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Lari A. Dierks

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A Lesson from *Goodfellas*: Why Current Illinois Consideration Based Pension Reform Proposals Still Fail

Lari A. Dierks

INTRODUCTION

In 2015, the Illinois Supreme Court found Illinois' landmark pension reform legislation unconstitutional under Article XIII, Section 5 of the Illinois Constitution.¹ Subsequently, a proposal to reduce state pension liabilities by modifying pension benefits using classic contract principles has resurfaced. The proposal was originally introduced by Illinois Senate President John Cullerton in 2013. Most recently, it has been championed by Governor Bruce Rauner. This Comment will analyze the constitutional protection of public pension benefits in detail, using this analysis to evaluate why the use of classic contract principles—offer, acceptance, and consideration—to modify pension benefits is incompatible with the key goals of pension reform.

Two key goals of pension reform are to reduce the contribution the state is statutorily required to pay to the pension systems each year and to reduce the state's unfunded pension liability. By reducing the state's required pension contribution each year, additional revenue is available to fund core government services at an increased level without increasing revenue.² Reducing the state's unfunded pension liability creates long-term stability for the pension systems.

Public employees have a unique position in this discussion, as employees are promised a defined benefit³ upon retirement as a benefit of employment but are also

¹ *In re Pension Reform Litig.*, 32 N.E.3d 1, 30 (Ill. 2015). Article XIII, Section 5 of the Illinois Constitution is commonly referred to as the "pension protection clause."

² As will be discussed in detail later in this Comment, the current pension debate often focuses on the need for additional revenue for core services such as education, public safety, and human services. Kevin Olsen, *Meet Illinois' \$100 Billion Python: Squeezy*, PENSIONS & INV. (Nov. 26, 2012), <http://www.pionline.com/article/20121126/PRINT/311269970/meet-illinois-100-billion-python-squeezy>; Jeffrey Brown, *Illinois Public Pension Reform: A Simple but Radical Idea*, FORBES (June 4, 2012), <https://www.forbes.com/sites/jeffreybrown/2012/06/04/illinois-public-pension-reform-a-simple-but-radical-idea/#602a18512382>; Jeff Bailey, *The Civic Federation's Laurence Msall Discusses Illinois' Dire Finances, Reform*, CHI. MAG. (Oct. 10, 2011), <http://www.chicagomag.com/Chicago-Magazine/October-2011/The-Civic-Federations-Laurence-Msall-on-Reform-and-the-Dire-Finances-of-the-City-County-and-State/>.

³ Defined benefit plans provide a benefit based on a set formula to the retiree for the duration of his or her life. COMM'N ON GOV'T FORECASTING & ACCOUNTABILITY, ILL. GEN. ASSEMBLY, ILLINOIS STATE RETIREMENT SYSTEMS: FINANCIAL CONDITION AS OF JUNE 30, 2017 (2018), <http://cgfa.ilga.gov/Upload/FinConditionILStateRetirementSysMar2018.pdf> [hereinafter ILLINOIS STATE

likely tax payers who benefit from government services. The recent spike in state contributions to public pension plans has resulted in ongoing conversations about modifying the statutory benefits for public employees.⁴

Public employees' position in the pension debate stems from the dual impact of the pension reform conversation on those employees. On one hand, if public employee benefits are modified, each employee will likely receive less money over the course of his or her retirement. On the other hand, if benefits are not modified, the state (or other local employer) must find an alternative solution to ease budgetary pressures. That solution would involve either a modified payment schedule that puts the fiscal health of the retirement system at risk, or increased revenue, requiring employees to pay more in taxes. While the legislature continues to debate whether benefits can be modified, the Illinois Supreme Court has definitively established that the pension protection clause does not allow the legislature to reduce an employee's retirement benefit.

Part I of this Comment discusses the political and financial climate in Illinois which led to the 2013 pension reform legislation and continues to pressure state actors to seek pension reform proposals to manage the ballooning pension payment required by the state. Part II gives a historical overview of the pension protection clause of the Illinois Constitution. Part III discusses the Illinois Supreme Court's interpretation of the pension protection clause. Part IV analyzes the proposals to reform public pensions using contract principles. Part V proposes that offering a subjectively superior benefit could survive a legal challenge as true consideration if an employee voluntarily chooses to reduce their pension benefit and briefly discusses non-legal alternative solutions.

I. A (PENSION) CRISIS—2008 AND BEYOND

Public pension benefits in Illinois are determined by state statute.⁵ The benefits set in statute are funded through three main sources: (1) employee contributions, (2) employer contributions, and (3) investment returns.⁶ The state is the sole employer contributor to the State Employees' Retirement System ("SERS"), General Assembly Retirement System ("GARS"), and Judges Retirement System ("JRS").⁷ The state is the primary contributor of employer contributions for the State Universities Retirement System ("SURS") and the Teachers Retirement System ("TRS").⁸

RETIREMENT SYSTEMS]. SURS is the only state system that also offers a defined contribution plan similar to a 401(k). *Id.* at 6.

⁴ Olsen, *supra* note 2; Brown, *supra* note 2; Bailey, *supra* note 2.

⁵ 40 ILL. COMP. STAT. ANN. 5/5-101 (West 1963).

⁶ See generally 40 ILL. COMP. STAT. ANN. 5.

⁷ For the purposes of this Comment, I focus on the proposed reform of the five state funded retirement systems. SERS, SURS, and TRS account for the bulk of the pension contributions the state must pay each year. The Judges Retirement System (JRS), and the General Assembly Retirement System (GARS), are an extremely small portion of the total required contribution and unfunded pension liability.

⁸ The City of Chicago has its own pension plan for public school teachers, and the state only contributes a small amount to this plan each year. 40 ILL. COMP. STAT. ANN. 5/17-127.

Until 2011, the state contributed an arbitrary percentage of payroll set in statute, rather than the actuarially calculated amount required to fund benefits in the future.⁹ The state is now required to contribute an amount each year that is calculated by actuaries employed by each pension system.¹⁰ The required state contribution is calculated using various actuarial factors including retirement rates, mortality rates, disability rates, salary growth, investment returns, and more.¹¹

Public pension systems in Illinois have been underfunded for a century.¹² Most recently, the crisis stems from consistently poor investment returns compounded by employer contributions below the actuarially required contribution level¹³ to fully fund pension benefits.¹⁴ The aggregate funded ratio of a pension system is determined by comparing the assets of the system with the current liabilities.¹⁵ In Illinois, the pension systems assets are based on the average value of the systems' assets over the past five years, often referred to as "asset smoothing."¹⁶ In 2000, the five state-funded public pension systems had an aggregate funded ratio of 74.7%; the SERS (with the highest funded ratio) was 81.7% funded at this time.¹⁷ As of 2015, the aggregate funded ratio had fallen to 41.9%, a slight improvement from the lowest recent funded ratio of 38.5% in 2009.¹⁸ Between 2008 and 2009, the aggregate funded ratio plummeted from 54.3% to 38.5%.¹⁹

The state pension systems' unfunded liability has continued to grow each year.²⁰ Various factors have caused the growth in unfunded liability, including lower than expected investment returns, inadequate employer contributions, and benefit

⁹ Act of Aug. 22, 1994, Pub. Act No. 88-593, 1994 Ill. Laws 1165, 1179–80; *see* ILLINOIS STATE RETIREMENT SYSTEMS, *supra* note 3, at 15.

¹⁰ *See generally* 40 ILL. COMP. STAT. ANN. 5.

¹¹ *See generally* SEGAL CONSULTING, TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS: ACTUARIAL VALUATION AND REVIEW OF PENSION BENEFITS AS OF JUNE 30, 2017 at (2018), https://www.trsil.org/sites/default/files/documents/Segal_Final_%20Actuarial_Valuation_Report_TRS.pdf; GRS RET. CONSULTING, STATE EMPLOYEES' RETIREMENT SYSTEM OF ILLINOIS: ANNUAL ACTUARIAL VALUATION AS OF JUNE 30, 2017 (2018), <https://www.srs.illinois.gov/PDFFILES/Valuations/SERS/sers%202017.pdf>; GRS RET. CONSULTING, STATE UNIVERSITIES RETIREMENT SYSTEM OF ILLINOIS: ACTUARIAL VALUATION REPORT AS OF JUNE 30, 2017, at (2018), <http://www.surs.com/sites/default/files/pdfsx/avr17.pdf>.

¹² Aaron B. Maduff, *Survey of Illinois Law: In re Pension Litigation*, 40 S. ILL. U. L.J. 725, 725 (2016).

¹³ The statutory contribution is less than the contribution the system's actuary would recommend to fully fund the normal cost while paying down the unfunded liability. *See* ILLINOIS STATE RETIREMENT SYSTEMS, *supra* note 3, at 33–34. The actuarially required contribution is the contribution recommended by the system's actuary in the actuarial evaluation. *See id.* at 34.

¹⁴ *Id.* at 27.

¹⁵ *The User's Perspective: Touring the Financial Statements, Part III: The Government Funds*, GOVERNMENTAL ACCT. STANDARDS BOARD, http://www.gasb.org/cs/ContentServer?pagename=GASB/GASBContent_C/UsersArticlePage&cid=1176156735732 (last visited Mar. 11, 2018).

¹⁶ ILLINOIS STATE RETIREMENT SYSTEMS, *supra* note 3, at 30.

¹⁷ *Id.* at 113.

¹⁸ *Id.* at 29.

¹⁹ *Id.*

²⁰ COMM'N ON GOV'T FORECASTING & ACCOUNTABILITY, ILL. GEN. ASSEMBLY, BRIEFING ON CAUSES OF STATE PENSION UNFUNDED LIABILITY 2 (2013), <http://cgfa.ilga.gov/Upload/Presentation%206-27-13.pdf> [hereinafter BRIEFING ON CAUSES OF STATE PENSION UNFUNDED LIABILITY].

enhancements.²¹ Although benefit enhancements²² were enacted by the legislature without a matching employee contribution source,²³ public employees have always contributed the statutorily required percentage of their salary.²⁴ Pension enhancements that have been enacted by the Illinois General Assembly include an increased automatic annual adjustment (commonly referred to as a Cost-of-Living Adjustment or COLA), a higher multiplier for calculation of the initial pension benefit, increased benefits for survivors, and more.

At the time benefit enhancements were enacted, no parties involved raised whether increased contributions should be required from public employees to offset the increase.²⁵ Although benefit enhancements are not the main contributor to the major increase in required pension contributions,²⁶ the legislature recognized that enacting such benefit increases would require substantial additional funding.²⁷

Since the drastic decline in the funded ratio and the resulting spike in unfunded pension liabilities, credit rating agencies the business community have continued to increase the pressure Illinois lawmakers to “reform” the public pension systems.²⁸ The key goals of pension “reform” are to reduce the state’s required contribution to the public pension systems each year and to reduce the unfunded pension liabilities.

Between 2015 and 2016, the state’s required pension General Revenue Fund (“GRF”) contribution increased by more than \$1 billion.²⁹ This is a 14% increase from the previous year and constitutes over 20% of the state budget from general revenue funds.³⁰ The pension payment continues to grow at a rate substantially greater than state

²¹ *Id.* at 3—11.

²² A benefit enhancement is an increase in the statutory benefit a public employee is entitled to receive upon retirement that has been approved by the legislature and signed by the governor. *See, e.g.*, ILLINOIS STATE RETIREMENT SYSTEMS, *supra* note 3, at 18.

²³ Act of Aug. 23, 1989, Pub. Act No. 86-273, 1989 Ill. Laws 2002, 2004 (enacting a 3% compounded automatic annual increase without a matching contribution from employees).

²⁴ *See generally* 40 ILL. COMP. STAT. ANN. 5.

²⁵ *See* Ill. H. Transcript, 86th Leg., Reg. Sess., 298–300 (June 30, 1989); Ill. S. Transcript, 86th Leg., Reg. Sess., 325–333 (June 30, 1989). While the debate recognized the increased benefits will require additional funding, the legislature did not express opposition to the change from a 3% simple automatic annual adjustment to a 3% compounded automatic annual adjustment without a corresponding increase to employee contributions.

²⁶ BRIEFING ON CAUSES OF STATE PENSION UNFUNDED LIABILITY, *supra* note 20, at 3—11.

²⁷ Ill. S. Transcript, *supra* note 25, at 328 (Senator Schuneman discussed the increased pension liability that would result from the proposed benefit increase).

²⁸ *See* Eric M. Madiar, *Is Welching on Public Pension Promises an Option for Illinois? An Analysis of Article XIII, Section 5 of the Illinois Constitution*, 48 J. MARSHALL L. REV. 167, 243–45 (2014) (discussing proposals by the Commercial Club of Chicago and Sidley Austin LLP to reduce pension benefits through reform); *see also* Meaghan Kilroy, *Moody’s, S&P Downgrade Illinois Again as Budget, Pension Liability Concerns Continue*, PENSION & INV. (June 9, 2016), <http://www.pionline.com/article/20160609/ONLINE/160609865/moodys-sampp-downgrade-illinois-again-as-budget-pension-liability-concerns-continue>.

²⁹ COMM’N ON GOV’T FORECASTING & ACCOUNTABILITY, ILL. GEN. ASSEMBLY, SPECIAL PENSION BRIEFING 9 (2016) <http://cgfa.ilga.gov/Upload/1116%20SPECIAL%20PENSION%20BRIEFING.pdf> [hereinafter SPECIAL PENSION BRIEFING].

³⁰ *Id.*; CTR. FOR TAX & BUDGET ACCOUNTABILITY, ILLINOIS GENERAL FUND SPENDING IN FY2016: HOW ELECTED OFFICIALS CUT BILLIONS IN CORE SERVICE EXPENDITURES WHILE WORSENING THE DEFICIT—

government revenue growth each year.³¹ As a result, the required pension contribution has continued to squeeze the discretionary spending available for important core services.³²

Public Act 87-1265 mandated the required pension contribution as a “continuing appropriation” each year.³³ A continuing appropriation is made by the comptroller to the designated agency with or without a statutory appropriation by the General Assembly.³⁴ So, if the General Assembly fails to enact a state budget, or does not include the pension contribution in the budget, the required state contribution as determined by statute will still be paid to the state pension systems.³⁵ The General Assembly is still free to change the contribution required in statute through normal legislative procedures.³⁶ Accordingly, the required contributions were still made to the state pension systems during the recent budgetary stalemate.

It is widely acknowledged that the required pension contribution in Illinois has put immense pressure on state funding available for education and human service programs.³⁷ The annual statutorily required pension contribution continues to grow, compounded by changes in actuarial accounting implemented by the pension systems’ Board of Trustees.³⁸ The required state contribution³⁹ is currently more than 20% of the total general revenue.⁴⁰ In fiscal year 2018,⁴¹ the projected pension contribution required by

ALL WITHOUT CASTING A VOTE 3 (2016), *available at* <http://www.ctbaonline.org/reports/illinois-general-fund-spending-fy2016-how-elected-officials-cut-billions-core-service>.

³¹ General Revenue Growth dropped 3.9% from FY 2015 to FY 2016 and is projected to drop by 10.6% from FY 2016 to FY 2017, while the pension payment grew 10% from FY 2015 to FY 2016. COMM’N ON GOV’T FORECASTING & ACCOUNTABILITY, ILL. GEN. ASSEMBLY, FY 2016 ECONOMIC FORECAST AND REVENUE ESTIMATE AND FY 2015 REVENUE UPDATE 25 (2015), <http://cgfa.ilga.gov/Upload/CGFAY2016EconomicForecastAndRevenueEstimate.pdf>; COMM’N ON GOV’T FORECASTING & ACCOUNTABILITY, ILL. GEN. ASSEMBLY, FY 2017 ECONOMIC FORECAST AND REVENUE ESTIMATE AND FY 2016 REVENUE UPDATE 24 (2016), <http://cgfa.ilga.gov/Upload/CGFAY2017EconomicForecast&RevenueEstimate.pdf>.

³² SPECIAL PENSION BRIEFING, *supra* note 29, at 23.

³³ Act of Jan. 25, 1993, Pub. Act. No. 87-1266, 1993 Ill. Laws 4235, 4351.

³⁴ 40 ILL. COMP. STAT. ANN. 15/1.1 (West 2017).

³⁵ *See generally* 40 ILL. COMP. STAT. ANN. 15.

³⁶ The bill would have to pass the House and Senate with a majority of votes and be signed by the Governor.

³⁷ *See, e.g., State of Illinois Pension Contributions to Increase Significantly in FY2018*, CIVIC FED’N: INST. FOR FISCAL SUSTAINABILITY, <https://www.civicfed.org/iifs/blog/state-illinois-pension-contributions-increase-significantly-fy2018> (last visited Mar. 11, 2018); Greg Hinz, *There’s No Escape, Illinois: It’s Time to Pay for Those Pensions*, CRAIN’S CHI. BUS. (Oct. 1, 2016), <http://www.chicagobusiness.com/article/20161001/ISSUE05/310019998/theres-no-escape-illinois-its-time-to-pay-for-those-pensions>; Dave McKinney, *The Illinois Pension Disaster*, CRAIN’S CHI. BUS. (Aug. 10, 2015), <http://www.chicagobusiness.com/section/pensions>.

³⁸ ILLINOIS STATE RETIREMENT SYSTEMS, *supra* note 3, at 29.

³⁹ *Id.*

⁴⁰ General funds include the General Revenue Fund (GRF), the Education Assistance Fund, the Common School Fund, and the General Revenue-Common School Special Accounts Fund. The GRF contains revenue from the personal income tax, corporate income tax, sales tax, inheritance tax, public utility tax, other various state taxes, and some federal sources. COMM’N ON GOV’T FORECASTING & ACCOUNTABILITY, ILL. GEN. ASSEMBLY, FY2018 ECONOMIC FORECAST AND REVENUE ESTIMATE AND FY 2017 REVENUE UPDATE 22 (2017), <http://cgfa.ilga.gov/Upload/FY2018%20Economic%20Forecast-Revenue%20Estimate%20and%20FY%202017%20Revenue%20Update.pdf> [hereinafter FY2018

the state was \$7,650,293,451.⁴² The total estimated general funds revenue for fiscal year 2018 was \$31,912,000,000.⁴³ The \$7.6 billion pension payment will account for approximately 24% of the total general revenue the state takes in during fiscal year 2018.

In 2013, Illinois enacted legislation that attempted to address the substantially increasing pension payments.⁴⁴ That legislation was the result of years of discussion and negotiation on the possible changes to pension benefits and the impact on the state budget.⁴⁵ In May 2015, the Illinois Supreme Court found the legislation unconstitutional as a violation of article VIII, section 5 (“the pension protection clause”) of the Illinois constitution.⁴⁶ The unfunded liability of Illinois’ public pension funds continues to climb each year and will continue to climb until at least 2028 if no action is taken by the legislature and governor.⁴⁷

II. ARTICLE VIII, SECTION 5—THE PENSION PROTECTION CLAUSE

In the 1970 Illinois constitution, the pension protection clause was included after substantial debate.⁴⁸ The clause establishes that:

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.⁴⁹

The Illinois Supreme Court has interpreted the pension protection clause as forming a two-part protection for public employee retirement benefits: (1) an enforceable contract right to benefits, and (2) benefits which cannot be “diminished or impaired.”⁵⁰ The court

ECONOMIC FORECAST AND REVENUE ESTIMATE]; CTR. FOR TAX & BUDGET ACCOUNTABILITY, THE ILLINOIS STATE BUDGET AND TAX PRIMER 8 (2013), http://www.ctbaonline.org/sites/default/files/FINAL_FY2013%20CTBA%20IL%20Budget%20and%20Tax%20Primer.pdf.

⁴¹ The state fiscal year (FY) runs from July 1 to June 30 each year. CTR. FOR TAX & BUDGET ACCOUNTABILITY, *supra* note 40, at 3. FY 2018 is July 1, 2017 to June 30, 2018.

⁴² ILLINOIS STATE RETIREMENT SYSTEMS, *supra* note 3, at 29.

⁴³ FY2018 ECONOMIC FORECAST AND REVENUE ESTIMATE, *supra* note 40, at 22.

⁴⁴ See Act of Dec. 5, 2013, Pub. Act No. 98-599, 2013 Ill. Laws 7148.

⁴⁵ See *id.*

⁴⁶ *In re Pension Reform Litig.*, 32 N.E.3d at 30.

⁴⁷ Currently, compounding interest works against the state pension systems due to the low funded ratio. As a result, the system must sell assets each year to pay out retiree benefits. In 2028, the funded ratio will have increased to a level that the compounding interest on investments will finally begin to pay down the unfunded liability. SPECIAL PENSION BRIEFING, *supra* note 29, at 10.

⁴⁸ RECORD OF PROCEEDINGS, SIXTH ILL. CONSTITUTIONAL CONVENTION, *Verbatim Transcripts*, vol. IV at 2925-31.

⁴⁹ ILL. CONST. of 1970, art. XIII, § 5.

⁵⁰ *Id.*; *Jones v. Mun. Emps.' Annuity & Benefit Fund of Chi.*, 50 N.E.3d 596, 603 (Ill. 2016); *In re Pension Reform Litig.*, 32 N.E.3d at 7; *Kanerva v. Weems*, 13 N.E.3d 1228, 1241 (Ill. 2014).

found that the clause is an absolute protection for all benefits flowing from public employment.⁵¹

The Illinois Supreme Court first interpreted the meaning of the pension protection clause in *Kanerva v. Weems*.⁵² In this case, the court first stated the pension protection clause clearly creates a contractual relationship between the state and public employees and the benefits of that relationship may not be unilaterally diminished or impaired.⁵³ The following section will discuss how the Illinois Supreme Court has analyzed the pension protection clause in several cases, including *Kanerva*, that challenged the constitutionality of pension reform packages.

III. INTERPRETATION OF THE PENSION PROTECTION CLAUSE

The Illinois Supreme Court's interpretation of the pension protection clause is consistent across three recent opinions: *Kanerva v. Weems*,⁵⁴ *In re Pension Reform Litigation*,⁵⁵ and *Jones v. Municipal Employees' Annuity & Benefit Fund of Chicago*.⁵⁶ These decisions provide substantial guidance on the scope of the pension protection clause and the only opportunities available to modify public employee benefits.

The court's broad interpretation of the scope of the pension protection clause in *Kanerva* set the legal parameters for any future pension reform efforts by the legislature.⁵⁷ In this decision, the court explained that any benefit that "qualifies as a benefit of the enforceable contractual relationship resulting from membership in one of the state's pension or retirement systems" "cannot be diminished or impaired."⁵⁸ This sweeping interpretation was criticized by the dissent as a limitless holding that would logically hold that a piece of legislation promising an honorary plaque "flows directly from" or is "conditioned on" membership in the retirement system.⁵⁹

The court's holding in *Kanerva* hinged on its interpretation of Public Act 97-695, which removed the statutory protection of subsidies to retirees for healthcare coverage, allowing changes to be collectively bargained and modified by administrative rule.⁶⁰ The court explained that the drafters of the 1970 Illinois constitution knew various benefits were attendant to membership in the pension systems.⁶¹ Consequently, the court inferred that the drafters would have specified that only core pension annuity benefits are protected by the pension protection clause and excluded all other employment benefits if they had intended to limit the protections to only the retirement annuity.⁶² This means

⁵¹ *Kanerva*, 13 N.E.3d at 1239 (explaining the drafters of the 1970 Constitution knew certain employment benefits [healthcare in this case] were connected to public pension benefits so those benefits in place at the time the clause was adopted should be protected by the clause as well).

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *See generally id.*

⁵⁵ *See generally In re Pension Reform Litig.*, 32 N.E.3d 1.

⁵⁶ *See generally Jones*, 50 N.E.3d 596.

⁵⁷ *Kanerva*, 13 N.E.3d at 1238–39.

⁵⁸ *Id.*

⁵⁹ *Id.* at 1246.

⁶⁰ Act of June 12, 2012, Pub. Act No. 97-695, 2012 Ill. Laws 507, 530.

⁶¹ *Kanerva*, 13 N.E.3d at 1240.

⁶² *Id.*

that the broad language of the pension protection clause covers all benefits associated with public employment that the drafters of the 1970 Illinois constitution could have envisioned.⁶³

In the 2015, the court found Illinois' landmark pension reform law, Public Act 98-599, unconstitutional.⁶⁴ The key components of Public Act 98-599 included benefit modifications that affected the accrual of employee benefits going forward and modified the required state contribution schedule.⁶⁵ In this decision, the court stressed that: "[I]f something qualifies as a benefit of the enforceable contractual relationship resulting from membership in one of the state's pension or retirement systems, it cannot be diminished or impaired."⁶⁶ The court determined that the benefit modifications in Public Act 98-599 diminished public employee pension benefits because employees are entitled to the benefit formula that was codified by statute at the time the employee began employment with the state.⁶⁷ Therefore, employees are entitled to the statutory automatic annual increase even though it is not a component used to calculate the retiree's original retirement annuity.⁶⁸

To defend the pension reform law, the state argued that its police powers permitted the reduction of benefits as required to protect the health and welfare of all citizens from the state's dire financial situation.⁶⁹ But, the court found this argument unpersuasive.⁷⁰ The court explained that legislation which impairs a contract will only survive contract clause scrutiny if the legislation is "reasonable and necessary to serve an important public purpose" and its impact on employees is not excessively severe.⁷¹ The court went on to recognize that changes to the factors used to calculate public pension benefits were an impairment that is "obviously substantial."⁷² The court concluded that as a matter of law, the state could not prove a financial situation so dire that it would permit the benefit modifications enacted in Public Act 98-599.⁷³

Finally, in *Jones*, the court signaled that public pension benefits could potentially be modified using classic contract principles.⁷⁴ Yet, the court found that the changes to pension benefits challenged in *Jones* did not satisfy the required criteria for a valid offer, acceptance, and consideration.⁷⁵ Therefore, the changes did not pass constitutional muster for benefit modification.⁷⁶ Pension benefits for members of the City of Chicago's Municipal Employees' Annuity and Benefit Fund (MEABF) and Laborers' Annuity and

⁶³ *Id.*

⁶⁴ *In re Pension Reform Litig.*, 32 N.E.3d at 30.

⁶⁵ 2013 Ill. Laws 7148.

⁶⁶ *In re Pension Reform Litig.*, 32 N.E.3d at 16 (quoting *Kanerva*, 13 N.E.3d at 1239).

⁶⁷ *Id.* (explaining the protections of the pension protection clause attach at the time an individual begins employment in a position covered by a public retirement system, not when they retire).

⁶⁸ *Id.*

⁶⁹ *Id.* at 18.

⁷⁰ *Id.* at 20.

⁷¹ *Id.* at 21.

⁷² *Id.*; see also *Felt v. Bd. of Trs. of the Judges Ret. Sys.*, 481 N.E.2d 698, 702 (Ill. 1985) (stating same).

⁷³ *In re Pension Reform Litig.*, 32 N.E.3d at 21.

⁷⁴ *Jones*, 50 N.E.3d at 609.

⁷⁵ *Id.*

⁷⁶ *Id.*

Benefit Fund (LABF) are established by state statute.⁷⁷ In an attempt to provide financial stability to these funds, the City of Chicago negotiated with union representatives to reach an agreement containing benefit modifications and increased funding requirements.⁷⁸ The court evaluated two arguments set forth by the City: (1) the financial stability provided in exchange for the benefit reductions equaled a net benefit sufficient to allow modification of the contract with employees, and (2) the agreement represented a bargained-for exchange.⁷⁹

First, the court found that the City's argument was flawed from the beginning because enhancing the City's funding obligation was not a benefit entitled to constitutional protection.⁸⁰ The court held that the City's assertion that providing financial stability is a benefit was inconsistent with the plain meaning of the pension protection clause because employees were previously entitled to statutory pension benefits, regardless of the financial condition of the pension funds.⁸¹ Therefore, a current "legally enforceable" benefit could not be used to justify the modification of pension benefits.⁸² The court stressed that for pension modifications to conform to contract principles, they would need to be made by mutual assent of the members, not by the legislature alone.⁸³

Second, the court held that the agreement was not the result of bargained-for exchange because the union members negotiating the agreement were not authorized representatives of the employees as a bargaining unit.⁸⁴ An affidavit from the Secretary/Treasurer and Chief of Staff of Service Employees International Union Local 73 (SEIU) detailing an approximately two-and-a-half-year negotiation process was presented in support of the City's argument that the enacted legislation was a bargained-for exchange.⁸⁵ Despite this letter, the court found that the unions were not acting as authorized agents within a collective bargaining process during the relevant time.⁸⁶ Therefore, the court did not find it necessary to resolve whether the individual members could have "bargained away" their constitutional rights.⁸⁷

Taken together, these cases illustrate the broad protections provided to public employees by the pension protection clause. Nevertheless, proponents of pension reform continue to search for clues in the language of the opinions that may provide an avenue for constitutional modification of public employee pension benefits.

⁷⁷ See 40 ILL. COMP. STAT. ANN. 5/8; ILL. CONST. of 1970, art. V, § 11.

⁷⁸ See Act of June 9, 2014, Pub. Act No. 98-641, 2014 Ill. Laws 138; *Jones*, 50 N.E.3d at 600.

⁷⁹ *Jones*, 50 N.E.3d at 602.

⁸⁰ *Id.* at 604.

⁸¹ *Id.* at 606.

⁸² *Id.* at 607.

⁸³ *Id.* at 607–08.

⁸⁴ *Id.* at 609.

⁸⁵ *Id.* at 608.

⁸⁶ *Id.* at 609.

⁸⁷ *Id.*

IV. CONSIDERING CONSIDERATION

As set forth above, the Illinois Supreme Court has consistently recognized that the pension protection clause creates an enforceable contractual relationship between an employer [state or local government] and public employees.⁸⁸ In addition to creating a contractual relationship, the clause “demands” that pension benefits not be “diminished or impaired.”⁸⁹

Discussion of legislation that would modify public employee pension benefits continues in the wake of these decisions. Governor Bruce Rauner and Senate President John Cullerton have proposed variations of the same idea to modify pension benefits—offer the employee a “choice.”⁹⁰ On January 11, 2017, President Cullerton introduced a bill that would require employees to “choose” between (a) their current 3% automatic annual increase, compounded each year, or (b) future salary increases being used to calculate their pension benefits upon retirement.⁹¹ If an employee “chooses” to reduce his or her automatic annual increase from 3% compounded each year to 3% simple or one-half the Consumer Price Index (whichever is less),⁹² the employee’s benefit upon retirement will be calculated in accordance with current law.⁹³ Under current law, pensionable salary is based on an employee’s average salary during a period prior to retirement.⁹⁴ If an employee does not elect to receive the lower automatic annual increase, future salary increases will not be used to calculate his or her final average salary upon retirement.⁹⁵ Acceptance of this change would fundamentally modify the calculation of an employee’s pensionable salary upon retirement. Thus, an employee must choose whether to reduce the automatic annual increase or the benefit received upon retirement.

The general thrust of these proposals focuses on the idea that public pension benefits can be modified if consideration is given for the modification and an employee consents to the change. The proposals rely on the court’s indication that classic contract

⁸⁸ *People ex rel. Sklodowski v. State*, 695 N.E.2d 374, 377 (Ill. 1998) (citing ILL. CONST. of 1970, art. XIII, § 5) (“The plain language of the pension protection clause makes participation in a public pension plan an enforceable contractual relationship and also demands that the ‘benefits’ of that relationship ‘shall not be diminished or impaired.’”); *In re Pension Reform Litig.*, 32 N.E.3d 1; *Jones*, 50 N.E.3d 596; *Kanerva*, 13 N.E.3d 1228.

⁸⁹ *Kanerva*, 13 N.E.3d at 1239 (stating “it is clear that if something qualifies as a benefit” of membership in a pension system of the State “it cannot be diminished or impaired”); *In re Pension Reform Litig.*, 32 N.E.3d at 16 (citing the court’s holding in *Kanerva* to reinforce the belief that “the [pension reform] clause means precisely what it says: [benefits cannot be diminished or impaired]”).

⁹⁰ Doug Finke, *Questions and Answers About Gov. Rauner’s Newest Pension Reform Proposal*, ST. J.-REG. (July 11, 2015), <http://www.sj-r.com/article/20150711/NEWS/150719899>; Monique Garcia and Kim Geiger, *Senate President Cullerton Offers New Pension Plan*, CHI. TRIB. (May 13, 2015), <http://www.chicagotribune.com/ct-illinois-pension-reform-cullerton-met-0513-20150512-story.html>.

⁹¹ S.B. 16, 100th Gen. Assemb., Reg. Sess. (Ill. 2017).

⁹² The employee will also not begin receiving an automatic annual increase until age 67. *Id.*

⁹³ *Id.*

⁹⁴ For Tier I employees, pensionable salary is the average of the highest four of the last ten years of employment. *See, e.g.*, ILLINOIS STATE RETIREMENT SYSTEMS, *supra* note 3, at 53. For Tier II employees, pensionable salary is the average of the highest eight of the last ten years of employment. 40 ILL. COMP. STAT. ANN. 5/1-160.

⁹⁵ S.B. 16, 100th Gen. Assemb., Reg. Sess. (Ill. 2017).

principles may be used to constitutionally modify pension benefits.⁹⁶ Additional support for this idea is drawn from the court's statement that pension benefits cannot be "unilaterally diminished or eliminated."⁹⁷

As discussed, the court has held that the pension protection clause creates a contractual relationship between the employer [state or local government] and the employee.⁹⁸ The court explained in *Jones* that to establish true consideration for modification of an employee's benefits: (1) modification must be knowing and voluntary by the employee and (2) valid consideration must be presented in exchange for modification of benefits.⁹⁹ The court explained that contracts undertaken by the state have a greater degree of protection than ordinary contracts between private parties.¹⁰⁰ Further, the pension protection clause provides another layer of protection: benefits associated with membership in a pension system shall not be diminished or impaired.¹⁰¹ For any proposed pension reform legislation, the legislature faces the challenge of resolving the conflict between the court's indication that pension benefits may be modified through a bargained-for exchange and the court's holding that a contract formed under the pension protection clause requires heightened protection compared to an ordinary contract.¹⁰²

While an employee may agree to a reduction in benefits in exchange for consideration, this agreement must be made knowingly and willingly.¹⁰³ This protection ensures that individuals will not be coerced into contract modifications without fully knowing and understanding the implications of accepting the contract modification.¹⁰⁴ In accepting a modification, members are bargaining away the constitutional protections given to employees in the pension protection clause.¹⁰⁵ Although ordinary contract principles can allow such a modification, the state will have to meet an incredibly high bar in showing each employee had sufficient information to know the implications of accepting reduced pension benefits.¹⁰⁶

The argument that modification of pension benefits utilizing classical contract principles of consideration could withstand constitutional challenge is valid. However, this would require voluntary consent of the employee and the consideration given would

⁹⁶ *Jones*, 50 N.E.3d at 609 ("To be sure, ordinary contract principles allow for the modification of pension benefits in a bargained-for exchange for consideration.").

⁹⁷ *In re Pension Reform Litig.*, 32 N.E.3d at 16 n.12 (emphasis added).

⁹⁸ *Id.* at 1, 30.

⁹⁹ *Jones*, 50 N.E.3d at 609.

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² Madiar, *supra* note 28, at 173.

¹⁰³ *Kraus v. Bd. of Trs. of the Police Pension Fund of Vill. of Niles*, 390 N.E.2d 1281, 1292 (Ill. App. Ct. 1979); *Jones*, 50 N.E.3d at 609.

¹⁰⁴ *Consideration for Modification*, 12A ILL. L. & PRAC. CONT. § 216, Westlaw (database updated Feb. 2018).

¹⁰⁵ *Jones*, 50 N.E.3d at 609.

¹⁰⁶ *Id.*

have to be a benefit not currently offered to state employees as a condition of employment.¹⁰⁷ On both of these requirements, recent pension reform proposals fail.

A. *Proposal 1: “Choose” between your currently protected Automatic Annual Increase or your (also currently protected) Pensionable Salary.*

Governor Rauner’s proposal to offer employees a “choice” between automatic annual increases (AAI) and pensionable salary increases¹⁰⁸ is fundamentally flawed. The AAI increases a retiree’s pension benefit by a statutorily set amount each year and is commonly referred to as a Cost-of-Living-Adjustment.¹⁰⁹ “Pensionable salary” is used to calculate a retiree’s initial pension benefit and is based on the highest four of the last eight years of employment for employees hired before January 1, 2011.¹¹⁰ AAIs and pensionable salary increases are both benefits protected under the pension protection clause.¹¹¹ Because both benefits are constitutionally protected, it would be unconstitutional to require public employees to “choose” one benefit or the other.

The Rauner proposal attempts to apply the principle laid out by the court in *Jones* that pension benefits may be modified through a bargaining process.¹¹² In *Jones*, the City of Chicago argued that ensuring the financial stability of the pension funds creates a *new* benefit for employees.¹¹³ The court rejected this argument on several grounds, but focused on the fact that employees already have “a legally enforceable right to receive the benefits they have been promised.”¹¹⁴ The court explained an employee can “knowingly and voluntarily” agree to modify pension benefits in exchange for “*valid consideration*” (emphasis added).¹¹⁵

In *Kanerva*, the court held that state employee and retiree healthcare benefits are protected by the pension protection clause.¹¹⁶ The statutory authorization of these benefits is not found in the pension code. Still, the court explained: “[I]t is clear if something

¹⁰⁷ Eric M. Madiar, *Pension Benefits Under Siege: Does State Law Facilitate or Block Recent Efforts to Cut the Pension Benefits of Public Servants?*, 27 A.B.A. J. LAB. & EMP. L. 179 (2012); Madiar, *supra* note 28; *In re Pension Reform Litig.*, 32 N.E.3d 1.

¹⁰⁸ Nick Blumberg, *Lawmakers Discuss Governor’s Pension Proposal, Democratic Response*, CHI. TONIGHT (Jan. 21, 2016, 10:33 PM), <http://chicagotonight.wttw.com/2016/01/21/lawmakers-discuss-governors-pension-proposal-democratic-response>.

¹⁰⁹ The statutory amount is 3%, compounded for each state funded pension system. *See generally* 40 ILL. COMP. STAT. ANN. 5. The amount varies for locally funded public pension systems. *Id.*

¹¹⁰ The calculation of final average salary was modified for employees hired after January 1, 2011, but is not relevant for this Comment as reform proposals focused primarily on employees hired before January 1, 2011. 40 ILL. COMP. STAT. ANN. 5/1-160.

¹¹¹ Modifications to AAI’s and pensionable salary were included in Public Act 98-599. 2013 Ill. Laws 7148; *see, e.g.*, 40 ILL. COMP. STAT. ANN. 5/14-114 (showing the Act included an “[a]utomatic increase in retirement annuity”); 40 ILL. COMP. STAT. ANN. 5/14-103.10 (showing the Act included “[c]ompensation”). The court ruled those changes were unconstitutional. *In re Pension Reform Litig.*, 32 N.E.3d at 16.

¹¹² *Compare Jones*, 50 N.E.3d at 609, with Blumberg, *supra* note 108.

¹¹³ *Jones*, 50 N.E.3d at 609.

¹¹⁴ *Id.* at 607 (quoting *In re Pension Reform Litig.*, 32 N.E.3d at 16).

¹¹⁵ *Id.* at 609.

¹¹⁶ *Kanerva*, 13 N.E.3d at 1239.

qualifies as a benefit of the enforceable contractual relationship resulting from membership in one of the state's pension or retirement systems, it cannot be diminished or impaired.”¹¹⁷ The court went on to explain that the benefits protected under the pension protection clause were not limited to only the retirement benefits set forth in the Pension Code.¹¹⁸ Instead, benefits protected by the pension protection clause include “subsidized health care both while an employee was working and after the employee retired, life insurance, eligibility for a retirement annuity, disability coverage and survivor benefits.”¹¹⁹ These benefits are included within the scope of the clause’s protection because they were known benefits when the clause was enacted at the 1970 Constitutional Convention.¹²⁰ Additionally, although the court has not ruled on the specific consideration that may be required in a bargained-for exchange that results in constitutional modification of pension benefits, classical contract principles can be used as a guide when analyzed within the recent court decisions.¹²¹

Applying the court’s logic to Governor Rauner’s consideration proposal, an employee is not offered a true choice when required to choose between: (1) the current 3% automatic annual increase and (2) the ability to count future salary increases towards pensionable salary. All public retirement benefits in Illinois are calculated using three core components: (1) the salary of an employee prior to retirement, (2) the number of years the employee has been a member of the pension system, and (3) the statutory multiplier set by the legislature.¹²² While each system has unique intricacies, these basic components are used to calculate the benefit all public employees receive upon retirement.¹²³ Every year after retirement, this core benefit is increased through a statutorily set automatic annual increase (COLA).¹²⁴ Both of Governor Rauner’s proposed “options” are protected benefits under the pension code;¹²⁵ accordingly choosing one of these “options” does not confer a new benefit on the employee that would constitute valid consideration.

Instead, this illusory choice would result in an unconstitutional diminishment of the employee’s benefit. Eric Madiar¹²⁶ previously recognized this point when he explained that most state employees “already have job and salary protection under the Personnel Code and collective bargaining agreements.”¹²⁷ Accordingly, future salary increases are a

¹¹⁷ *Kanerva*, 13 N.E.3d at 1239.

¹¹⁸ *Id.* at 1240.

¹¹⁹ *Id.* at 1243.

¹²⁰ *Id.* at 1242.

¹²¹ *Doyle v. Holy Cross Hosp.*, 708 N.E.2d 1140, 1144–45 (Ill. 1999).

¹²² *See generally* 40 ILL. COMP. STAT. ANN. 5.

¹²³ *See id.*

¹²⁴ *See id.*

¹²⁵ *In re Pension Reform Litig.*, 32 N.E.3d at 17 (showing automatic annual increases and compensation (the SERS term for pensionable salary) are key components of retirement benefits set forth in the pension code).

¹²⁶ Eric Madiar was President Cullerton’s General Counsel and point person on public pension reform legislation. Madiar, *supra* note 28, at 167. He is recognized as a leading public pension expert in Illinois and has received an award from the Illinois Public Pension Fund Association for his legal research on the Illinois Constitution’s Public Pension Clause. *Id.* His work has critically analyzed the legal challenges to reforming Illinois’ public pension systems. *Id.*

¹²⁷ *Id.* at 272.

protected benefit of public employment. Even if employees were no longer in collective bargaining units, giving a current benefit back to an employee as “consideration” is nonsense.¹²⁸ In such a situation, the state would not suffer any detriment by returning to the status quo: the employee would simply be made whole rather than receive any additional benefit. Any concept of bargained-for exchange is eviscerated by such a “choice.”

B. *Proposal 2: Incentives to Cave*

Governor Rauner’s alternative proposal to offer members of SERS an incentive package to voluntarily lower their pension benefits is a flawed solution, even though the premise has a slightly stronger basis for constitutional permissibility.¹²⁹ One reason the “incentive package” is flawed is that it interferes with the current collective bargaining structure—instituting the illusion of a benefit without providing an actual benefit to employees—because an employee is simply being made whole once again by “accepting” the incentive package. The court has not determined what circumstances are necessary for employees to waive their constitutional rights.¹³⁰ Based on existing case law, it is unlikely that the illusory “benefits” in this package amount to true consideration, as required for such a waiver.

The state, as an employer, cannot disregard obligations established to attract and retain “a skilled and loyal workforce” simply because it now perceives the obligations to be inconvenient or burdensome.¹³¹ In *Doyle v. Holy Cross Hospital*, the employer changed the discharge provisions in the employee handbook after plaintiff employees were hired.¹³² The employees argued the unilateral changes to the employment contract were not supported by consideration because the “consideration” was more show than substance.¹³³ The court noted the “illusion (and the irony) . . . apparent” in the asymmetric choice being given to employees: quit or accept the detriment.¹³⁴

The Governor’s plan sets new “baselines” for members of the SERS.¹³⁵ The “incentive package” included in the proposal would return employees to their current package of employee benefits.¹³⁶ The sweeping opinion in *Kanerva* arguably protects all

¹²⁸ *People ex rel. Sklodowski*, 695 N.E.2d at 377–78 (stating consideration consists of some detriment to the offeror, some benefit to the offeree, or some bargained-for exchange between them, and that any act or promise which is of benefit to one party or disadvantage to the other is sufficient consideration).

¹²⁹ Finke, *supra* note 90.

¹³⁰ *Jones*, 50 N.E.3d at 609 (finding it is unnecessary to determine whether the affidavit detailing the negotiations bound members because the unions were not acting as authorized agents within a collective bargaining process).

¹³¹ *Doyle*, 708 N.E.2d at 1147.

¹³² *Id.* at 1143.

¹³³ The court goes on to explain that a current employee can receive future benefits added to a contract by the employer because such a unilateral modification would be supported by consideration. *Id.* at 1147. An employee is not required to accept future detriments simply because they would be able to accept future benefits. *Id.* at 1148.

¹³⁴ *Id.* at 1146 (quoting the appellate court ruling).

¹³⁵ The new “baselines” would increase the time an employee must work to receive overtime pay from 37.5 hours to 40 hours, vacation time is “reset” (reduced), and “bumping rights” are modified. Finke, *supra* note 90. “Bumping rights” control when a newer employee can surpass an employee in the seniority level. *Id.*

¹³⁶ *Id.*

benefits associated with state employment.¹³⁷ Although overtime and vacation benefits are not directly set forth in statute, both benefits are included in the calculation of a retirement annuity.¹³⁸ Reducing these employment benefits to create a new “baseline” would reduce the employee’s retirement benefit calculation upon retirement.¹³⁹ The illusion is apparent in the “choice” this proposal would give state employees between lower pension benefits and the benefits adopted to attract and retain them.

Therefore, the Governor’s proposal to give employees the choice between a lower “baseline” of vacation and overtime benefits or taking a reduced automatic annual adjustment runs into the exact same problem as the proposal to choose between two constitutionally protected pension benefits, even if it looks more palatable on the surface. The court has explicitly stated that article VIII, section 5 applies to benefits beyond the retirement annuity itself.¹⁴⁰ Even if the benefits offered in the incentive package are not constitutionally protected, the plan does not provide consideration by giving employees the “choice” to return to the position they were in prior to the enactment this proposal.

Regardless of whether offering an incentive package for modification of retirement benefits is permissible under the Illinois constitution, such a proposal could only apply to the SERS.¹⁴¹ SERS accounts for only 23.6% of the total unfunded liability of state pension systems;¹⁴² this leaves 76.4% of the total unfunded liability unaffected by this proposal.¹⁴³ Any similar employment benefit changes for members of TRS and SURS would have to be implemented through local school districts, community colleges, and state universities.

V. WHERE CAN WE GO FROM HERE?

A. *Knowing and Voluntary Consideration*

In theory, public pension benefits can be modified if the state either: (1) provides a benefit to the employee or detriment to the state sufficient to justify modification of the

¹³⁷ *Kanerva*, 13 N.E.3d at 1243. The court discusses that although health coverage is not addressed in the pension code, eligibility is conditioned on membership in one of the retirement systems. *Id.* As a result, all benefits that flow from such a relationship are constitutionally protected under the pension protection clause.

¹³⁸ *See, e.g.*, 40 ILL. COMP. STAT. ANN. 5/14-103.10 (discussing “Compensation”).

¹³⁹ *In re Pension Reform Litig.*, 32 N.E.3d at 5 (explaining the amount of a retirement annuity benefit under SERS is calculated based on (1) the member’s final average compensation, (2) their total service credit (years of membership in the system), and (3) the statutory multiplier).

¹⁴⁰ *Kanerva*, 13 N.E.3d at 1240 (“Giving the language of article XIII, section 5, its plain and ordinary meaning, all of these benefits, including subsidized health care, must be considered to be benefits of membership in a pension or retirement system of the State and, therefore, within that provision’s protections.”).

¹⁴¹ The State is the employer for members of SERS. Members of TRS and SURS are employed by local school districts, community colleges, and state universities. 40 ILL. COMP. STAT. ANN. 5/14-101. The State could pass legislation to encourage local employers to make employment modifications but does not directly handle the employment contracts for members of TRS and SURS.

¹⁴² SPECIAL PENSION BRIEFING, *supra* note 29, at 1.

¹⁴³ *Id.*

contract (consideration);¹⁴⁴ or (2) collectively bargains for modifications that are knowingly and voluntarily accepted by employees (bargained-for exchange).¹⁴⁵ But, turning these principles into realistic pension reform is not so simple. There is a fundamental inconsistency between the goal of pension reform—to lower the required state pension contribution—and classic contract principles—providing a benefit to the employee or detriment to the employer. Additionally, even if the state could reach an agreement through collective bargaining to modify public pension benefits, the court has yet to address whether employees’ constitutional rights can be “bargained away.”¹⁴⁶

Proponents of the Governor’s proposal may argue that consideration could be “knowing[ly] and voluntar[ily]” accepted on an individual employee basis.¹⁴⁷ But, it would likely be impossible for the state to adequately undertake an outreach program that would overcome the court’s standard for adequately informing every individual of the impact of their decision to accept a modification of benefits to ensure that each employee is making a knowledgeable, voluntary decision.¹⁴⁸

While the proposals discussed above fail on classic contract principles, a proposal offering a true benefit to the employee could withstand a constitutional challenge.¹⁴⁹ The inconsistency between the goal of pension reform¹⁵⁰ and offering consideration for benefit reduction can be reconciled by offering a subjectively greater benefit to employees than they are currently receiving.¹⁵¹ State employees receive a monetary benefit upon retirement.¹⁵² Employees have been promised this benefit throughout their career and the pension protection clause was enacted to ensure employees felt secure that the benefit would be available upon retirement.¹⁵³

¹⁴⁴ *In re Pension Reform Litig.*, 32 N.E.3d at 21 (explaining the burden is higher to justify modification of state contracts).

¹⁴⁵ *See Doyle*, 708 N.E.2d at 1146; *Jones*, 50 N.E.3d at 609 (articulating “classical contract principles” for modification of employment contracts).

¹⁴⁶ *Jones*, 50 N.E.3d at 609.

¹⁴⁷ *Pension Reform Bill* (July 8, 2015), <https://chicagotonight.wttw.com/sites/default/files/article/file-attachments/Summary%20of%20Rauner%27s%20Pension%20Plan.pdf>, in Natalie Valdes, *Analyzing Gov. Rauner’s Latest Pension Plan*, CHI. TONIGHT (July 9, 2015), <https://chicagotonight.wttw.com/sites/default/files/article/file-attachments/Summary%20of%20Rauner%27s%20Pension%20Plan.pdf>; Mike Riopell, *Rauner Backs Pension Plan that Offers Choice, with Caveat*, DAILY HERALD (Jan. 22, 2016), <http://www.dailyherald.com/article/20160121/news/160129798/>; Sun-Times Staff, *Rauner Backs Cullerton Pension Plan—but Cullerton Says it’s Not his Plan*, CHI. SUN-TIMES (Jan. 21, 2016), <http://chicago.suntimes.com/news/rauner-backs-cullerton-pension-plan-but-cullerton-says-its-not-his-plan/>.

¹⁴⁸ *Buddell v. Bd. of Trs., State Univ. Ret. Sys. of Ill.*, 514 N.E.2d 184, 186–87 (Ill. 1987); *Kraus*, 390 N.E.2d at 1292; *see also York v. Cent. Ill. Mut. Relief Ass’n*, 173 N.E. 80, 82 (Ill. 1930).

¹⁴⁹ *Kraus*, 390 N.E.2d at 1293 (“Nothing prohibits an employee from knowingly and voluntarily agreeing to modify pension benefits from an employer in exchange for valid consideration from the employer.”); *see Chi. Coll. of Osteopathic Med. v. George A. Fuller Co.*, 776 F.2d 198, 208 (7th Cir. 1985) (showing under the preexisting duty rule, agreement to do what one is contractually obligated to do is not valid consideration).

¹⁵⁰ The goal of pension reform is reducing the liabilities of the systems, which can only be achieved through reduction of current benefits.

¹⁵¹ Terence R. Mitchell & Amy E. Mickel, *The Meaning of Money: An Individual-Difference Perspective*, 24 ACAD. MGMT. REV. 568, 575–76 (1999).

¹⁵² *See generally* 40 ILL. COMP. STAT. ANN. 5.

¹⁵³ *In re Pension Reform Litig.*, 32 N.E.3d at 8.

Non-monetary employee benefits could improve the lives of state employees without a negative impact on the state budget. Potential alternative benefits include increased flex time, improved working conditions, and career support systems, among others. Incentive packages will only provide adequate consideration if new benefits are included that are currently unavailable to employees.¹⁵⁴

Additionally, incentive packages could potentially be accepted in two ways: (1) through a collective bargaining agreement with an authorized agent of the union, or (2) by allowing each employee to choose whether to modify their benefits by accepting the new benefit package. If the package is accepted through the collective bargaining process between an authorized union representative and the legislature, there will be more certainty about the fiscal impact of the reform. However, the current political climate has made it difficult to reach an agreement with union representatives.¹⁵⁵ Allowing each employee to modify their benefits by taking the new incentive package would be a challenging process. The state would be required to adequately educate each employee about the impact of his or her election to modify his or her employment benefits. Requiring an employee to make a decision without adequate information could cause the changes to still be found unconstitutional.¹⁵⁶

Realistically, modification of pension benefits will not provide the budgetary relief sought to fund other core state services at a higher level. Instead, the state will likely need to look for alternative solutions to solve the current pension situation.

B. *Solutions Without Benefit Implications*

1. Increased Revenue

State revenue can always be increased by changing the tax structure. For years, the legislature has discussed various proposals to increase revenue to fund the increasing pension payment.¹⁵⁷ These proposals include an increased income tax rate, instituting a progressive income tax rate, expanding the sales tax base, and taxing retirement income over a certain amount.¹⁵⁸ Illinois is one of only three states that does not tax retirement

¹⁵⁴ *Kanerva*, 13 N.E.3d at 1239–40 (explaining all benefits considered to be components of employment at the time of the 1970 Constitution are protected within the scope of the pension protection clause).

¹⁵⁵ The Governor introduced a package of legislative changes to various business and labor provisions after taking office. See THE ILL. TURNAROUND, COMPILED PACKET (2014), <https://www.illinois.gov/gov/Documents/CompiledPacket.pdf>. A commitment to passing these changes has led to declining relations between the Governor's office and union employees. *Id.*; Rick Pearson, *Morning Spin: Rauner Turnaround Agenda isn't Shelved—Just on Hiatus Until After November Election*, CHI. TRIB. (July 1, 2016), <http://www.chicagotribune.com/news/local/politics/ct-bruce-rauner-budget-impasse-aftermath-20160630-story.html>; Brian Mackey, *Illinois Issues: The Social Cost of Rauner v. Labor*, WSIU PUB. BROADCASTING (Oct. 24, 2015), <http://news.wsiu.org/post/illinois-issues-social-cost-rauner-v-labor#stream/0>.

¹⁵⁶ *Jones*, 50 N.E.3d at 608 (“Whether members of the Funds may be ‘better off’ under the new terms of the Act despite the unconstitutional diminishment of their benefits . . . is not for the General Assembly to decide unilaterally.”).

¹⁵⁷ See generally CTR. FOR TAX & BUDGET ACCOUNTABILITY, ISSUE BRIEF: A COMPARISON OF MAJOR ILLINOIS TAX PROPOSALS (2010), available at <http://www.ctbaonline.org/reports/issue-brief-comparison-major-illinois-tax-proposals>.

¹⁵⁸ See generally *id.*

income¹⁵⁹ and one of only eight states that has a flat income tax rate.¹⁶⁰ Further, Illinois taxes only seventeen services; the average number of services taxed by a state is fifty-six.¹⁶¹ Illinois has one of the narrowest tax bases in the country. Thus, Illinois could rectify the current pension “problem” without benefit modification through reform of the state tax code.¹⁶²

Unsurprisingly, increasing taxes is not a politically popular option. In fact, from 2009–2016, the percentage of Illinoisans who favored fixing the budgetary deficit through increased revenues alone has steadily remained around 10%.¹⁶³ When looking at party differences, Democrats favored increasing revenue alone slightly more at 16%, but only 4% of Republicans approved of using revenue-only solutions to address the budget deficit.¹⁶⁴

On a more positive note, the percentage of Illinoisans who favor fixing the budget deficit through both increased revenues and cuts to state services has increased slightly since 2009, from 27% to 33%.¹⁶⁵ Along the same lines, the percentage of Illinoisans who favor a solution containing solely cuts to state spending has decreased by 10% since 2009, from 57% to 47%.¹⁶⁶

While this data shows the political challenge presented by the idea of increasing revenue, it also suggests an opening for a larger solution that combines increases in revenue with reductions in spending. The spiking annual required contributions to the five state-funded pension systems continues to strain the state’s fiscal health.¹⁶⁷ As such, without increased revenue the growing pension payment will continue to cut into the revenue available to fund core services each year, including: elementary, secondary, and higher education; human services; and public safety.

2. Changes to the State’s Annual Required Contribution

Modification of the funding schedule provides another option to alleviate pressure on the state budget. As noted at the beginning of this Comment, public employee retirement benefits are funded through three main sources in Illinois: (1) employee contributions, (2) employer contributions, and (3) investment returns.¹⁶⁸ Each pension system calculates the annual required state contribution using actuarial science to

¹⁵⁹ Kari Lydersen, *Age-Old Question: Time for State Retirement Tax?*, BETTER GOV’T ASS’N (Apr. 20, 2016), <http://www.bettergov.org/news/age-old-question-time-for-state-retirement-tax>.

¹⁶⁰ Jamey Dunn, *Illinois Issues: Why Does the State Have a Flat Income Tax?*, NPR ILL. (Apr. 21, 2016), <http://nprillinois.org/post/illinois-issues-why-does-state-have-flat-income-tax#stream/0>.

¹⁶¹ See COMM’N ON GOV’T FORECASTING & ACCOUNTABILITY, ILL. GEN. ASSEMBLY, SERVICE TAXES: 2011 UPDATE, at i, (2017), <http://cgfa.ilga.gov/Upload/ServiceTaxes2011update.pdf>.

¹⁶² CTR. FOR TAX & BUDGET ACCOUNTABILITY, IT IS ALL ABOUT REVENUE: A COMMON SENSE SOLUTION FOR ILLINOIS’ FISCAL SOLVENCY (2015), available at <http://www.ctbaonline.org/reports/it-all-about-revenue-common-sense-solution-illinois%E2%80%99-fiscal-solvency>.

¹⁶³ John Jackson, Charles W. Leonard & Shiloh L. Deitz, *The Climate of Opinion in Illinois 2008–2016: Roots of Gridlock*, 47 SIMON REV. 1, 49 (2016).

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ *Id.* at 36.

¹⁶⁸ See generally 40 ILL. COMP. STAT. ANN. 5

estimate retirement rates, mortality rates, salary growth, and more.¹⁶⁹ The systems also set an assumed rate of return and discount rate.¹⁷⁰ These factors are used to calculate the state contribution that is required in the present year for the system to reach 90% funding by 2045.¹⁷¹

In 1995, the current funding structure was enacted in Public Act 88-593.¹⁷² This legislation gradually increased pension payments on a statutorily set “ramp” until 2011.¹⁷³ In 2011, the state began making contributions at the actuarially required level for each system to reach 90% funded by 2045.¹⁷⁴ This is commonly referred to as a “funding schedule.”

By lengthening the funding schedule, the legislature can reduce the pressure on the state budget in early years but will pay more for the benefits in the long term.¹⁷⁵ The sooner pension systems are infused with funding, the sooner compounding interest begins to help increase the funding level rather than increase the unfunded liability. Payments to the systems increase drastically for the next ten years, but then will begin to level and eventually decrease.¹⁷⁶ To lessen the pressure on the state budget today, the statutory funding schedule could be modified.

3. Issue Bonds to “Buy Out” Members Benefits

A final note on non-legal solutions comes from recent discussions in the Illinois House of Representatives. Several proposals have been introduced to allow members to purchase their benefit as a “lump-sum buyout” as soon as they retire.¹⁷⁷ Under these proposals, members have the opportunity to receive the present value of their pension benefit¹⁷⁸ upon retirement instead of receiving annuity checks each month until their death. Currently, a retiree can designate a survivor to continue to receive a benefit after

¹⁶⁹ See, e.g., TEACHERS’ RET. SYS. OF THE STATE OF ILL., COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE FISCAL YEAR ENDED JUNE 30, 2015, at 86–102 (2015), https://www.trsil.org/sites/default/files/documents/fy15_0.pdf.

¹⁷⁰ *Id.* at 90.

¹⁷¹ See, e.g., 40 ILL. COMP. STAT. ANN. 5/14-131 (discussing “Contributions by State”).

¹⁷² 1994 Ill. Laws 1165, 1179–80.

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ Paying down the unfunded liability is like paying down credit card debt. When a household’s income is not sufficient to pay off all of the debt at one time it accrues interest each month. As a result, the long-term cost is higher, but the payments are sustainable for the household income.

¹⁷⁶ SPECIAL PENSION BRIEFING, *supra* note 29, at 29.

¹⁷⁷ H.B. 4427, 99th Gen. Assemb., Reg. Sess. (Ill. 2015); H.B. 5625, 99th Gen. Assemb., Reg. Sess. (Ill. 2015). These plans are commonly referred to as a “pension buyout.” Olivia Mitchell, *A Proposal for Allowing State Pension Buyouts*, FORBES, (Aug. 17, 2016), <https://www.forbes.com/sites/pensionresearchcouncil/2016/08/17/a-proposal-for-allowing-state-pension-buyouts/#a44a51e337e2>.

¹⁷⁸ The present value of a retiree’s benefit is calculated using many of the same actuarial factors discussed above, including retirement, disability and mortality rates. See, e.g., *Learn About Pensions: 16.13 Calculation of Present Value of a Defined Benefit Pension*, PENSION ANALYSIS CONSULTANTS, INC., <http://www.pensionanalysis.com/CM/LearnAboutPensions/Calculation-of-Present-Va.html> (last visited Mar. 23, 2018).

their death.¹⁷⁹ The retiree would forfeit all benefits associated with membership in the pension system.¹⁸⁰

Implementing a buyout system would reduce future liabilities today. However, allowing any retiree to take the buyout option can be dangerous to the financial stability of the pension systems due to the poor funding levels. Instead, a more secure version of this option would incentivize all inactive members¹⁸¹ to utilize the buyout option, substantially reducing the current unfunded liability in a predictable manner.

CONCLUSION

Illinois faces drastically increasing pension payments that will continue to strain the revenue available for other vital state services. While current employees' retirement benefits could be modified through classic contract principles, the illusory proposals offered by Governor Rauner or Senate President Cullerton will likely fail in the courts. To successfully withstand a constitutional challenge, the consideration offered to employees must provide a true benefit that is not currently available to the employee. While this idea is generally inconsistent with the overall goal of pension reform, it may be possible to offer a new, subjectively greater, benefit to the employee that would result in monetary relief for the state.

At the end of the day, significant decisions must be made by the Governor and the legislature to ensure the fiscal health of the state and the pension systems. The Illinois Supreme Court established the boundaries of these potential decisions through its decisions emphasizing that pension benefits may not be unilaterally diminished or impaired. It is true that the court may entertain modification of pension benefits using the classic contract principles of valid offer, acceptance, and consideration. Still, the key to this caveat left by the court focuses on the validity of the consideration offered. The choice between two currently available benefits does not satisfy the test for valid consideration; thus, it is unlikely that the current "consideration" proposals would withstand the court's scrutiny. Put bluntly, such a false promise of consideration does nothing to rectify Illinois' growing pension payments and liabilities. Going forward, responsible debate should focus on true consideration, reform of the tax system, or modification of the state's statutorily required contribution.

¹⁷⁹ See, e.g., 40 ILL. COMP. STAT. ANN. 5/14-120.

¹⁸⁰ *Id.*

¹⁸¹ Inactive members of a pension system are no longer employees of the state but have worked long enough to receive benefits from the system upon obtaining the required retirement age. See, e.g., *Inactive Members*, ST. U. RETIREMENT SYS., <http://www.surs.com/inactive-members> (last visited Mar. 23, 2018).