benefits of membership in a pension system cannot be based solely on the fact that a pension benefit has been reduced. There is no overall impairment if the police power measure substantially improves life for all in the State and thereby gives slightly reduced pension checks greater value. A statute that is necessary to maintain a government that is financially capable of providing basic

protections and functions cannot diminish or impair the benefits of any citizen's membership in a pension system.

STATEMENT OF RELEVANT FACTS

In summarizing the events and factual developments that led to the enactment of Public Act 98-599, the Civic Committee will cite both to materials in the public record and to affidavits that were submitted in the Circuit Court by the State Defendants (which will be cited simply by the name of the affiant and the relevant page or paragraph).

I. The Pension Systems At Issue.

Illinois has five State-funded pension systems: the General Assembly Retirement System (GARS), the State Universities Retirement System (SURS), the State Employees Retirement System (SERS), the Teachers Retirement System (TRS), and the Judges Retirement System. Each is governed by a separate article of the Illinois Pension Code. Because of separation of powers and related constitutional restrictions, the Judge's Retirement System has a unique constitutional status. Public Law 98-599 thus amends only the provisions of the pension code that govern state legislators, state university employees, other non-judicial state employees, and teachers outside of Chicago.

Each of these systems establishes a "defined benefit" pension plan in which employees who work a certain number of years are entitled to receive monthly annuities after they reach a specified retirement age and until their deaths. Terry, ¶¶ 17-20. The initial amount of each member's payment is based both on the employee's annual compensation in the last years of service and on the number of years of service. *Id.* Since 1989, the pension code has also required annual 3% increases in the size of these annuities.

There are two basic sources of funds used to pay these pensions. First, annual contributions are made to the systems by both the employees and the State. Second, there are earnings from investments of the contributed monies in stocks and bonds. Terry, ¶ 20. A pension system is deemed to be “fully funded” under relevant accounting standards if it has assets equal to the present value of the pension benefits that have been earned to date, with the present value determined by using the expected future rate of return on investment to discount the projected future stream of payments. Such a system will continue to be “fully funded” if contributions are made each year that represent the present value of the additional pension benefits earned and accrued that year (known as the “normal cost of retirement systems”). *Id.* & ¶¶ 58-62.

But these determinations require an array of exceedingly complicated actuarial calculations that depend on predictions about such events as future salaries, future retirement dates, life expectancies, and the future earnings that will be realized from investments over periods that span 50 to 70 years. *Id.* ¶¶ 21-44. In this regard, the predictions about expected future earnings are based on both historical experience and future expectations, and as noted, the assumed rate of return is also the discount rate used to determine the present value of the future liabilities. *Id.* ¶¶ 49-57. All these actuarial assumptions are subject to constant revision as circumstances change.

When actual events deviate from the actuarial assumptions (or when the actuarially required cost has not been contributed), the present value of a system’s liabilities can exceed its assets, such that the system has an “unfunded actuarial accrued liability.” When unfunded liabilities exist, the future annual contribution to the system should ideally be not just the “normal cost” but also two other amounts. One is referred to as “interest on the unfunded liability,” which is equal to the discount rate multiplied by

the unfunded liability. The contribution of the normal cost plus interest on the unfunded liability means that the unfunded liability will not increase. Terry Report, ¶ 63. Second, the unfunded liability is ideally then amortized over a period of years, and a further amount is contributed to cover the portion of the unfunded liability allocated to that year under the amortization schedule. *Id.*

When defined benefit pension systems are underfunded and end up with insufficient assets to pay the promised benefits when they are due, members of the pension system can be at risk. In that event, the promised pensions will be paid only if the employer has the ability to inject additional funds into the system.¹

II. Historic Pension Funding In Illinois And The 1994 Act.

Historically, pension systems in Illinois have not been fully funded. For example, when the Pension Clause was adopted in 1970, each of the five systems was significantly underfunded.² Although the Pension Clause was copied from a New York constitutional

¹ In the private sector, members of pension systems historically did not receive 100 cents on the dollar when pension systems did not have sufficient assets to make the required payments and the employer went out of business or could not both honor the pension commitments and remain a viable business. The Employment Retirement Income Security Act (29 U.S.C. § 1001, *et seq.*) was enacted to provide some relief, and it provides that a plan is transferred to the federal Pension Benefits Guaranty Corporation (“PBGC”) in such circumstances. See PBGC, *Pension Plan Termination Fact Sheet*, <http://www.pbgc.gov/about/factsheets/page/termination.html>. But by law, this federal corporation will not pay any benefit greater than a statutory maximum which is set at levels deemed to represent reasonable retirement income (and which is now \$5,011.36 per month (\$60,136.32 per year) for workers retiring at age 65). See PBGC, *Maximum Monthly Guarantee Tables*, <http://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee.html>.

² In 1970, all five systems were less than 50% funded, with TRS, SERS, and SURS then having funding ratios of 40%, 43%, and 47%, respectively. REPORT OF THE ILLINOIS PUBLIC EMPLOYEES PENSION LAWS COMMISSION 32 (1969). The aggregate unfunded liabilities for the five pension systems was approximately \$2.5 billion, which was slightly less than the State’s General Funds budget for 1970, of \$2.75 billion. The least well-funded system at the time was the Judges’ Retirement System, which was then 32% funded. *Id.* The Judges Retirement System was then the only State system that had been

provision that had been interpreted to require full actuarial adequate funding of state pension systems, the framers of the Pension Clause stated repeatedly during the 1970 Convention that the Illinois Pension Clause did not require full funding of the pensions and would even allow a pay as you go system in which the State would pay “the benefits out of [current] income as they come due.” 4 Record of Proceedings, Sixth Illinois Constitutional Convention 2927 (“Proceedings”).

With no constitutional requirement of actuarially adequate funding of the four systems, the Illinois Constitution of 1970 did not lead to any immediate attempts to eliminate or even substantially reduce the unfunded liabilities, and the systems remained underfunded. But as the pension code was amended to increase the size of benefits and as total unfunded liabilities grew relative to the State’s annual budget, there was growing pressure to adopt a comprehensive funding schedule.

Such a schedule was enacted in 1989 (Public Act 86-273), but it proved unacceptable. In 1994, the General Assembly enacted a comprehensive funding statute, Public Act 88-593. It required that the systems achieve 90% funding by 2045. Under this Act, there was a 15-year “ramp up” period in which contributions were increased annually, and, beginning in 2011, the Act required annual contributions equal to that year’s normal cost, the interest on the unfunded liabilities, and the portion of the unfunded liabilities allocated to that year under the amortization formula. This statute was defended on the ground that, with future inflation and future growth in State revenues, the costs would be a very small portion of State revenues by the later years of the amortization period. Based on the facts that were foreseen in 1994, Public Act 88-

held to give members a contractual right to the promised benefits, and the benefits promised by the other four systems were regarded as “gratuities” that could be canceled at will. *Bardens v. Bd. of Trustees*, 22 Ill. 2d 56, 60 (1961).

593 would have achieved its funding objective, and pension costs would have remained manageable portions of the State budget. The 1994 Act was supported by the State employees' unions and other unions.³ The bill passed the General Assembly unanimously, and it was then signed into law by Governor Edgar.

Under the 1994 Funding Act, the Illinois Commission on Government Forecasting and Accountability ("COGFA") was required to prepare periodic reports on whether the 90% funding ratio by 2045 continued to represent an appropriate goal. 40 ILCS 5/1-103.3. The pension systems' practice was to project the amount of its unfunded liabilities in each future year, and COGFA's reports tracked the system's unfunded liabilities and the level of state contributions that would be required each year up to 2045. Up until 2008, these reports made virtually identical projections that were consistent with the original assumptions and showed that Illinois was on track to make the required contribution until the end of 2007.⁴

III. The Unforeseen Events That Increased Unfunded Liabilities By \$70 Billion In The Last Decade.

But events then occurred that had not been foreseen when the 1994 Funding Schedule was enacted and that radically increased the State's unfunded liabilities and its annual future pension costs.

The Stock Market Collapse of 2007-2008. The most significant single such event was the stock market collapse in 2007-2008 (and the structural changes in the

³ Christopher Wills, *State Workers Target Pensions*, St. Louis Post-Dispatch (Apr. 6, 1994); Dave McKinney, *Big Names Litter Road to Pension Disaster*, Chicago Sun Times (Apr. 18, 2013).

⁴ See COGFA, PENSIONS: REPORT ON THE FINANCIAL CONDITION OF THE STATE RETIREMENT SYSTEMS 13, 69 (2008), available at <http://cgfa.ilga.gov/Upload/2008FinCondReportwithcover.pdf>; COGFA, REPORT ON THE 90% FUNDING TARGET OF PUBLIC ACT 88-0593 14-15 (Jan. 2006), available at http://cgfa.ilga.gov/Upload/Funding_PA_88-0593.pdf.

economy that it reflected). This event was wholly outside the range of financial risks assumed by the systems. *See* Terry, ¶¶ 96-113. This event radically increased the System's unfunded liabilities, and the State's pension costs, for two reasons. *See* Arnold, ¶¶ 30-38.

First, the collapse meant that there were several consecutive years in which the systems incurred enormous losses, rather than returns within the broad range consistent with expected rates of return. For this reason alone, despite normal returns in intervening years, the systems' assets were \$26 billion lower in 2013—and the unfunded liabilities were \$26 billion higher—than had been previously foreseen for 2013. Terry, ¶¶ 96-113.

Second, the 2007-2008 collapse reflected changes in the economy that mean future expected returns on investment will be significantly lower than were previously predicted and foreseen. In at least the previous two decades, public pension systems foresaw returns that would average 8.5%. In light of the events of 2007 and 2008, the expected returns of pension systems have been reduced. In 2010 and 2012, SURS and SERS reduced their discount rate to 7.75% and TRS reduced its discount rate to 8.0%. These changes alone increased unfunded liabilities of the systems by \$10 billion in 2013. Additional 0.5% reductions in expected returns occurred in late 2014 in three of the four systems, which led to an additional \$7 billion increase in unfunded liabilities. Terry, ¶¶ 127-30

For these two reasons, unfunded liabilities of the four systems were \$43 billion higher in 2013 than had been previously foreseen for that year (and are now \$50 billion higher). Because the 1994 Act required the funding of 90% of unfunded liabilities by 2045, this increase in the unfunded liabilities translated into a dramatic increase in the required future contributions to the pension system and in the percentages of the State

budget that each contribution would represent. For example, it meant that the contribution required for 2013 under the 1994 Act was \$1.9 billion higher than had been projected for that year in 2006, and that rather than contribute the anticipated 21% of the 2013 payroll, the State was required to contribute 33% of payroll. Terry, ¶¶ 132-33. Because of other features of the 1994 Funding Schedule, these unfunded liabilities will grow by another \$2-3 billion each year for the next decade,⁵ meaning that these direct effects of the Great Recession, by themselves, will cause annual increases in the State's pension costs of more than \$2 billion over the next several decades.

Increased Life Expectancies and Related Matters. While the Great Recession was the unforeseen event that had the most significant impact, its effects were compounded by other changes in conditions that, too, were not foreseen in the relevant past periods and that independently caused significant increases in unfunded liabilities. For example, life expectancy increased between 1997 and 2013 to a degree not previously foreseen, which itself increased the unfunded liabilities by \$4 billion. Terry, ¶¶ 134-151. In addition, by virtue of related and previously unforeseen changes in mortality, unfunded pension liabilities will increase by an additional \$5 billion. These unforeseen changes, in turn, affected other demographic assumptions such as the expected age and salary at retirement, and these changed demographic assumptions increased the unfunded liabilities by at least another \$3 billion. Terry, ¶¶ 152-60. In sum, these unforeseen changes in life expectancy and related matters increased unfunded liabilities by a total of \$12 billion.

⁵ See Fiscal Futures Project of the Institute of Government and Public Affairs of the University Of Illinois, FACT SHEET, PEERING OVER ILLINOIS' FISCAL CLIFF: NEW PROJECTIONS FROM IGPA'S FISCAL FUTURES MODEL (Oct. 2013), available at <http://igpa.uillinois.edu/system/files/Fiscal-Cliff-Fact-Sheet.pdf> (hereinafter, "PEERING OVER ILLINOIS' FISCAL CLIFF").

Other Events and the \$70 Billion Overall Increase In The Unfunded

Liabilities. A series of other events caused additional increases in the unfunded pension liabilities that had not been foreseen at the prior relevant times. The total effect of all the individual unforeseen events can be readily quantified, for during the period between 1990 and the present, the four systems' actuaries forecast what the unfunded liabilities of the systems would be each year of the next several decades. 1990 was the year after the pension code was amended to require automatic annual compounded 3% increases in annuities, which was the last major change to the statutory pension formulas prior to Public Act 98-599. In 1990, the four systems foresaw a total unfunded liability of \$27 billion in 2013, but the actual unfunded liability was \$98.8 billion in that year—more than \$70 billion higher than anticipated. Terry, ¶¶ 83-85.

In fact, between 1990 and 2005, the unfunded liability that was foreseen for fiscal year 2013 was between \$26 billion and \$47 billion each year. The actual unfunded liability for 2013 was thus between \$50 billion and \$70 billion higher than had been foreseen each year during the period from 1990 to 2005. Terry, ¶¶ 86-89. Indeed, as recently as 2000, the unfunded liability was \$15 billion, and it was anticipated that it would grow to \$26 billion in 2013. *Id.* So events unforeseen as recently as 2000 caused a \$70 billion increase in the unfunded liability, and the unfunded liability was \$50 billion higher than had been foreseen as recently as 2005. *Id.*, ¶¶ 86-90

In this regard, this rapid and unforeseen growth in unfunded liabilities is entirely independent of the historic funding levels and funding policies of the State. *See* Terry, ¶ 91. Whatever the past levels of funding had been and whatever the level of unfunded liabilities that had been projected for 2013, unforeseen events increased the magnitude of

the unfunded liabilities by some \$70 billion. *Id.* In Public Act 98-599, the State simply ameliorates the consequences of this unforeseen increase in unfunded liabilities.

IV. The Large And Growing Gap Between State Revenues And Its Non-Pension Expenses.

Further, Illinois experienced this radical increase in its unfunded liabilities and pension costs at the same time that unforeseen events of the past decade depressed the State's revenues, increased its non-pension expenses, and created what has been termed a large and growing "chronic structural budgetary gap" that is independent of the State's pension liabilities and costs.

These points have been repeatedly explained by the Fiscal Futures Project of the Institute of Government and Public Affairs of the University of Illinois. Even apart from the State's pension liabilities, it has concluded that the State has a chronic, structural fiscal problem because the spending necessary to perform essential government functions is growing at a rate of 3.7% and state revenues are only growing at a rate of 2.3%. *See PEERING OVER ILLINOIS' FISCAL CLIFF, supra.*

Whether or not the recent temporary tax increase is made permanent, the Institute projects multibillion budget deficits that will increase each year for the next decade, with the deficits increasing from \$1 billion in 2014 to \$7 billion in 2025 if the tax increase is made permanent, and from \$1 billion in 2014 to \$14 billion in 2025 if it is not. *Id.* These figures reflect both the State's structural chronic budget gap and costs associated with the unfunded pension liabilities. *Id.*

The Institute's projections reflect the fact that the State has experienced steadily declining revenues and increasing costs for the last 12 years. Lowder, p. 11. This adverse trend was compounded by the stock market collapse in 2008 and the underlying changes in the economy that both led to it and that have resulted from it.

The stock market collapse of 2007-2008 resulted in a deep recession nationally, but Illinois's recession was more severe than the nation's, and Illinois's recovery has lagged the rest of the nation's. Arnold, ¶ 27. The market collapse—and the structural changes in the economy that underlay it—has had severe and lasting effects on Illinois. Historically, Illinois's tax revenue had increased by about 3% annually, except for a 0.5% reduction in fiscal 2002 during the post 9/11 recession. Lowder, p. 2-3. But in 2007-08, Illinois suffered a 12% loss in State revenues over a two year period, *id.*, and excluding the effects of the temporary tax increase enacted in 2011, revenues have not returned to the pre-recession level. Arnold, ¶¶ 39-44. That is so because the Great Recession led to an unexpected, persistent downward shift in the expected total personal income and per capita income in the State. *Id.*

This decline in State revenues also occurred at a time when there was an unprecedented increase in demand for government services, with, for example, Medicaid eligibility increasing by 28%, eligibility for Temporary Assistance for Needy Families increasing by 71%, eligibility for the Supplemental Nutrition Assistance Program increasing by 57%, and eligibility for need-based college assistance growing by over 50%. Lowder, p. 4.

V. The State's Prior Responses to These Events and Their Inadequacy.

In view of the decline in State revenues and increases in its pension costs, the State's prior responses to the growing structural budgetary deficits have been twofold: (1) deep cuts to expenses unrelated to the unfunded pension liabilities and legacy pension costs and (2) tax increases.

First, despite the unprecedented demand for government services, the decline in revenues meant that Illinois was forced to make massive budgetary cuts beginning in

2008. Lowder, p. 6. These cuts reduced the State workforce from more than 65,000 in 2001 to fewer than 45,000 in 2013—the lowest staffing level in the State in at least 25 years. S. 1 Amend. § 1, 98th Gen. Assemb. (Ill. Apr. 30, 2013) These cuts also greatly reduced funding for health, education, and public safety and resulted in the deferrals of essential infrastructure investments. *Id.* Overall, discretionary spending was reduced by over \$2.8 billion between fiscal year 2009 and 2013, “including reductions for primary education of nearly \$1 billion, higher education of over \$230 million, public safety of over \$200 million, and human services, including health care for the poor, of nearly \$1.3 billion.” *Id.* The State also held back funds necessary for infrastructure maintenance, causing roughly 73% of roads in the State to be in poor or mediocre condition. *Id.* In an initial attempt to reduce pension costs, the State also adopted a new and lower schedule of benefits for persons hired on or after January 1, 2011, who became known as “Tier 2” employees. *Id.*

But these cuts were insufficient to bring tax revenues in line with expenses. *Id.* The State issued additional pension bonds to make pension contributions in two years, and even with this borrowing, there were insufficient revenues to fund other programs, and the State was forced to withhold payments to vendors and other State contractors. In fiscal year 2010, there were \$9.1 billion in unpaid bills. Lowder, p. 7

Second, in January 2011, the General Assembly passed a temporary tax increase raising the personal income tax rate from 3% to 5% and the corporate income tax rate from 7.3% to 9.5%. It was set to remain in effect from 2011 through 2014 and to be phased out thereafter. It was designed to provide enough funds to pay the unpaid bills, make the required pension contribution, cover expenses, and generate a reserve to be relied upon while base revenues recovered in future years. Lowder, p. 5. But revenue

growth lagged at the same time that the estimated future pension costs were substantially increased still further. *Id.*

The tax increase led to a decline in economic activity in the State. Prior to mid-2011, COGFA found that Illinois's recovery from the Great Recession was in line with the rest of the nation. Arnold, ¶ 28 (quoting COGFA). However, COGFA found that since mid-2011, Illinois "has lagged both the region and the nation in job growth." *Id.* In 2013, 31,000 workers left the State's labor force, and the State lost about 9,000 manufacturing jobs—while neighboring states saw gains on both measures. Editorial, *What's the Matter with Illinois*, Wall St. J. (Apr. 14, 2014).

Even with the increased tax revenues, Illinois has not been able to pay all its contractors, with \$7.1 billion in unpaid bills in Fiscal Year 2013 and over \$6 billion in unpaid bills today. Lowder, p. 7

For all these reasons, the Institute For Government and Public Affairs of the University of Illinois concluded in October 2013 that Illinois will face fiscal imbalances for many years to come unless Illinois makes "aggressive changes in multiple areas" including "pension changes [that] are crucial," as well as "increases in economic growth," "increases in taxes," and "cuts in spending." PEERING OVER ILLINOIS' FISCAL CLIFF. It concluded that none "alone" can be sufficient. *Id.*

The reasons that the Institute concluded that neither budget cuts nor tax increases may solve the structural deficit are readily apparent.

It would be irresponsible and harmful to vital State interests to attempt to eliminate the entire deficit through budget cuts, for there have already been deep cuts in essential government programs. The further cuts required to eliminate the budget deficit (or match the savings that would result from Public Act 98-599) would threaten to

eliminate governmental programs essential to the economic viability of the State.

Lowder, p. 7-11.

It would be similarly harmful to attempt to rely on tax increases for this purpose. The total tax burden that Illinois and its political subdivisions impose is already greater than those in the states adjacent to Illinois. Worthington, p. 14-22. These states are aggressively courting new businesses and existing Illinois business, and the massive tax hikes required to eliminate the entire deficit would accelerate that process. *Id.*; Arnold, ¶¶ 45-54. To rely on tax hikes in this context could result in a death spiral in which each hike causes more businesses to locate outside the State, which would reduce revenue, create the need for further tax hikes, leading to more departing businesses, etc.

VI. Public Act 98-599 And Its Benefits.

The Civic Committee began advocating pension reform in 2009. After four years in which the General Assembly examined a number of different proposals to restructure the pensions systems and various proposed alternatives to pension reform, the General Assembly concluded that “that the fiscal problems facing the State and its retirement systems cannot be solved without making some changes to the structure of the retirement systems,” and the General Assembly accordingly enacted Public Act 98-599. It modifies the pension systems that apply to the members of the General Assembly itself (GARS) as well as SURS, SERS, and TRS. The Act was designed to “minimiz[e] the impact on current and retired State employees” and to adopt other measures that would be “advantageous” to “employees impacted by these changes” and that would “require more fiscal responsibility of the State.” Public Act 98-599 § 1.

Reductions In Pension Costs. First, the Act adopts three modifications to the statutory pension formulas that will achieve pension cost savings for the State through

measures that have no or minimal impact on the reasonable expectations and substantial reliance interests of system members.

First, most of the Act's savings result from the Act's amendment to the Automatic Annual Increase or "AAI." As enacted in 1989, the AAI required automatic annual 3% increases in each retiree's annuity. In 1989, inflation had averaged 5.5% for a decade and it was projected to continue to exceed 4%. Terry, ¶¶ 163-65. In 1990, the AAI could not have been reasonably expected to protect more than 99% of the purchasing power of the prior year's annuity. But because inflation rates averaged 2.7% between 1990 and 2013 and are projected to remain below 3% for the foreseeable future, the AAI can be fairly be characterized as conferring windfalls on members of the four systems.

Second, Public Act 98-599 increases the retirement age by four months for every year that a current employee is younger than 46, thus increasing the retirement age by four months for a 45-year old and up to five years for employees under the age of 32. As noted above, unforeseen increases in life expectancies created unforeseen advantages for system members (greater cumulative payments) and unforeseen burdens for the State (greater liabilities that must be funded), so this change too is facially reasonable. Further, by having the increase depend on the number of years an employee is younger than 46, the General Assembly assured that the measure cannot materially interfere with any substantial reliance interest.

Third, Public Act 98-599 provides that pensions will not be increased as a result of future raises that increase an employee's salary above the higher of \$109,971 or the employee's salary on the effective date of the Act. This measure has no impact on the substantial reliance interests of any employee. Whether any employee receives future raises—and their amount—is committed to the discretion of the employer. Thus, no

employee can have relied on future salary increases, much less that they will result in higher pensions.

Enhanced Funding. Second, the Act greatly enhances the provisions that govern the funding of pensions. One section of the Act requires the State to make actuarially required contributions at levels that will achieve 100% funding no later than 2044. § 2-124. A second section requires the State to make supplemental annual pension contributions of at least \$364 million starting in 2019, until the State pension system is 100% funded. § 20(c-10). Because of the combined effects of these requirements, the Act requires full funding by 2039, as opposed to the 90% funding by 2045 that the 1994 Act required.⁶

Overall effect. The net effect of these provisions is to reduce the State's future pension costs by over \$2 billion annually. As the Civic Committee demonstrates in the margin, the total cost savings are higher than was suggested in some of the testimony filed below.⁷

⁶ COGFA, ILLINOIS STATE RETIREMENT SYSTEMS: FINANCIAL CONDITION AS OF JUNE 30, 2013 102-04, 106 (Mar. 2014) (hereinafter "2014 COGFA REPORT"), *available at* <http://cgfa.ilga.gov/Upload/FinCondILStateRetirementSysFY13Mar2014.pdf>.

⁷ In some of the submissions below, it was suggested that these benefit changes will cause the State pension costs to be only \$1.3 billion less per year than they would have been if the formulas had not been amended. Mr. Terry attested that, as reported in March 2014, the effect of the Act was to reduce the unfunded pension liabilities of the system by \$20 billion. Terry, ¶¶ 46-47. Professor Worthington attested that this equates to annual savings of \$1.3 billion. To arrive at this figure, she used an interest rate of 4.8% and an amortization schedule of 30 years, with the 4.8% rate representing the State's borrowing cost including the credit spread over equivalent maturity U.S. Treasury rates. *See* Worthington, p. 8-9.

But this figure does not represent the total annual future savings that will result.

First, the calculations do not use the current discount rate to determine the present value of the future pension liabilities. After March 2014, the discount rates for three of the four systems were reduced by 0.5%, and using the current discount rates, the Act's benefit changes have led to approximately a \$21 billion reduction to the unfunded liabilities.

Many legislators opposed Public Act 98-599 not because it was unfair to State employees, but because they thought it did not go far enough in reducing pension costs.⁸

Second, the State's future pension savings are not determined only by the size of the system's current unfunded liabilities. Rather, the required annual future State contributions to the four pension systems have two components (1) the "normal cost," which is the additional pension benefits that accrue each future year, and (2) costs associated with the unfunded liabilities. Professor Worthington's analysis focused only on the latter. But the Act's changes to the benefit formula also reduce the normal cost. Using the current discount rates, the present value of these normal cost savings is approximately \$13 billion. *Compare* COGFA, IL STATE RETIREMENT SYSTEMS: FINANCIAL CONDITION AS OF JUNE 30, 2012 Tables 11, 17, 23, and 35 (Feb. 2013) (showing projected future normal costs before the Act was passed), *available at* <http://cgfa.ilga.gov/Upload/FinCondILStateRetirementSysFY2012Feb2013.pdf>, *with* 2014 COGFA REPORT Tables 11, 16, 21, and 30 (showing projected future normal costs after the Act was passed). Thus, the present value of the Act's total savings is approximately \$34 billion. If the annual future savings is determined with the 4.8% rate assumption and an amortization schedule of 30 years, then the annual savings are about \$2.2 billion.

Third, for purposes of determining the annual future savings, it is more consistent to use the same rate that was used to discount the future costs to present value. If future savings are discounted to present value using the current weighted-average discount rate of 7.39%, and if average annual future savings are estimated using 4.8%, the average annual savings are understated. Using the current annual weighted-average discount rate of 7.39% for both purposes, the future savings that result from the Act are about \$2.9 billion annually.

⁸ *See, e.g.*, Representative Ives, 98th General Assembly House of Representatives Transcription of Debate, 1st Special Session, at 23 (Dec. 3, 2013) ("We don't have time for small reform, but today, that is what is before us and we cannot vote for small reform."); *id.* at 25 ("This Bill reduces our unfunded liability at best by 20%, taking us back to 2011 levels . . . And yet our fiscal situation is not better but instead worse . . . [R]eal reforms [would] include[] moving all current workers into a hybrid program, not optional, of both defined benefits and defined contributions . . . [and] extend[ing] retirement ages over time up to the Social Security age of 67, and . . . generally suspend[ing] all COLAs for retirees until the system is 80% funded."); *id.* at 25-56 ("Whether this Bill passes or not, either way, state funded pensions are in jeopardy. Both insufficient reform and no reform will lead to the same result. We cannot continue to spend 20 percent of general revenue on public pensions, when most states spend only 5% and remain an attractive place to live and do businesses."). Economists and other experts have voiced similar concerns. *See, e.g.*, Alex Keefe, *Study: Pension Savings 'Barely Dent' Illinois Fiscal Woes*, WBEZ (Jan. 21, 2014), *available at* <http://www.wbez.org/news/study-pension-savings-barely-dent-illinois-fiscal-woes-109547>.

The Institute for Government and Public Affairs of the University of Illinois has stated that Public Act 98-599 “was a huge step in the direction of fiscal stability for Illinois,” but that “the state’s fiscal problems are so great that much still remains to be done.” Fiscal Futures Project, ILLINOIS STILL HAS SERIOUS FISCAL PROBLEMS AFTER DECEMBER 2013 PENSION LAW CHANGES (Jan. 2014), *available at* <http://igpa.uillinois.edu/system/files/Pension-Reform-Will-Not-Fix-Deficit.pdf>.

It concluded that even with (1) Public Act 98-599’s pension reform and (2) legislation making permanent the income tax hike put in place in 2011, there is still “a large projected budget gap ... of \$1 billion in FY 2014, which is projected to grow to \$5 billion by 2025.” *Id.* at 2. It concluded that the gap would be \$4 billion in FY 2015 and would grow to \$12 billion in 2025 if the tax increase is not made permanent and the pension reform is upheld. It again stated that the State will need some tax increases, some spending cuts, and increases in economic activity to close the rest of the gap.

VII. This Litigation.

Public Act 98-599 was challenged in five lawsuits that were consolidated in the Sangamon County Circuit Court. The primary challenges were based on the Pension Clause of the Illinois Constitution. The State asserted as an affirmative defense that the Act is a reasonable and constitutional exercise of the State’s “reserved sovereign powers or police powers.” Order 1. The State relied on the decisions of this Court, the U.S. Supreme Court, and other courts holding that the constitutional bans on the impairment of pension and other State contracts are not absolute, that they do not prohibit any and all modifications that can be claimed literally to impair the obligations of these contracts, and that the State can modify its own contracts when the modifications are necessary to advance important State interests, when they are responses to changes in conditions

which were not foreseen when the contracts were formed or when they otherwise are reasonable. The State submitted extensive evidence, including some six expert reports, that demonstrates that the State has a massive fiscal crisis, that unforeseen increases in pension costs are crowding out expenditures on basic governmental functions, and that it would be harmful if the State had attempted to achieve Public Law 98-599's savings through tax increases or further budget cuts. Based on this evidence, the State filed a motion for summary judgment.

Plaintiffs moved to strike the affirmative defense and for judgment on the pleadings, claiming that the Pension Clause is an absolute prohibition on State laws that cause any member of a pension system to receive lower pensions than those that had been promised on her first day of work, regardless of any other circumstances. The circuit court granted this motion. It concluded that the Pension Clause creates a right to full payment of all previously pension benefits that is "absolute and without exception." Order ¶ 3. The court held "as a matter of law that that the defendants' affirmative matter provides no legally valid defense. The Pension Protection Clause contains no exception, restriction or limitation for an exercise of the State's police powers or reserved sovereign powers." *Id.* According to the court, reading the Pension Clause to preserve the State's police powers would amount to "rewrit[ing] the pension protection clause to include restrictions and limitations that the drafters did not express and the citizens of Illinois did not approve." *Id.* (quoting *Kanerva v. Weems*, 2014 IL 115811, ¶ 41).

Having rejected the State's defense as a matter of law, the court held that plaintiffs were entitled to judgment: "Because 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. The Court

holds that Public Act 98-599 is unconstitutional.” Order ¶ 4. In view of its reading of the Pension Clause, the court declined even to consider the evidence submitted by the State that Public Act 98-599 was a reasonable and necessary measure to preserve the State’s ability to perform essential functions. In the court’s words, “[the court] need not and does not reach the issue of whether the facts would justify the exercise of such a power if it existed, and the Court will not require the plaintiffs to respond to the defendants’ evidentiary submissions.” Order ¶ 6.

ARGUMENT

The circuit court’s interpretation of the Pension Clause is wrong for multiple reasons. It is contrary to this Court’s prior decisions. It violates basic principles of constitutional interpretation. It is contrary to the terms and history of the Pension Clause.

The overriding reality is that it is simply impossible as a matter of elementary linguistics, logic, and common sense to conclude that any law that reduces pension benefits has necessarily diminished or impaired the benefits of membership in a pension system, regardless of the government interests that the law advances. To take an extreme example, if payment of 100% of the promised pensions meant that there was not enough money to maintain a police force and that marauding hordes of gangs were stealing all the pension checks each month, the benefits of membership in the pension systems would be meaningless. In that circumstance, if a reduction in the pensions produced savings that enabled the re-establishment of the police force and meant that retirees could cash somewhat reduced pension checks and actually buy things, the statute would decidedly not “diminish or impair the benefits of membership in the state pension systems,” notwithstanding that the pension was lower than had been required under the pension formula in effect on the retiree’s first day of work.

That vividly illustrates why the mere fact that Public Act 98-599 will reduce some pensions cannot establish a per se violation of the Pension Clause. When there are substantial police power justifications for the statute, there is no overall impairment if the police power measures substantially improve life for all in the State and create a society in which the slightly reduced pension has greater value. Benefits of membership in pension systems—like all rights—are meaningful only in the context of civilized society, and determinations whether rights are impaired cannot be made without considering the effect of a measure on the society in which those rights are exercised.

This is why—as explained below—the U.S. Supreme Court and this Court have repeatedly held that no substantive constitutional rights are absolute and that all are subject to compromise when necessary to achieve vital governmental interests.

That is why the Contract Clause decisions hold that this clause “does not immunize contractual obligations from every conceivable kind of impairment or from the effect of a reasonable exercise by the States of their police power.” *George D. Hardin, Inc. v. Vill. of Mount Prospect*, 99 Ill. 2d 96, 103 (1983). That is why a decision whether there is an unconstitutional impairment of any contract mandates an assessment of the degree of the impairment and application of a balancing test in which “[t]he severity of the impairment measures the height of the hurdle the state legislature must clear” to establish a reasonable exercise of the police power. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 245 (1978).

That also explains why, in *Felt v. Board of Trustees of Judges Ret. System*, 107 Ill. 2d 158, 165-67 (1985), when the State was understood to have argued that this same standard applied under the similarly worded Pension Clause, this Court denied a motion

to strike evidence supporting the police power defense and applied this same balancing test to decide the defense on the merits.

That is also why the terms and history of the Pension Clause may only reasonably be read to provide pension contracts with the same protections that the Contract Clause provides to other contracts with the State of Illinois—as the official contemporaneous interpretation of the Clause stated.

Finally, that is why the Pension Clause could not be “absolute,” even if it gave pension contracts an exalted status and greater protection that other contracts receive under the Contract Clause.

All these points are developed more fully below.

I. The Circuit Court’s Decision Is Contrary To This Court’s Prior Construction Of The Pension Clause.

The short answer to the circuit court is that this Court has already rejected the reading of the Pension Clause that the circuit court adopted. In *Felt*, the Court considered a constitutional challenge to a statute that changed the manner of computing pension benefits for members of the Judicial Retirement System of Illinois. As the Court explained, the change resulted in a reduced retirement annuity for each of the plaintiffs. *Id.* at 162-63. The State defendants argued that the statute was constitutional even though it meant pension benefits would be reduced because it was a “reasonable exercise ... of [the State’s] police power.” *Id.* at 165-66 (quoting *George D. Hardin, Inc.*, 99 Ill. 2d at 103).

In assessing the State’s defense, this Court noted the extensive authority that contractual obligations are not “immunize[d] ... from every conceivable kind of impairment,” “or from the effect of a reasonable exercise by the States of their police power.” *Felt*, 107 Ill. 2d at 165 (quoting *George D. Hardin*, 99 Ill. 2d at 103). As the

Court explained, this analysis is performed by application of a balancing test in which the reviewing court assesses the “severity” of the impairment and the magnitude of the state interest advanced by the statute. *Id.* at 165-66. The Court “presumed” that the State was contending that this standard applies under the Pension Clause, which (1) gives contractual status to the provisions of the pension code in effect on an employee’s first day of work and (2) prohibits any diminution or impairment of the benefits of membership in the pension systems. The Court then denied the plaintiff’s motion to strike the evidence submitted in support of the State’s police power defense and applied this standard to determine if the State’s defense was factually valid.

The Court first noted that the State had “enacted the amendment from concerns that the Judicial Retirement System was not adequately funded.” *Id.* at 166. In the Court’s view, this was a legitimate State interest: “The legislature has an undeniable interest and responsibility in ensuring the adequate funding of State pension systems.” *Id.* On the evidence before the Court, however, the statute was not a reasonable exercise of the State’s police power, because the pension code amendment was found not to in fact advance the legislature’s “undeniable interest” in preserving the health of the pension fund. *Id.* Thus, the Court declared, “the amendment severely impairs the retirement benefits of the plaintiffs and those similarly situated and *on the record here* is not defensible as a reasonable exercise of the State’s police powers.” *Id.* at 167 (emphasis added).

The circuit court’s decision cannot be reconciled with *Felt*. In stark contrast with the circuit court’s dismissal of the State’s police power defense and refusal to consider the State’s evidence that Public Act 98-599 is a reasonable exercise of the police power, *Felt* denied a motion by the plaintiffs to strike the State’s evidence of reasonableness

under the police power. *Id.* at 165. Although this Court in *Felt* ultimately rejected the State’s police power defense, it did so as a factual matter, based “on the record” before the Court. *Id.* at 167.

The circuit court simply ignored this part of the *Felt* opinion. While the circuit court cited *Felt*,⁹ it made no mention of *Felt*’s discussion of reasonable exercises of the State’s police power—and did not attempt to explain how the circuit court’s refusal to consider the State’s evidence and the defense could be squared with this Court’s analysis in *Felt*. It cannot be. In a similar vein, there is no basis for the circuit court’s reliance on *Kanerva v. Weems*, 2014 IL 115811 (2014). The only issue in that case was whether health insurance subsidies are “benefits of membership of pension systems” that are *subject* to the prohibition on diminution or other impairments. There was no issue in that case under the police power.

II. The Pension Clause, Like All Constitutional Provisions, Must Be Presumed To Preserve The State’s Police Power.

But even if this Court had not previously decided the issue, the circuit court’s conclusion that the Pension Clause creates rights that are “absolute and without exception” is contrary to fundamental principles of constitutional interpretation. According to the circuit court, the rights granted in the Pension Clause are not subject to reasonable exercises of the State’s police power because the clause that was approved by the constitutional convention and by the voters “contains no [express] exception,

⁹ The court quoted *Felt* for the proposition that to hold that pension rights are subject to the State’s police power “we would have to ignore the plain language of the Constitution of Illinois.” Order ¶ 3 (quoting *Felt*, 107 Ill. 2d at 167-68). The quoted language is inapposite. In that section of the opinion, the Court rejected an argument that the Illinois Constitution could be interpreted to have the same meaning as the constitutions of other states that expressly permit certain modifications of pension benefits—it was not addressing how the State’s police power applies to pension benefits.

restriction or limitation for an exercise of the State's police powers or reserved sovereign powers." Order ¶ 3. But the absence of an *express* reservation of the State's police power is immaterial, and the rule is the precise opposite of the circuit court's holding. Under decades of precedent, *all* substantive constitutional rights are presumed to be subject to the police power, and it can be invoked unless it is unmistakably clear from the terms, purposes, or history that the framers and the voters intended to create immunity from the police power because of separation of powers or related concerns.

In particular, while it is commonplace that substantive constitutional provisions are written in absolute terms, it is well established that "[n]o [constitutional] rights are absolute." *Pena v. Mattox*, 84 F.3d 894, 897-98 (7th Cir. 1996). As this Court has stated, "[e]ven fundamental constitutional rights are not absolute and may be reasonably restricted in the public interest." *In re J.W.*, 204 Ill. 2d 50, 78 (2003); *accord In re Marriage of Diehl*, 221 Ill. App. 3d 410, 427 (2d Dist. 1991). Instead, "[b]ehind the words of the constitutional provisions are postulates which limit and control." *Principality of Monaco v. State of Mississippi*, 292 U.S. 313, 322 (1934). As the Supreme Court has explained, while the Constitution and Bill of Rights provide a "general guaranty of fundamental rights of person and property," that guaranty is not absolute: "In maintaining this guaranty, the authority of the state to enact laws to promote the health, safety, morals, and general welfare of its people is necessarily admitted." *Near v. State of Minnesota ex rel. Olson*, 283 U.S. 697, 707 (1931).

All substantive constitutional provisions presuppose the existence of State governments capable of securing public safety, establishing the necessary infrastructure, promoting public health, providing education, and otherwise creating the conditions that allow individual citizens to live, work, and prosper. Constitutional rights have value only

in such societies, and it is impossible to determine if rights have been abridged without determining the extent to which a law promotes vital government interests and makes the rights more valuable. Thus, implied in every constitutional provision is the existence of sovereign “police” power that can respond to evolving conditions and accommodate the values protected by the constitutional provision to the imperative of promoting these vital state interests. That is why it has often been said, by this Court and others, that the Constitution is not a “suicide pact” that requires the State to sacrifice the well being of the public to literalism and rigid adherence to doctrinaire logic. *See Pooh-Bah Enters., Inc. v. County of Cook*, 232 Ill. 2d 463, 475 (2009) (adopting argument that “the first amendment is not a suicide pact [which prohibits] the government [from] subsidiz[ing] the fine arts unless it is also willing to subsidize activities that are known to have negative secondary effects”); *Edmond v. Goldsmith*, 183 F.3d 659, 663 (7th Cir. 1999) (“When urgent considerations of the public safety require compromise with the normal principles constraining law enforcement, the normal principles may have to bend. The Constitution is not a suicide pact.”); *Terminiello v. City of Chicago*, 337 U.S. 1, 37 (1949) (“[t]here is danger that, if the Court does not temper its doctrinaire logic with a little practical wisdom, it will convert the constitutional Bill of Rights into a suicide pact.”) (Jackson, J., dissenting).

Courts routinely recognize that States must retain some ability to engage in reasonable and necessary exercises of the police power even when the language of a particular constitutional provision appears to be absolute. One prominent example is the Equal Protection Clause of the federal Constitution. The language is absolute: “No State shall ... deny to any person within its jurisdiction the equal protection of the laws.” U.S. CONST., amend. XIV, § 1. But it is beyond peradventure that this provision does *not*

require that all people be treated equally in all circumstances. To the contrary, in most circumstances, States may exercise their police power in a manner that benefits one group over another so long as there is any “rational basis” for doing so. *See, e.g., Williamson v. Lee Optical of Oklahoma, Inc.*, 348 U.S. 483, 487-88 (1955) (upholding state law that favored optometrists and ophthalmologists over opticians against an equal protection challenge, and explaining that “it is for the legislature, not the courts, to balance the advantages and disadvantages” of the law); *F.C.C. v. Beach Commc’ns, Inc.*, 508 U.S. 307, 315 (1993) (upholding regulation that favored some communications companies over others and holding that on rational-basis review, “a legislative choice is not subject to courtroom fact-finding and may be based on rational speculation unsupported by evidence or empirical data”). In short, nearly all economic legislation satisfies such rational-basis review and thus passes constitutional muster—even though it differently benefits and burdens the people. This Court follows the same standards in applying the “absolute” terms of the equal protection clause of the Illinois Constitution, ILL. CONST. OF 1970, art. I, § 2.¹⁰

Another example of a constitutional provision written in absolute terms but not so applied is the First Amendment. The text states that “*no law*” shall be made that “prohibit[s] the free exercise” of religion or that “abridg[es] the freedom of speech, or of the press.” U.S. CONST., amend. I (emphasis added). Again, however, courts routinely uphold statutes and regulations that are reasonable and necessary exercises of the police power even where such laws impinge on First Amendment rights. In the context of free exercise of religion, states are free under the First Amendment—despite the provision’s

¹⁰ *See, e.g., People v. Shephard*, 152 Ill. 2d 489, 499 (1992) (“The equal protection clauses of the United States and Illinois Constitutions do not deny the State the power to draw lines that treat different classes of persons differently.”).

absolute terms—to enact laws that impinge on free religious exercise so long as those laws are generally applicable and not targeted at religion. *Emp’t Div., Dept. of Human Res. of Oregon v. Smith*, 494 U.S. 872, 882-83 (1990). In the context of speech, states are free to criminalize, for example, speech that constitutes obscenity in order to promote the general welfare. *See, e.g., Roth v. United States*, 354 U.S. 476, 483-85 (1957) (affirming conviction for publication of obscene material and stating, “it is apparent that the unconditional phrasing of the First Amendment was not intended to protect every utterance”). States may likewise restrict speech that endangers public safety. *See Schenck v. United States*, 249 U.S. 47, 52 (1919) (“When a nation is at war many things that might be said in time of peace are such a hindrance to its effort that their utterance will not be endured so long as men fight and that no Court could regard them as protected by any constitutional right.”).

The Supreme Court summarized the point in *Konigsberg v. State Bar of California*, stating categorically that not even the fundamental guarantees of the First Amendment are absolute.

At the outset we reject the view that freedom of speech and association, as protected by the First and Fourteenth Amendments, are “absolutes,” not only in the undoubted sense that where the constitutional protection exists it must prevail, but also in the sense that the scope of that protection must be gathered solely from a literal reading of the First Amendment. Throughout its history this Court has consistently recognized at least two ways in which constitutionally protected freedom of speech is narrower than an unlimited license to talk. On the one hand, certain forms of speech, or speech in certain contexts, has been considered outside the scope of constitutional protection. On the other hand, general regulatory statutes, not intended to control the content of speech but incidentally limiting its unfettered exercise, have not been regarded as the type of law the First or Fourteenth Amendment forbade Congress or the States to pass, when they have been found justified by subordinating valid governmental interests, a

prerequisite to constitutionality which has necessarily involved a weighing of the governmental interest involved.

366 U.S. 36, 49-51 (1961) (citations omitted). While the Illinois Constitution's guarantee of freedom of speech, ILL. CONST. OF 1970, art. I, § 4, is not coextensive with the federal First Amendment, this Court routinely follows the U.S. Supreme Court's precedents in interpreting the Illinois guarantee.¹¹

These decisions interpreting the Equal Protection Clause and the guarantees of freedom of speech are examples of the broad principle that constitutional provisions must be read to permit States' reasonable use of police power. In nearly every constitutional context, this Court, the U.S. Supreme Court, and federal courts of appeals have reiterated again and again that constitutional provisions do not create absolute rights, and are not read to forbid the State from reasonable and necessary exercises of the police power. *See, e.g., People v. Hollins*, 2012 IL 112754 ¶ 31 ("This court has observed that the Illinois Constitution goes beyond federal constitutional guarantees by expressly recognizing a zone of personal privacy, and that the protection of that privacy is stated broadly and without restrictions. Even under the expanded privacy protections afforded by the Illinois Constitution, however, the constitutional right to privacy is not absolute") (citations and internal quotation marks omitted); *District of Columbia v. Heller*, 128 S. Ct. 2783, 2816-17 (2008) ("Like most rights, the right secured by the Second Amendment is not unlimited."); *Rocky Mountain Farmers Union v. Corey*, 730 F.3d 1070, 1107 (9th Cir. 2013) (the dormant Commerce Clause does not "require that reality be ignored in lawmaking," such that states' "efforts to find a workable solution"

¹¹ *See, e.g., City of Chicago v. Pooh Bah Enters., Inc.*, 224 Ill. 2d 390, 447-48 (2006).

based on “good and non-discriminatory reason” be struck down in the name of “archaic formalism.”).

Particularly apposite to interpretation of the Pension Clause are interpretations of the Contract Clause contained in both the Illinois and federal Constitutions. *See* ILL. CONST. OF 1970, art. I, § 16; U.S. CONST., art. I, § 10.¹² By its terms, the Pension Clause creates a “*contractual* relationship.” ILL. CONST. OF 1970, art. XIII, § 5. And the Pension Clause uses nearly identical language to that used in the Contract Clause: Just as the Pension Clause provides that the benefits of pension contracts and the resulting membership in pension systems “shall not be diminished or impaired,” both the federal and State Contract Clauses bar the enactment of any law “impairing the obligation of contracts.”

It is well settled that despite the “absolute” terms of the Contract Clause approved by the 1970 Constitutional Convention and ratified by the voters, the Contract Clause does not create absolute rights. As this Court explained, although “the language of the contract clause is absolute,” the Clause “has not been so interpreted.” *George D. Hardin*, 99 Ill. 2d at 103. To the contrary, “[b]oth United States Supreme Court decisions and decisions of this court have held that the contract clause does not immunize contractual obligations from every conceivable kind of impairment or from the effect of a *reasonable exercise by the States of their police power*.” *Id.* (emphasis added); *see also Exxon Corp. v. Eagerton*, 462 U.S. 176, 189-90 (1983) (“Although the language of the Contract Clause is facially absolute, its prohibition must be accommodated to the inherent police power of the State to safeguard the vital interests of its people.”); *Home Bldg. & Loan*

¹² As this Court has explained, the Illinois and federal Contract Clauses are properly “interpreted in the same fashion.” *George D. Hardin*, 99 Ill. 2d at 103.

Ass'n v. Blaisdell, 290 U.S. 398, 428 (1934) (“the Contract Clause’s “prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula”); *id.* at 434-36 (notwithstanding the absolute terms of the Contract Clause, “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)).

As the U.S. Supreme Court has explained, it is essential that the Contract Clause must be read to preserve the State’s “authority to safeguard the vital interests of its people,” and the “reservation of essential attributes of sovereign power is [thus] read into [all] contracts as a postulate of the legal order.” *Blaisdell*, 290 U.S. at 433-35. As the Supreme Court has also stated, “literalism in the construction of the Contract Clause . . . would make it destructive of the public interest by depriving the State of its prerogative of self-protection.” *W.B. Worthen v. Thomas*, 292 U.S. 426, 433 (1934). In *Blaisdell*, the Court explained the State’s “reserved power” must be “construed in harmony” with the “fair intent of the constitutional limitation,” and a state law would thus be upheld if it was “addressed to a legitimate end and the measures taken are reasonable and appropriate to that end.” 290 U.S. at 438-39.¹³

Under these principles, the Supreme Court has upheld not only state laws that effectively modified private contracts, as in *Blaisdell*, but also laws that modified the State’s own contractual obligations with its citizens or with citizens of other states. For example, in *El Paso v. Simmons*, 379 U.S. 497 (1965), the Supreme Court upheld a state law that modified Texas’s contracts with purchasers of public lands to eliminate a

¹³ See also *New York Rapid Transit Corp. v. City of New York*, 303 U.S. 573, 591 (1938) (to be effective, relinquishment of the State’s sovereign power to tax “‘must be clear and unmistakable’”) (quoting *Erie R. Co. v. State of Pennsylvania*, 88 U.S. 492, 493 (1874)).

perpetual right to redemption. The Court reasoned that previously unforeseen events had made this provision more valuable to land purchasers than had been anticipated and meant that the measure was interfering with the state's important interest in orderly administration of its lands. *Id.* at 513-14. It concluded that "the Contract Clause of the Constitution does not render Texas powerless to take effective and necessary measures to deal with" such issues. *Id.* Instead, as the Supreme Court later stated, the Contract Clause allows a State to substantially impair its own contractual obligations when events have occurred that were not foreseen when the contract was formed and the modification is "reasonable and necessary to serve an important public purpose." *U.S. Trust Co. v. New Jersey*, 431 U.S. 1, 23-24 (1977).¹⁴

In the years since *U.S. Trust*, federal courts of appeals have uniformly rejected the Contract Clause challenges to state or municipal laws that unilaterally modified state or municipal collective bargaining agreements with their employees where events that had not been previously foreseen meant that the contract could not be honored without interfering with the state or municipality's ability to maintain its fiscal integrity and provide important government services.

For example, in *Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362 (2d Cir. 2006), the Second Circuit upheld a statute that unilaterally modified a collective bargaining

¹⁴ In fact, far from reading the Contract Clause's absolute terms to eliminate states' reserved police power, the U.S. Supreme Court has made clear that *no contract* that a State enters into may be read to relinquish the State's police power. That Court has "often stated that 'the legislature cannot bargain away the police power of a State.'" *U.S. Trust*, 431 U.S. at 23 (quoting *Stone v. Mississippi*, 101 U.S. 814, 817 (1880)); accord *Atl. Coast Line R. Co. v. City of Goldsboro*, 232 U.S. 548, 558 (1914) ("[I]t is settled that neither the 'contract' clause nor the 'due process' clause has the effect of overriding the 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; that this power can neither be abdicated nor bargained away, and is inalienable even by express grant; and that all contract and property rights are held subject to its fair exercise.").

agreement with employees of the City of Buffalo to impose a wage freeze. The court noted that the City of Buffalo had had a chronic structural budget deficit and that the statute was enacted after tax increases had been adopted and after it was discovered that the budgetary deficit would nonetheless be \$20 million greater than had previously been foreseen. *Id.* at 366. The court held that the wage freeze constituted a substantial impairment of the wage guarantees in the collective bargaining agreement, but that in light of the unanticipated increase in the deficit and the imperative that the fiscal situation be improved, the law was necessary to allow “basic interests of society” to be protected. *Id.* at 369.

Baltimore Teachers Union v. Mayor & City Council of Baltimore, 6 F.3d 1020 (4th Cir. 1993), is similarly instructive. There, the court rejected a Contract Clause challenge to a Baltimore statute that unilaterally modified its collective bargaining agreement with its employees to impose furloughs and salary reductions. These measures were adopted to save \$2 million after there was an unanticipated \$24.2 million reduction in state aid and after the City had evaluated other options and “concluded that it had no better alternatives” for balancing its budget. The Court held that there had been a substantial impairment, but concluded that the measure was “reasonable and necessary to serve an important public purpose” as part of the “sovereign power necessarily reserved by the States to safeguard the welfare of their citizens.” *Id.* at 1018 (quotations and citations omitted). The Court rejected claims that the statute was unnecessary and unreasonable because “the City *could have* shifted the burden from another program” or “*could have* raised taxes,” noting that “these courses are always open, no matter how unwise they may be.” *Id.* at 1019-20. The court held that, notwithstanding the fact that the City’s own financial obligations were at stake, it would provide “some deference” to

Baltimore's determinations of reasonableness and necessity and confine its review to the questions whether the City had "consider[ed] impairing contracts on a par with other policy alternatives" or "imposed a drastic impairment when an evident and more moderate course would serve its purposes equally well." *Id.* at 1020. Because the City had explored other alternatives and had sought to tailor the plan as narrowly as possible to meet the perceived shortfall, the court held that the measure was a reasonable and lawful exercise of the City's reserved sovereign powers.

Another relevant decision is *United Auto., Aerospace, Agr. Implement Workers of Am. Int'l Union v. Fortuno*, 633 F.3d 37, 39 (1st Cir. 2011). There, the United States Court of Appeals for the First Circuit rejected a Contract Clause challenge to a Puerto Rican statute that modified its collective bargaining agreements with over 50,000 public employees to freeze salaries and suspend other provisions as part of a plan "intended to eliminate [a] \$3.2 billion structural deficit." The court upheld the district court decision that dismissed the complaint for failure to state a claim. The First Circuit held that Puerto Rico's determinations of reasonableness and necessity are entitled to some deference and that the plaintiff bore the burden of pleading and proving that the measure was unreasonable and unnecessary, but that the complaint had alleged no facts sufficient to make that showing. *Id.* at 46.

In its decisions under the Contract Clause of the Illinois Constitution, this Court has followed the federal cases interpreting the federal Contract Clause. It has held that "[a]ll contracts are made subject to the authority of the State to safeguard the interests of the people." *Sanelli v. Glenview State Bank*, 108 Ill. 2d 1, 23 (1985); *see also Stelzer v. Matthews Roofing Co., Inc.*, 117 Ill. 2d 186, 190 (1987) (citing *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 242-44 (1978)). The Court has thus rejected a Contract

Clause claim and upheld retroactive modifications of contract rights when it “further[ed] a ‘broad societal interest’—the continued availability of financing for owners and developers of real estate.” *Sanelli*, 108 Ill. 2d at 24, 26 (legislation that modifies contractual rights is valid when it is “a reasonable exercise of the police power to secure an important public interest”). And this Court, too, has recognized that the State and its political subdivision can unilaterally modify their own obligations when necessary to achieve an important state goal and otherwise a reasonable response to unforeseen events. *George D. Hardin*, 99 Ill. 2d at 103 (following the U.S. Supreme Court’s *U.S. Trust, supra*).

The circuit court’s ruling ignores this wealth of case law. By holding that the State may exercise reserved police power only when the reservation is express, the circuit court disregarded the multitude of cases that hold precisely the opposite in dealing with constitutional provisions that are indistinguishable from the Pension Clause. In doing so, the circuit court elevated the right to pension benefits under the Illinois Constitution above not only all other contract rights, but all other constitutional rights, and above the basic constitutional responsibility of the government: providing the basic functions that allow citizens to safely live, work and better themselves. This ruling is contrary to the basic principles of constitutional interpretation that, substantive constitutional restrictions on government are subject to the police power unless the terms, history, or structure of the provision clearly and unmistakably provide otherwise.¹⁵

¹⁵ The plaintiffs have argued previously in this litigation that an absolutist reading of the Pension Clause is supported by two decisions that implicate the constitutional doctrine of separation of powers.

In *Lyle v. City of Chicago*, 360 Ill. 25 (1935), this Court held that judicial salaries could not be reduced during the Depression because the Court strictly applied a constitutional requirement that compensation of municipal officers could not be “increased or

III. The Text And History Of The Pension Clause Do Not Support The Decision Below.

Against this background, the Pension Clause—like the Contract Clause and all other substantive restrictions on the power of government—must be held to be subject to reasonable exercises of the police power unless the terms and history of the Clause unmistakably established that the clause was understood by its sponsors and the voters to be an exception to the rules applicable to similarly worded and equally “absolute” constitutional provisions and to have immunized pension contracts from reasonable exercises of the police power.

Here, the terms and history establish that the Pension Clause extends the same protections to pensions that the Contract Clause grants to other contracts with the State, and pensions are subject to the police power to the same extent as are other contracts. But even if that were not the case, the Pension Clause cannot be read to be absolute and immune from the police power under basic principles of constitutional interpretation.

diminished” during the elected term of office. But unlike the Pension Clause or the Contract Clause, this provision is not an overall limitation on the State’s power, but an allocation of the State’s existing power between branches of government. The obvious purpose of this provision is to prevent an officer’s salary during his term from being subject to legislative modifications that can have the effect of punishing or rewarding particular official actions, and thus assuring that the officer acts independently of legislative influence in the exercise of official duties. Similarly, in *Jorgensen v. Blagojevich*, 211 Ill. 2d 286 (2004), this Court held that the constitutional prohibition on diminution of judicial salaries must be strictly applied and broadly interpreted because it is an essential feature of promoting the constitutional requirement of separation of powers, for if the rule were otherwise, legislators could use threats of salary reductions to influence judicial decisions or to inhibit or punish decisions with which the legislators disagree, and thereby subvert the core principle of judicial independence from legislative influence or control. Neither decision has any pertinence to the Pension Clause, which implicates no issue involving separation of powers.

A. The Pension Clause Must Be Read To Allow Legislative Modification Of Pension Contracts In The Same Circumstances In Which The Contract Clause Allows Modification Of Other Contracts Under The Police Power.

The text and history of the Pension Clause establish that it provides the protections that the Contract Clause provides to other contracts. The Pension Clause states:

Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.

ILL. CONST. OF 1970, art. XIII, § 5.

Breaking the text into its two constituent parts, the first clause provides that membership in any pension system of the State “shall be an *enforceable contractual relationship*.” The plain language thus creates a “contractual relationship”—*i.e.*, a relationship that gives rise to *contract* rights. Consistent with this plain text, this Court has stated numerous times that the Pension Clause creates a contractual relationship. *E.g.*, *Kanerva v. Weems*, 2014 IL 115811, ¶ 38 (discussing “the enforceable contractual relationship resulting from membership in one of the State’s pension or retirement systems”); *People ex rel., Sklodowski v. State*, 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 ... [that] is governed by the actual terms of the Pension Code at the time the employee becomes a member of the pension system.”); *McNamee v. State*, 173 Ill. 2d 433, 438-39 (1996) (same). Notably, the circuit court did not discuss or even address this language in the Pension Clause.

The second clause of the Pension Clause provides that the “benefits” of the enforceable contractual relationship described in the first clause “shall not be diminished

or impaired.” Considering this language in isolation, the circuit court concluded from it that the right to full payment of pension benefits is “absolute and without exception,” and that “any attempt to diminish or impair pension rights is unconstitutional.” Order ¶¶ 1, 3. But that conclusion ignores the meaning of this language in the context of provisions that protect contractual relationships. In particular, the language of this second clause of the Pension Clause tracks the language of the Contract Clause of both the Illinois and federal Constitutions: Just as benefits of the “enforceable contractual relationship” described in the Pension Clause may not be “diminished or impaired,” the Contract Clause provides that contract rights may not be “impaired.” *Compare* ILL. CONST. OF 1970, art. I, § 16 (“[N]o ... law impairing the obligation of contracts ... shall be passed.”); U.S. CONST., art. I, § 10, cl. 1 (“No State shall ... pass any ... Law impairing the Obligation of Contracts”). Thus, this second clause does not create “absolute” rights to pension benefits, but makes the “enforceable contractual relationship” created in the Pension Clause subject to the same protections as other traditional contracts—as this Court held in *Felt*, 107 Ill. 2d 158. *See* Part I, *supra*.

That this is the proper reading of the Pension Clause is confirmed by contemporary statements by the proponents of the constitutional amendment to add the Pension Clause. As the sponsors of the Pension Clause repeatedly stated, the purpose of that Clause was to ensure that pension benefits had the same status as contract rights—not to elevate them above and beyond all other constitutional rights.

Prior to the adoption of the Constitution of 1970, Illinois adhered to the traditional classification of pension plans as either “mandatory” or “optional.” *McNamee*, 173 Ill. 2d at 439-40. When an employee’s participation in a plan was “optional”—as it was in the judges’ retirement plan—the participant’s contributions were “voluntary

consideration” and “created vested contractual rights” that were protected against diminishment or other impairments by the Contract Clause of the Illinois Constitution (which was then Article II, Section 14 of the Illinois Constitution). *Bardens*, 22 Ill. 2d at 60 (invalidating amendment to Judges Retirement System under Contract Clause). By contrast, if the participant’s contributions were mandatory, the pension rights were considered to be in the nature of a gratuity that could be revoked at will. *McNamee*, 173 Ill. 2d at 439-40. The four plans affected by Public Act 98-599 were mandatory plans that did not have contractual status prior to 1970.

The Pension Clause was adopted in 1970 because of concerns that municipalities would exercise their newly created home-rule powers to refuse to pay pensions in mandatory plans on the ground that they were gratuities. 4 Proceedings at 2926. As this Court has explained, “The primary purpose behind the inclusion of section 5 of article XIII was to eliminate the uncertainty surrounding public pension benefits created by the distinction between mandatory and optional pension plans.” *McNamee*, 173 Ill. 2d at 439-40 (citations omitted); *see also Sklodowski v. State*, 182 Ill. 2d 220, 228-29 (1998). Based on a detailed review of the history of the Pension Clause, this Court concluded in *McNamee* that “the framers of the Illinois Constitution set out only to put state and municipal governments on notice that they may not abandon their pension obligations on the belief that such payments were gratuities.” 173 Ill. 2d at 444.

In other words, in the Pension Clause, the framers conferred contractual status on all pension plans and barred diminishment or other impairments of pension benefits. As the official Commentary on the Illinois Constitution states, the Pension Clause “provides that benefits prescribed in the [pension] contract may not be diminished or impaired” and “states explicitly what is found in the more general language of Section 16, Article I [the

re-enacted Contract Clause].” ILL. CONST. OF 1970, art. 13, § 5 (Constitutional Commentary) (Smith Hurd).

Further support for this interpretation of the Pension Clause is found in the determination of the delegates that the Pension Clause should not be interpreted to require actuarially adequate annual funding of the pension systems. This was a rejection of proposals that were widely believed necessary to assure the payment of the pensions that had been promised. An advisor to the Convention, Professor Rubin Cohn of the University of Illinois Law School, had warned that protecting the pension rights of state employees required full and adequate funding of pension systems and that simply establishing a contract right to payment of pension benefits “may turn out to be the stuff of which dreams are made.” Cohn, *Public Employee Retirement Plans—The Nature of the Employee Rights*, 1968 Ill. L. F. 32, 62 (1968). Additionally, prior to the 1970 Convention, the Executive Director of the State Universities Retirement System had proposed adoption of a constitutional provision that not only granted contractual status to pension benefits, but also “direct[ed] the General Assembly to take the necessary steps to fund the pension obligations on a basis consistent with sound actuarial principles.” Eric M. Madiar, *IS WELCHING ON PUBLIC PENSION PROMISES AN OPTION FOR ILLINOIS? AN ANALYSIS OF ARTICLE XIII, SECTION 5 OF THE ILLINOIS CONSTITUTION 13* (rev. ed. May 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1774163.

But in the 1970 Constitution Convention, the framers did not adopt this proposal and otherwise “made it explicit that they *merely* extended contractual protection to pensions” and “set out *only* to put state and municipal governments on notice that they may not abandon their pension obligations on the belief that such payments were gratuities.” *McNamee*, 173 Ill. 2d at 444 (emphasis added). This Court has accordingly

held in three separate cases that the Pension Clause imposes no specific obligations on the legislature to fund pensions, and grants beneficiaries no judicially enforceable right to any minimum funding level. *Illinois Fed'n of Teachers v. Lindberg*, 60 Ill. 2d 266, 273-74 (1975) (Pension Clause provides only contractual rights to benefits promised in plan); *McNamee*, 173 Ill. 2d at 446-47 (same); *Skłodowski v. State*, 182 Ill. 2d 220, 233 (1998) (rejecting claim that funding schedule in 1989 amendment to Pension Code became an enforceable provision of pension contract). It would be strange indeed for the Clause to create an irrevocable obligation on the legislature to pay 100 cents on the dollar for each State employee's pension benefits—even where doing so would subject the State to fiscal ruin and compel the State to abdicate its duties to public safety and welfare—when the framers refused to impose any obligation on the legislature to ensure that the plans were adequately funded, as other States have done.

In this regard, this history forecloses any notion that the framers intended to give exalted status to pension contracts and impose extraordinary restrictions to assure that promised benefits were strictly adhered to in all circumstances. A failure to fully fund the systems assuredly does literally impair the benefits of membership of pension systems, as the New York courts had held in construing the provision of the New York Constitution from which the Illinois Pension Clause was copied. *See McNamee*, 173 Ill. 2d at 443 (discussing New York Constitution). By failing to treat inadequate funding of the systems as an “impairment” of the benefits of membership in pension systems, the framers created inherent risks that retirees would not receive 100% of promised benefits. If legislatures adopt a “pay as you go” system in which benefits arising from a retiree's past service are paid from future State revenues, there is an inevitable risk of partial nonpayment if the legislature concludes in a session that it has insufficient funds to both

pay promised benefits and to achieve some other essential purpose. If the legislature then refused to appropriate the funds necessary to pay pensions in full, the retiree's recourse would be to sue (which would itself be a burden) and a court sitting in equity can refuse to order payment of 100% of the pension if that would mean some other compelling government and public interest was subverted. In this regard, while the framers referred to the right to bring suit in these circumstances, they nowhere stated that the contract claim would have priority over all other State interests in such litigation. The fact that the framers were unwilling to require full actuarially adequate advance funding of pensions—and merely provided contractual status and contractual remedies to members of pension systems—belies any notion that their intent was to give pension contracts greater protections than other contracts receive under the Contract Clause.¹⁶

¹⁶ In pleadings in the circuit court, plaintiffs relied upon the Arizona Supreme Court's decision in *Fields v. Elected Officials' Ret. Plan*, 320 P.3d 1160 (Ariz. 2014), to support the claim that any reduction in Illinois pension benefits violates the Pension Clause and that pensions are not subject to the police power to the same extent of other contracts. But that decision is inapposite. In *Fields*, the Arizona Supreme Court held that the differently worded pension protection clause of the Arizona Constitution does not create contractual rights that are subject to modification in all the same conditions in which the Contract Clause allows modifications of other contracts. The Arizona court based its conclusion on the fact that the Arizona provision was comprised of two independent clauses. The first provided that "Membership in a public retirement system is a contractual relationship that is subject to article II, § 25 [the contract clause of the Arizona constitution]," and thus subjected pension contracts to the restrictions of the Contract Clause. Because the second clause provided that "public retirement system benefits shall not be diminished or impaired," the *Fields* court concluded that the second clause must do more than extend the same protections as the Contract Clause because if that is all the second clause did, it would be superfluous. *Id.* at 1163.

But the Illinois Pension Clause does not have this structure and no language of the Clause formally applies the provisions of the Contract Clause to pension benefits. Rather, the Pension Clause, read as a whole, gives pensions the same protections that the Contract Clause gives traditional contracts. The Illinois Pension Clause is an independent provision that, by its terms, provides that membership in the systems is an enforceable contractual relationships and grants members of pension systems the same protections against diminishment or other impairments that the separate Contract Clause provides to parties to other actual contracts. As Justice Freeman has stated, no portion of

The terms and history of the Pension Clause thus establish that the Pension Clause gives pension “contracts” the same protections that the Contract Clause provides to other contracts with the State of Illinois.

B. Even If The Pension Clause Could Be Deemed To Provide Different Protections Than The Contract Clause Affords Other Contracts, The Pension Clause Is Still Subject To The Police Power.

Finally, the circuit court’s holding would be wrong even if the Contract Clause and the Pension Clause were not to be read *in pari materia*, and even if the Pension Clause could be interpreted to provide pensions with greater or different protections than the Contract Clause extends to traditional contracts. In this regard, all applications of the police power require accommodation between the values protected by a specific constitutional provisions and State interests. That is why the First Amendment restricts government in different ways than does the Equal Protection Clause. So the fact that two constitutional provisions are not identical could never mean that one is entirely exempt from the police power and the other is not.

As explained above, the rule is that all constitutional provisions are subject to the police powers unless the terms, history, or structure of the constitutional provisions clearly establish that the framers and the voters who ratified the constitution intended otherwise. The reality is that if the framers intended the Pension Clause to relinquish the

the Pension Clause is surplusage because the Contract Clause cannot reasonably be construed to be applicable to pensions. *Sklodowski v. State*, 162 Ill. 2d 117, 147 (1994) (“To avoid rendering the general impairment-of-contracts provision surplusage where State pensions are concerned, that general provision’s scope cannot include protection afforded membership in the [pension] systems here.”). Also, whereas the Illinois Pension Clause imposes no funding requirement, the Arizona Clause explicitly requires “that the plan be funded ‘using actuarial methods and assumptions that are consistent with generally accepted actuarial standards.’” *Fields*, 320 P.3d at 1168 (quoting ARIZ. CONST., art. 29, § 1(A)), so unlike the Illinois Constitution, the Arizona Constitution otherwise provided pensions with greater protections than other contracts with the state.

State’s police power and to be exempt from rules applicable to similarly worded and equally absolute constitutional provisions, the framers were obligated to indicate so expressly in the text of the Clause—or otherwise make that principle unmistakably clear. But the text says no such thing—and the framers said no such thing at the Constitutional Convention. Thus, even if the Pension Clause could be read to provide pensions contracts with greater or different protections than other contracts receive under the Contract Clause, pension contracts are still subject to the police power, and the circuit court was wrong in refusing to address the State’s evidence and police power defense.

IV. Even Under Its Flawed Reading Of The Pension Clause, The Circuit Court Was Required To Determine Whether The Overall Effect Of Public Act 98-599 Is To “Diminish Or Impair” Pension Benefits.

Having held that the Pension Clause is not subject to the State’s reasonable police power, the circuit court declared the case over. The court determined that because some members of the affected pension systems would see annuities reduced as a result of Public Act 98-599, the statute was *per se* invalid under the Pension Clause. *See* Order ¶ 2 (declaring that “on its face, the Act impairs and diminishes the benefits of membership in State retirement systems”). That, too, was error.

Whether pension benefits are diminished or impaired cannot be determined on technicalities. For this reason, it is not the case that a “diminish[ment]” or other “impair[ment]” of the “benefits” of pension beneficiaries’ contractual relationship is established by the mere fact that Public Act 98-599 will cause some members’ to have reduced *claims* to monthly annuities in the future than the prior terms of the Pension Code would have literally required. Put differently, that Public Act 98-599 reduces some beneficiaries annuities *on paper* does not, on its own, answer the question whether their benefits of membership are diminished or impaired. Instead, the proper inquiry is

whether the overall, real-world effect of Public Act 98-599 is to make those beneficiaries better off or worse off. Thus, the circuit court was required to consider the State's evidence that Public Act 98-599 would also *benefit* pensioners by adequately funding pension systems, so that systems can continue to pay benefits as they come due.

The Supreme Court explained this concept in *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942). In that case, the City of Asbury Park, New Jersey, became insolvent, and its finances were taken over by the state's Municipal Finance Commission. *Id.* at 503-06. Pursuant to a state law, the City's bond debt was refunded and reissued at a lower interest rate. The plaintiff bondholders challenged the legislation as a violation of the Contract Clause on the ground that it impaired their right to receive the originally contracted-for interest rate.

On the record before it, the U.S. Supreme Court rejected the challenge. The Court explained that the "Constitution is 'intended to preserve practical and substantial rights, not to maintain theories.' Particularly in a case like this are we in the realm of actualities and not of abstractions and paper rights, of what things are worth in dollars and cents, and in what is proposed to realize paper values." *Faitoute Iron & Steel Co.*, 316 U.S. at 515 (quoting *Davis v. Mills*, 194 U.S. 451, 457 (1942)). A substantive right is not "impaired" through measures designed to enhance the state's ability to perform its contractual obligations, even if the measure affects the plaintiff's "paper rights." *Id.* at 514. Instead, "[i]mpairment of an obligation means refusal to pay an honest debt; it does not mean contriving ways and means for paying it. The necessity compelled by unexpected financial conditions to modify an original arrangement for discharging a city's debt is implied in every such obligation for the very reason that thereby the obligation is

discharged, not impaired.” *Id.* at 511. Because the state action in *Faitoute Iron & Steel* would improve the bondholders’ ability to be repaid, it did not “impair” their rights:

To call a law so beneficent in its consequences on behalf of the creditor who, having had so much restored to him, now insists on standing on the paper rights that were merely paper before this resuscitating scheme, an impairment of the obligation of contract is indeed to make of the Constitution a code of lifeless forms instead of an enduring framework of government for a dynamic society.

316 U.S. at 516.

As *Faitoute Iron & Steel Co.* demonstrates, whether there literally is an “impairment” cannot be answered by looking solely at whether certain annuitants will see a decrease in the amount of benefits they can *claim*, but instead depends on the overall effect of the statute. There plainly is no *net* impairment when any reduction in the paper value of an annuity is more than offset by other statutory changes that increase the value of the annuity. In this regard, this Court has already recognized in *Felt* that the benefits from measures that improve the funding of pension systems can justify statutes that reduce the annuities that some system members will be paid. 107 Ill. 2d at 166-67 (invalidating pension code amendment that reduced claimant’s annuity only because the Court determined that the measure would not improve pension system funding).

Here, the State submitted evidence to the court to show that Public Act 98-599 serves to enhance the overall value of pensioners’ membership in the State pension systems, in that the legislation rehabilitates those funds from the severe and unforeseen financial blows brought about by the Great Recession. *See, e.g.*, Defs. Statement of Facts ¶¶ 85-156, 167-74. In particular, as the legislature found in passing the legislation, “the pension debt is so great, and the State’s fiscal condition is so challenged [as a result of the Great Recession], that it is unclear whether any set of actions by the State that do not

include substantial reforms to its pension systems can result in the full payment of all promised benefits.” S. 1, 98th Gen. Assembly, Preamble (Ill. 2013); *see also* Defs. Statement of Facts ¶ 170 (“The General Assembly recognizes that without significant pension reform, the unfunded liability and the State’s pension contribution will continue to grow, and further burden the fiscal stability of both the State and its retirement systems. ... [F]iscal problems facing the State and its retirement systems cannot be solved without making some changes to the structure of the retirement systems.”).

Having invalidated the statute based solely on its effects on pensioners’ “paper rights,” the circuit court failed even to consider this evidence. As the U.S. Supreme Court’s decision in *Faitoute Iron & Steel Co.* makes clear, however, if the State’s evidence is credited, Public Act 98-599 will not literally “impair” the benefits of membership in the retirement systems because economic events had already impaired the “paper” pension rights that have been asserted, and because the Act confers countervailing benefits by requiring full funding of annuities that will assure the payment of the benefits promised by the amended code and by enabling essential government services that create a public order in which the annuities have greater value. Even accepting the circuit court’s erroneous conclusion that the rights granted in the Pension Clause are not subject to the State’s reasonable exercises of police power, the court was nonetheless required to consider this evidence.

CONCLUSION

For the reasons stated, the circuit court's judgment in favor of plaintiffs should be vacated, and the decision should be remanded with directions that the circuit court assess the State's evidence and rule on its police powers defense.

Respectfully submitted,

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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 the pages containing the Rule 341(d) cover, the Rule 341(h)(1) statement of points and authorities, and the Rule 341(c) certificate of compliance, is 50 pages.

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