

LITIGATING FOR THE FUTURE OF PUBLIC PENSIONS

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ABSTRACT

Public pensions are horribly unfunded; millions of public employees are being forced to make greater contributions to their pensions; retirees are being forced to take benefit cuts; retirement ages and service requirements are being increased; and the list goes on and on. These alarming developments involve all levels of American government, from the recent move to require new federal employees to contribute more to their pensions, to the significant underfunding of state and local public pension funds across the country, to the sad spectacle of the Detroit municipal bankruptcy where the plight of public pensions plays a leading role in that drama.

As a result, government officials, employees, and retirees are in the midst of litigating for the future of American public pensions. This Article, for the first time, focuses on all three levels of American government (federal, state, and local) and reviews the current status of pension litigation at each level. After discussing the federal employee pension system in the United States, the Article then considers one state's (Wisconsin's) recent experience with pension-reform legislation and litigation, and one city's (Detroit's) experience with the municipal bankruptcy process to illustrate emerging trends in American public pension litigation.

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The start of a solution lies with harmonizing and standardizing the existing hodgepodge of American public pension law. Although ERISA is far from perfect in regulating private-sector pension plans in the United States, it nevertheless has provided uniform standards for management and administration of employer-sponsored retirement plans. To replicate that same consistency, this Article proposes a hybrid approach, which seeks to avoid some of the federalism pitfalls of previous public pension-reform proposals. By applying ERISA to federal employee pension plans, and by permitting states to adopt uniform, state-wide pension legislation, public pension plans can take advantage of reliable and stringent pension frameworks that will make future underfunding and plan-fiduciary lapses less likely.

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INTRODUCTION

It is nearly impossible in the United States today to go long without reading a headline about some aspect of the American public pension crisis or about some state undertaking public pension reform.¹ Public pensions are horribly unfunded;² millions of public employees are being forced to make greater contributions to their

1. See Hazel Bradford, *Pace of Pension Reform Ebbs After 49 States Change Laws*, PENSIONS & INVESTMENTS, Apr. 14, 2014, available at www.pionline.com/article/20140414/PRINT/304149975/pace-of-pension-reform-ebbs-after-49-states-change-laws (“The financial crisis and its aftermath sparked some kind of pension reform in every state except Idaho.”); Mark Miller, *How Much Are Public-Sector Pensions Shrinking? Often, A Lot*, REUTERS (May 20, 2014, 10:38 AM), <http://www.reuters.com/article/2014/05/20/us-column-miller-pensions-idUSBREA4J0IV20140520> (“You’d have to be living in a cave not to have heard that many states are bailing out struggling pension plans by cutting benefits.”).

2. The Pew Center on the States estimates that the total cost of providing pension benefits to all public employees in the United States will exceed over \$2.73 trillion dollars and that the average total funding level is only at about 85%, or \$2 trillion dollars right now. See PEW CTR. ON THE STATES, *THE TRILLION DOLLAR GAP: UNDERFUNDED STATE RETIREMENT SYSTEMS AND THE ROADS TO REFORM 1* (2010), available at http://www.pewtrusts.org/~media/legacy/uploadedfiles/pcs_assets/2010/TrillionDollarGapUnderfundedStateRetirementSystemsandtheRoadstoReform.pdf. Others have estimated the aggregate public pension plan deficit in the United States as high as \$3.39 trillion dollars. See Robert Novy-Marx & Joshua D. Rauh, *Policy Options for State Pension Systems and Their Impact on Plan Liabilities*, 10 J. PENSION ECON. & FIN. 173, 181 (2011); see also Alicia H. Munnell et al., *The Funding of State and Local Pensions: 2012-2016*, 32 CENTER FOR RETIREMENT RES. (2013), available at http://crr.bc.edu/wp-content/uploads/2013/07/slp_32-508.pdf (estimating funding deficit at \$3.8 trillion based on 2012 numbers).

pensions;³ retirees are being forced to take benefit cuts;⁴ retirement ages and service requirements are being increased; and the list goes on and on.⁵

These headlines involve all levels of American government, from the recent move to require new federal employees to contribute more to their pensions,⁶ to the significant underfunding of state and local public pension funds across the country,⁷ to the sad spectacle of the Detroit municipal bankruptcy where the plight of public pensions plays a leading role in that drama.⁸ The underfunding of public pension plans has led not only to a number of bankruptcy proceedings, but also to various states reducing promised pension payouts to retired plan members or increasing contribution requirements for active employees.⁹

There are also issues surrounding public pensions that transcend the level of government involved. For instance, a country-wide push exists for public plans to adopt consumer-driven, defined contribution plans of the 401(k) variety, though such new plans are largely limited to new employees.¹⁰ Additionally, legislation to offer

3. See *infra* Part III.

4. See Alicia H. Munnell, Jean-Pierre Aubry & Mark Cafarelli, *COLA Cuts in State/Local Pensions*, 38 CENTER FOR RETIREMENT RES. 2 (2014), available at <http://crr.bc.edu/briefs/cola-cuts-in-statelocal-pensions/> (finding that seventeen states have “reduced, suspended, or eliminated” cost-of-living-adjustments (COLAs) for public employee pensions).

5. See Bradford, *supra* note 1 (“[T]he Center for Retirement Research at Boston College found most already have taken steps to reduce future pension costs by some combination of increasing employee contributions, raising age and tenure requirements, trimming salary calculation formulas used to set pension levels and shrinking or stopping cost-of-living increases.”).

6. The Bipartisan Budget Act of 2013, H.J. RES. 59, 113th Cong., increased the required employee pension contribution for new employees first hired after December 2013 to 4.4% of pay. See Kellie Lunney, *What the Budget Deal Means for Federal Employees*, NAT’L J. (Dec. 11, 2013), <http://www.nationaljournal.com/budget/what-the-budget-deal-means-for-federal-employees-20131211>.

7. Only one-third of American states have put aside sufficient money to fund their pensions, and some twenty states have funding levels below 80%, which is considered an unhealthy rate. See PEW CTR. ON THE STATES, *supra* note 2, at 3-4.

8. See *infra* Part IV.

9. See *infra* Part III.

10. See Hazel Bradford, *Baltimore Approves Moving New City Employees to D.C. or Hybrid Plan*, PENSIONS & INVESTMENTS (May 7, 2014, 3:33 PM), <http://www.pionline.com/article/20140507/ONLINE/140509869/baltimore-approves-moving-new-city-employees-to-dc-or-hybrid-plan> (“Baltimore will offer new employees the choice of a defined contribution plan or a hybrid plan under reforms approved Monday by the City Council.”); Meaghan Kilroy, *Oklahoma*

public retirement system participation to private-sector workers in a number of states¹¹ and through the federal government's Thrift Savings Plan (TSP) has started to take root.¹² Needless to say, there is much happening in the American public pension world.

Regardless of whether the crisis of the day involves federal, state, or local pension plans, not lurking too far in the background is an ongoing debate about how the current public pension system must be reformed to provide a more secure and cost-effective retirement for public employees in the future.¹³ Implementation of reforms, especially ones that either increase the financial burden on employees and/or retirees, or diminish the benefits that employees and/or retirees will receive, inevitably leads to protracted litigation.¹⁴ Indeed, it can be said without embellishment that the various

Senate Sends Bill to Create DC Plan to Governor, PENSIONS & INVESTMENTS (May 27, 2014, 3:51 PM) <http://www.pionline.com/article/20140527/ONLINE/140529897/oklahoma-senate-sends-bill-to-create-dc-plan-to-governor> (stating that “[t]he Oklahoma Senate passed a bill last week that would shift some new employees into a new defined contribution plan administered by the \$8 billion Oklahoma Public Employees Retirement System,” and noting the governor is likely to sign it into law). Yet, there has not been as much activity as some expected. See Bradford, *supra* note 1 (“CRR [Center for Retirement Research] researchers found that just 15% of public plan sponsors introduced some form of defined contribution plan after 2008.”).

11. See Hazel Bradford, *States Pushing to Offer Retirement Accounts to Private Sector*, PENSIONS & INVESTMENTS (May 12, 2014), <http://www.pionline.com/article/20140512/PRINT/305129971/states-pushing-to-offer-retirement-accounts-to-private-sector> (“Expanding the public retirement system to the private sector moved to political reality from abstract concept this year, as 16 states either are considering legislation or taking the first steps toward implementing new approaches.”); see also *id.* (“One approach being considered by various states is the Secure Choice Pension proposed by NCPERS [National Conference on Public Employee Retirement Systems]. Modeled after cash balance plans, with voluntary contributions to a public/private partnership, it calls for states to set up boards and administrators for professionally managed plans with diversified portfolios. Participation would be voluntary and benefits would be portable.”).

12. On the federal side, Senator Marco Rubio has proposed opening up the federal Thrift Savings Plan, a defined contribution plan offered to federal employees and to military personnel, to all employees. See Josh Hicks, *Rubio, Retirement Benefits and a Thrift Savings Plan for all Americans*, WASH. POST (May 14, 2014), <http://www.washingtonpost.com/blogs/federal-eye/wp/2014/05/14/rubio-retirement-benefits-and-a-thrift-savings-plan-for-all-americans/>.

13. And there is no shortage of public pension-reform proposals in the United States. “In terms of reform attempts, the National Conference of State Legislatures found 29 states saw 166 pension bills introduced in 2014 alone” See Bradford, *supra* note 1.

14. See *infra* Parts III-IV.

stakeholders involved in the American public pension funding crisis are presently litigating for the future of American public pensions.

This Article focuses on all three levels of American government (federal, state, and local) and reviews the current state of pension litigation at each level. Although pension litigation does not exist as of the writing of this Article at the federal level, there has been a large swath of litigation involving state and local pensions over the last few years, with diverse outcomes. After discussing the federal employee pension system in the United States, the Article then considers one state's (Wisconsin's) recent experience with pension-reform legislation and litigation, and one city's (Detroit's) experience with the municipal bankruptcy process to illustrate emerging trends in public pension litigation that are currently playing out throughout the United States.

More specifically, the Wisconsin state case study involves changes made to one of the healthiest public pension programs in the country, the Wisconsin Retirement System (WRS).¹⁵ These pension reforms were part of the infamous anti-union laws, Act 10 and Act 32, which were enacted in 2011 by Republican Governor Scott Walker.¹⁶ The recently completed Wisconsin litigation, *Madison Teachers, Inc. v. Walker*,¹⁷ involved a provision that did not permit the City of Milwaukee to pay its employees' pension contribution share.¹⁸ This case nicely illustrates some of the major constitutional arguments being advanced concerning whether such reform proposals are consistent with existing employee and retiree pension rights.

15. See Robert J. Conlin, Mike Huebsch & Gregory L. Gracz, *Study of the Wisconsin Retirement System: In Accordance with 2011 Wisconsin Act 32*, DEP'T OF EMP. TRUST FUNDS 9 (June 30, 2012), available at etf.wi.gov/publications/wrs-study.pdf (reporting that WRS I "is an efficient and sustainable retirement system," which has been nearly fully funded since 2004).

16. See A.B. 11, 2011 Leg., Spec. Sess. (Wis. 2011), available at <http://docs.legis.wisconsin.gov/2011/related/acts/10.pdf>; A.B. 40, 2011 Leg., Reg. Sess. (Wisc. 2011), available at <http://docs.legis.wisconsin.gov/2011/related/acts/32.pdf>. For additional information on the enactment of Act 10 and its aftermath, see generally Paul M. Secunda, *The Wisconsin Public-Sector Labor Dispute of 2011*, 27 A.B.A. J. LAB. & EMP. L. 293 (2012).

17. 2014 WI 99, 851 N.W.2d 337.

18. WIS. STAT. § 62.623(1) (2014) ("Beginning on July 1, 2011, in any employee retirement system of a 1st class city, . . . employees shall pay all employee required contributions for funding benefits under the retirement system. The employer may not pay on behalf of an employee any of the employee's share of the required contributions.").

The Detroit city case study involves the ongoing (as of the writing of this Article) municipal bankruptcy litigation. Many have placed the blame for the Detroit bankruptcy on out-of-control legacy costs, including costs to fund various local city pension plans.¹⁹ Rather than involving litigation in state or federal court, the Detroit drama has played out in federal bankruptcy court under Chapter 9 of the United States Bankruptcy Code.²⁰ As will be discussed, this is a very underdeveloped area of the law, and the bankruptcy judge has had to grapple with many challenging issues involving the interplay of the bankruptcy system and state constitutional provisions, which protect against the diminishment of pension rights.²¹ This is a particularly interesting area of American public pension law to explore from a comparative perspective because it differs greatly from how pensions would be treated if, for instance, Canadian municipalities found themselves in financial distress.²²

After surveying the current state of public pension litigation in the federal, state, and local context in the United States, the Article concludes by suggesting that all public pension plans could benefit from being uniformly regulated either through ERISA (for federal pension plans) or through adoption of a uniform law (for state and local pension plans).²³ Following analyses undertaken by other public pension commentators,²⁴ but providing an innovative twist to

19. See, e.g., Richard Summerfield, *Legacy Costs Push Communities to the Brink*, FINANCIER WORLDWIDE MAG. (Oct. 2013), <http://www.financierworldwide.com/legacy-costs-push-communities-to-the-brink/#.VGjuO4vF8s0> (“While no two cases are ever the same, one of the most common themes running through the majority of insolvent cities and towns is the presence of crippling legacy costs.”).

20. 11 U.S.C. §§ 901-946 (2012).

21. See David A. Lieb, *Detroit Bankruptcy Tests State Pension Protections*, YAHOO! NEWS (July 24, 2013, 3:10 PM), <http://news.yahoo.com/detroit-bankruptcy-tests-state-pension-protections-065517091.html>.

22. See John R. Sandrelli & Valerie Cross, *American Municipal Bankruptcies: The View from Canada*, in ANNUAL REVIEW OF INSOLVENCY LAW 2013, at 385, 387 (Janis P. Sarra ed., 2014) (“Canada’s model paints a more stable picture of municipal finance, suggesting America may need to more rigorously and closely monitor municipal distress.”).

23. See *infra* Part V.

24. See Richard E. Mendales, *Federalism and Fiduciaries: A New Framework for Protecting State Benefit Funds*, 62 DRAKE L. REV. 503, 503 (2014) (arguing for “a uniform state code . . . that states could adopt to govern both state and local benefit plans”); Amy B. Monahan & Renita K. Thukral, *Federal Regulation of State Pension Plans: The Governmental Plan Exemption Revisited*, 28 A.B.A. J. LAB. & EMP. L. 291, 292, 297-98 (2013) (providing an overview of

past proposals, this Article argues for a hybrid approach to the public pension crisis in the United States.

First, Congress should remove the governmental plan exemption from ERISA for federal government employee pension plans. On the other hand, because of significant federalism concerns in having the federal government regulate state and local pension plans,²⁵ the best option is for states to adopt a rigorously regulated, uniform, state-wide public pension plan in place of current state and local pension plans. The combination of these two approaches will lead to public employees benefitting from better reporting and disclosure, fiduciary, funding, vesting, and benefit accrual requirements, which in turn will ensure the future security of their pensions. At the same time, the federal, state, and local governments will benefit by being able to spend more predictable amounts of money on pension obligations, thereby substantially reducing their pension obligations over time.

This Article proceeds in five parts. Because of the peculiar hodgepodge that constitutes the American employer-sponsored pension system, Part I seeks to provide a brief overview of the difference between public and private-sector occupational pensions in the United States, as well as the difference between defined benefit and defined contribution pension plans. Having set out those distinctions, the next three parts examine the status of litigation at the various levels of American government. Part II lays out the pension system for federal employees and notes the current lack of litigation. Part III then considers Wisconsin pension litigation and explores the constitutional causes of actions utilized in such cases. Part IV next reviews the ongoing Detroit municipal bankruptcy litigation's impact on city employee pensions and appraises the unique characteristics of that legal system. Part V concludes by suggesting that current public pension litigation is likely to lead to inconsistent results in different venues²⁶ and, therefore, advances a proposal to expand ERISA's

reasons why ERISA has not been expanded to federal, state, and local governmental plans).

25. See Monahan & Thukral, *supra* note 24, at 297-98.

26. Not only will public pension litigation results likely be inconsistent across federal, state, and local disputes, but as Professor Olivia Mitchell aptly observes, it is also unclear "how much can be learned from one state to another" when it comes to public pension litigation. See Jonathan Miltimore, *States Eye MN Pension Lawsuit*, WATCHDOG (Aug. 24, 2010), <http://watchdog.org/6322/states-eye-mn-pension-lawsuit/> (quoting Olivia S. Mitchell, Director of the Pension Research Council at the Wharton School).

coverage to cover federal employees and to encourage states to adopt a uniform, state-wide law on public pensions. This type of two-prong, federal–state legislative approach will provide the necessary legal standards for public pension plans to avoid the problems that have been plaguing them over the years and lead to a more secure retirement for American public employees at all levels of government.

I. OVERVIEW OF AMERICAN EMPLOYER-SPONSORED PENSION SYSTEM

Although the federally enacted Employee Retiree Income Security Act of 1974 (ERISA)²⁷ governs private-sector employee benefits law in the United States, the law does not apply to federal, state, or local pensions, which are exempted “governmental plans.”²⁸ Consequently, public employee pension schemes are regulated by the federal government for federal employees,²⁹ and by state and local governments for their employees.³⁰ These public pension funds, numbering about 4,000 plans in total and covering some 27 million employees,³¹ represent an extremely important segment of the overall American pension market. Indeed, “[s]tate and local defined benefit pension funds held \$3.05 trillion in assets in fiscal year 2012 State plans held \$2.53 trillion and locally administered plans held

27. 29 U.S.C. §§ 1001-1461 (2012). Congress enacted ERISA to protect employees’ retirement and welfare benefits. *Id.* § 1001(b). Section 2 of ERISA contains the Findings and Declarations of Policy. *Id.* § 1001. Specifically, it states, “It is hereby declared to be the policy of [the Act] to protect . . . the interests of participants in employee benefit plans and their beneficiaries” *Id.* § 1001(b).

28. *Id.* § 1003(b)(1) (“The provisions of this [title] shall not apply to any employee benefit plan if—such plan is a governmental plan (as defined in section 1002(32)”). In turn, ERISA § 1002(32) reads, “The term ‘governmental plan’ means a plan established or maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.” *Id.* § 1002(32); *see also id.* § 1321(b)(2) (exemption of governmental plans from PBGC insurance scheme); I.R.C. §§ 401, 414(d) (2012) (exemption of governmental plans from applicable tax code provisions).

29. *See infra* Part II.

30. State pension plans are discussed *infra* Part III, and local pension plans are discussed *infra* Part IV.

31. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-12-322, STATE AND LOCAL GOVERNMENT PENSION PLANS: ECONOMIC DOWNTURN SPURS EFFORTS TO ADDRESS COSTS AND SUSTAINABILITY (2012), available at <http://www.gao.gov/assets/590/589043.pdf>.

\$521 billion in assets, including cash and investments.”³² Although these plans owe as much as one trillion dollars more in promised benefits than what they hold,³³ most public pension funds are not in danger of defaulting on their pension promises in the near future.³⁴

32. See Hazel Bradford, *State and Local Pension Plans Pass \$3 Trillion Mark in Fiscal Year 2012*, PENSIONS & INVESTMENTS (Apr. 29, 2014, 4:22 PM), <http://www.pionline.com/article/20140429/ONLINE/140429829/state-and-local-pension-plans-pass-3-trillion-mark-in-fiscal-year-2012>; see also U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 31 (finding that “[o]ver 27 million [individuals] are covered by state and local government pension plans”).

33. See *supra* note 2 and accompanying text; see also William Selway, *U.S. Public Pension Shortfalls Exceed \$1 Trillion, Study Finds*, BLOOMBERG BNA PENSION & BENEFITS DAILY (June 10, 2014, 11:32 AM), http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=48012983&vname=pbnotallissues&jid=a0f1n6x7d5&split=0 (citing Alicia H. Munnell, Jean-Pierre Aubry & Mark Cafarelli, *The Funding of State and Local Pensions: 2013-2017*, 39 CENTER FOR RETIREMENT RES. (2014)). However, “[t]he study assumes annual investment gains of 7.7 percent to calculate the cost, in today’s dollars, of benefits that will be paid out in the coming decades. If that is reduced to 4 percent, the shortfall grows to as much as \$3.8 trillion.” Selway, *supra*.

34. See Amy B. Monahan, *State Fiscal Constitutions and the Law and Politics of Public Pensions*, U. ILL. L. REV. (forthcoming 2015) (manuscript at 6), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2436587 (“Despite this large deficit, the \$1 trillion funding gap does not mean [sic] that public plans are in imminent danger of being unable to pay benefits.”). *But see* Terrance O’Reilly, *A Public Pensions Bailout: Economics & Law*, 47 U. MICH. J.L. REFORM (forthcoming 2014) (manuscript at 5), available at <http://ssrn.com/abstract=2368045> (citing studies that in close to half of states public pension plans may become insolvent). See also Jack M. Beerman, *The Public Pension Crisis*, 70 WASH. & LEE L. REV. 3, 10-16 (2013) (summarizing arguments by both those who believe a public pension crisis is imminent and those who think such claims are unfounded and largely a conservative ploy to undermine public-sector employee unions). Professor Beerman, for his part, concludes, “[W]hile there may be some exaggeration out there, the pension funding crisis is real.” *Id.* at 15. That being said, not everyone agrees that there is a pension funding crisis in the United States. Critics have pointed to the lack of sharp spikes in state and municipal bonds prices, like the ones seen in recent years in Greece, Italy, and Spain, and this suggests that investors are still willing to buy the paper of most American states and municipalities (with the State of Illinois and the City of Detroit being important exceptions). See John Cummings et al., *PIMCO’s Outlook on Municipal Bonds*, XYPRIA INVESTMENT ADVISORS (Nov. 6, 2013), <http://xypriainvestment.com/pimcos-outlook-on-municipal-bonds/> (“While recent articles in the press have painted the market with a broad brush, the municipal market is very diverse and each credit is unique. In the aggregate, the municipal bond market is not facing a debt crisis; the average state debt level totals 7.3% of gross state product while local debt totals 11% of U.S. GDP. By comparison several European peripheral countries have debt-to-GDP ratios above 100%. Interest costs and rollover risk do not present a near-term systemic threat to the municipal market.”).

That being said, the significant underfunding of pensions has had a major impact on state and local finances.³⁵

As far as state and local government pension plans in the United States, these plans initially had many similar attributes as private-sector employer-sponsored plans under ERISA.³⁶ Now, however, with there being more stringent regulations of private pension plans (especially with regard to funding), and a dramatic shift to defined contribution plans in the private sector,³⁷ there has been significant divergence in pension plan structure, design, and governance in the private and public sectors.³⁸ For instance, a pension plan subject to ERISA “must design, structure, and fund its plan in accordance with federal rules,” whereas public pension plans “are largely free to structure their pension plans as they see fit and are not subject to any funding requirements other than what state law might impose.”³⁹ The lack of strict or predictable funding requirements for many of these pension plans is often blamed for the significantly underfunded state of many of these plans today.⁴⁰

As far as not subjecting public plans to the stricter requirements of ERISA, it might be that Congress thought it unnecessary to legislate fiduciary and disclosure standards for the public plans because it saw state and local taxpayers as the primary backstops if these public plans failed.⁴¹ Federalism concerns also played a

35. See Monahan, *supra* note 34 (manuscript at 7) (“The increased funding needs caused by plan underfunding is putting significant fiscal pressure on both states and cities, and has been recognized as one of the most critical issues in state and local finance today.”).

36. See Charles B. Stockdale, Douglas A. McIntyre & Michael B. Sauter, *The Sixteen States That Are Killing Their Pensions*, 24/7 WALL STREET (Mar. 4, 2011), <http://247wallst.com/2011/03/04/the-sixteen-states-that-are-killing-their-pensions>.

37. See William T. Payne & Stephen M. Pincus, *The Constitutional Limitations of Public Employee Pension Reform Legislation*, 19 PUB. LAW. 12, 13 (2011) (“[D]efined benefit plans still make up the bulk of the retirement plans in the public sector.”); COLLEEN E. MEDILL, INTRODUCTION TO EMPLOYEE BENEFITS LAW: POLICY AND PRACTICE 121-22 (3d ed. 2011) (chart showing that in 2007 in the private sector there were 48,982 DB plans and 658,805 DC plans and that there were more than three times as many DC plan participants than DB plan ones).

38. See Monahan & Thukral, *supra* note 24, at 291-92.

39. *Id.* at 292.

40. See Monahan, *supra* note 34 (manuscript at 7-11) (setting out the mechanics of public pension funding); see also *id.* (manuscript at 11-13) (describing “politicians’ inclination to underfund” public pensions).

41. See Monahan & Thukral, *supra* note 24, at 297 (“Congress believed ‘the ability of the governmental entities to fulfill their obligations to employees

dispositive role as far as Congress not trying to assume power over public plans.⁴² Later, numerous bills were introduced to provide for federal regulation of public pension plans, but all were defeated on federalism grounds.⁴³

As far as the structural issues, federal, state, and local workers have much broader access to defined benefit plans than defined contribution pension plans.⁴⁴ This difference in pension plan structure is crucial. In defined benefit (DB) plans, “the burden is placed on the employer to contribute funds to the pension plan on an actuarially-sound basis so that sufficient funds exist to pay the worker when [he or] she retires.”⁴⁵ The employer invests funds on a periodic basis on behalf of its employees so that the individual is entitled at retirement to a guaranteed payment (in a lump sum or annuity form) based on some set payment formula related to years of

through their taxing power’ eliminated much of the need to regulate how pension plans were funded.”) (quoting S. REP. NO. 93-383, at 81 (1973)).

42. See O’Reilly, *supra* note 34 (manuscript at 16) (“This sort of [federal] oversight has been consistently and vigorously opposed by state and local officials on the grounds that it ‘run[s] counter to a fundamental principle of American federalism, namely, that the states ought to be free to formulate their own employee compensation policies without being restrained by federal government regulations or mandates.”) (quoting Abraham D. Beame, *Preface* to ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS, A-71, STATE AND LOCAL PENSION SYSTEMS: FEDERAL REGULATORY ISSUES (1980), *available at* <http://babel.hathitrust.org/cgi/pt?id=mdp.39015081358460;view=1up;seq=1>).

43. *Id.* (“[N]one of the bills proposed in the wake of ERISA, whether styled as PERISA [Public Employee Retirement Income Security Act of 1982] or the Public Employees Pension Plan Reporting and Accountability Act of 1984 (PEPPRA), was enacted.” (citing CONG. RESEARCH SERV., 101-P, PUBLIC PENSION PLANS: THE ISSUES RAISED OVER CONTROL OF PLAN ASSETS (1990), *available at* <http://babel.hathitrust.org/cgi/pt?id=pst.000016128316;view=1up;seq=1>) (paraphrased material)).

44. Whereas 87% of state government workers and 83% of local workers had access to participate in defined benefit pension plans, only 43% of state workers and 24% of local workers had access to defined contribution plans. See U.S. Bureau of Labor Statistics, *State and Local Government Employee Benefits, March 2010*, ECON. DAILY (Mar. 9, 2011), *available at* http://www.bls.gov/opub/ted/2011/ted_20110309.htm. Common examples of defined contribution plans in the public sector include § 403(b) plans (for educational and other non-profit organizations) and § 457 plans (for state and local government employees). See MEDILL, *supra* note 37, at 104.

45. See Paul M. Secunda, *The Forgotten Employee Benefit Crisis: Multiemployer Benefit Plans on the Brink*, 21 CORNELL J.L. & PUB. POL’Y 77, 84 (2011).

service and salary history.⁴⁶ Some of these DB plans are backed by government insurance schemes in case of company insolvency. In the United States, for example, the Pension Benefit Guaranty Corporation (PBGC) undertakes this role by providing government insurance for terminated private-sector DB plans.⁴⁷

On the other hand, defined contribution (DC) plans place all of the respective risk (i.e., risk of longevity, risk of investment return, and risk of inflation) on the employee.⁴⁸ In a typical 401(k), 403(b), or 457 plan,⁴⁹ the employer provides a suitable menu of investment options to the employee and then may or may not match whatever salary contribution the employee makes to their individual pension account.⁵⁰ After that contribution, the employer is completely off the hook; they have no additional pension funding responsibilities.⁵¹ Whether an employee has sufficient funds for retirement under a DC plan depends greatly on the investment return the employee receives on the funds in her individual pension account and whether employees prematurely remove funds from their accounts, many times incurring significant tax penalties, prior to retirement age.⁵²

Consumer-driven retirement investment devices, such as DC plans, have the advantages of portability, permitting employees to have more control over their pensions, and the option to elect a lump sum distribution, as opposed to an annuity.⁵³ The disadvantage of placing the onus of retirement security on employees, however, is

46. JEFFREY M. HIRSCH, PAUL M. SECUNDA & RICHARD A. BALES, *UNDERSTANDING EMPLOYMENT LAW* 198-99 (2d ed. 2013).

47. The PBGC is established under Title IV of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. §§ 1301-1311 (2012); see Mark Daniels, *Pensions in Peril: Single Employer Pension Plan Terminations in the Context of Corporate Bankruptcies*, 9 HOFSTRA LAB. L.J. 25, 32 (1991) (providing analysis and critique of treatment of pension plan obligations during corporate bankruptcies).

48. See generally Paul M. Secunda, *401K Follies: A Proposal to Reinvigorate the United States Annuity Market*, 30 A.B.A. SECTION OF TAXATION NEWSQUARTERLY 13, 13-14 (Fall 2010).

49. See HIRSCH, SECUNDA & BALES, *supra* note 46, at 199-200 (explaining different forms of defined contribution plans).

50. See *id.*

51. See Payne & Pincus, *supra* note 37, at 13 (“Underfunding is never an issue with 401(k) plans because the retiree receives only what has been contributed and any investment returns. The risk is squarely on the worker if his or her investment choices do not perform up to expectations.”).

52. HIRSCH, SECUNDA & BALES, *supra* note 46, at 199.

53. Secunda, *supra* note 48, at 14. *But see generally* Steven L. Willborn, *The Problem with Pension Portability*, 77 NEB. L. REV. 344 (1998) (discussing potential costs that could be distributed among employees and workers with added pension portability).

that they may be financially illiterate, apathetic, or just not have the money to put away in retirement given other life exigencies like first homes, student loans, and unpredictable medical expenses.⁵⁴ Additionally, DC plans are not backed by government insurance schemes, like under the PBGC.⁵⁵ Although some movement exists in the public sector towards adopting DC plans,⁵⁶ for now the DC plan dilemma primarily afflicts the private-sector pension world.

Public pension plans, whether for federal, state, or local employees, also look significantly different in design and operation from private-sector pension plans under ERISA. For instance, with regard to state and local pension plans, little federal oversight exists, and much discretion is left to individual state and local jurisdictions.⁵⁷ Important differences also exist in the budgeting

54. See Secunda, *supra* note 48, at 13 (“[N]o guarantee exists that a participant will receive any specified amount of benefit at retirement and many baby boomers are waking up to this strange new world of being in charge of their future retirement.”). 401(k) fees are also a serious concern for participants, and one recent, prominent study has illustrated how the fees in numerous 401(k) plans are so high that they negate the tax advantages of having such a retirement plan in the first place. See generally Ian Ayres & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and “Dominated Funds” in 401(k) Plans*, 124 YALE L.J. (forthcoming 2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2399531.

55. See HIRSCH, SECUNDA & BALES, *supra* note 46, at 199.

56. See Bradford, *supra* note 10 (newly hired workers in Baltimore can choose to contribute 5% of their salary either to a hybrid DB plan or to a DC plan); see also PAULA SANFORD & JOSHUA M. FRANZEL, *THE EVOLVING ROLE OF DEFINED CONTRIBUTION PLANS IN THE PUBLIC SECTOR* 6 (2012), available at <http://www.slge.org/wp-content/uploads/2012/10/The-Evolving-Role-of-Defined-Contribution-Plans.pdf> (“Many public officials are concerned with the long-term costs of their current defined benefit programs and will continue to redesign these plans and consider alternative retirement arrangements. However, most of the changes implemented to date, including switching to hybrid and core defined contribution plans, usually affect new employees.”). Still other states, like Kentucky, have adopted cash balance plans for their state retirement plans, which are a type of DB plan that seeks to make funding costs more predictable going forward. See PEW CHARITABLE TRUSTS, *PUBLIC PENSION CASH BALANCE PLANS: A PRIMER* 3-5 (2014), available at http://www.pewstates.org/uploadedFiles/PCS_Assets/2014/Cash-Balance-Brief_v7.pdf.

57. For instance, many states do not require their public-sector plans to pre-fund at any given level, like ERISA does. This state of affairs has led many state and local pension plans to be significantly underfunded. See Payne & Pincus, *supra* note 37, at 13. Of course, pension plans for federal employees are regulated by the federal government, but interestingly not to the same extent as DB private-sector plans under ERISA when it comes to funding. See discussion *infra* Section II.A.

process and the applicable accounting standards.⁵⁸ Design issues for public pension vary because the focus is on public-sector-specific issues such as: (1) the need to make up for the lack of Social Security participation and coverage for some public employees;⁵⁹ (2) the issue of whether there should be tax deductible employee contributions;⁶⁰ and (3) the need to address earlier mandatory retirement ages for police and firefighters.⁶¹ Finally, public plans require a higher degree of public transparency because of the governmental decision making involved.⁶²

Differences in structure, design, and operation between American public- and private-sector pension plans mean that unique issues must be considered in the public context that either do not apply in the private sector or apply less often.⁶³ Additionally, because the government is acting in an employment capacity when it deals with public pensions, every time that the state employer seeks to modify or amend the pension structure for employee pensions, a host

58. See Mendales, *supra* note 24, at 505-08; see also Bradford, *supra* note 1 (“One new wrinkle in 2014 that could dampen recent improvements is Governmental Accounting Standards Board rules that will, for the first time, add another number to the political equation: net pension liability. . . . Adding a system’s total unfunded liability, instead of just the current amount due, to its financial reports will make an underfunded plan look worse, and even a relatively well-funded one look less so.”).

59. See CTR. FOR STATE & LOCAL GOV’T EXCELLENCE, STATE AND LOCAL PENSIONS: AN OVERVIEW OF FUNDING ISSUES AND CHALLENGES 5 (2011), available at <https://transformgov.org/Documents/Document/Document/302480> (“All private sector employees participate in Social Security, while 30 percent of state and local employees do not.”); see also U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-08-248T, SOCIAL SECURITY: ISSUES REGARDING THE COVERAGE OF PUBLIC EMPLOYEES 3 (2007), available at <http://www.gao.gov/new.items/d08248t.pdf> (statement of Barbara D. Bovbjerg, Director of Education, Workforce, and Income Security) (observing that about one out of every four employees covered by public pension plans receive no benefits under the Social Security system because their employers have opted out of it).

60. See PUB. PLANS PRACTICES TASK FORCE OF THE AM. ACAD. OF ACTUARIES, RISK MANAGEMENT AND PUBLIC PLAN RETIREMENT SYSTEMS 3 (2010), available at http://actuary.org/pdf/pension/PPPTF_Final_Report_c.pdf.

61. *Id.*

62. See *id.*

63. See Mendales, *supra* note 24, at 508 (“Many of the key issues that need to be addressed, including adequate public funding, protecting state credit, and states’ ability to offer attractive benefit packages to their employees, differ from those addressed by ERISA, which is designed primarily to protect individual beneficiaries of privately sponsored benefit plans.”).

of constitutional concerns must be considered.⁶⁴ Indeed, although many see ERISA as providing more stringent regulation of private-sector pensions than state public pension laws do with regard to public plans, it is actually easier to amend private plans than public plans. This is because although ERISA “protects accrued benefits . . . it allows employers to change the terms going forward. In contrast, most states have legal provisions that constrain sponsors’ ability to make changes to *future* benefits for current workers.”⁶⁵

For instance, under both a federal and state constitutional contract clause claim,⁶⁶ plaintiff employees or retirees may obtain injunctive relief to enjoin the contemplated pension reform, with regard to cuts on both already-earned pension benefits and future rates of benefit accrual.⁶⁷ Moreover, for a number of states that see pension rights as property rights, the Due Process and Takings Clauses of the Fifth and Fourteenth Amendments of the federal Constitution may also provide some protection for interference with public pension rights, though that protection may be minimal.⁶⁸

64. These constitutional considerations are absent when private employers seek to amend, modify, or terminate their pension benefits because there is a lack of state action. See George Rutherglen, *State Action, Private Action, and the Thirteenth Amendment*, 94 VA. L. REV. 1367, 1370 (2008) (“All the . . . provisions of the Constitution regulate the structure and function of government, and if they confer individual rights, they protect only against ‘state action,’ in the broad sense of action by the federal government as well as by the states.”).

65. Munnell, Aubry & Cafarelli, *supra* note 4, at 1; see also Amy B. Monahan, *Statutes as Contracts? The “California Rule” and Its Impact on Public Pension Reform*, 97 IOWA L. REV. 1029, 1032 (2012) (“The practical result of this rule is that pension benefits for current employees cannot be detrimentally changed, even if the changes are purely prospective. Thus, the only readily available option for changing employee pension benefits in these states is to limit such changes to new hires.”).

66. U.S. CONST. art. I, § 10, cl. 1. State constitutional impairment of contract provisions are identical to the federal one and are subject to the same legal analysis. See Monahan, *supra* note 65, at 1040.

67. See Monahan, *supra* note 65, at 1032.

68. U.S. CONST. amends. V, XIV; see Prof’l Firefighters Ass’n of Omaha, *Local 385 v. City of Omaha*, No. 8:10-CV-19, 2010 WL 2426446, at *1, *5 (D. Neb. June 10, 2010) (finding that cutting pension benefits can constitute an abridgement of a property right). Although a number of states have found that pensions constitute a property right, such characterizations do not necessarily provide much protection for pension participants. See Amy B. Monahan, *Public Pension Plan Reform: The Legal Framework*, 5 EDUC. FIN. & POL’Y 617, 637 (2010) (“Construing a participant’s right to pension benefits as a property right potentially provides too little protection for participants in public pension plans.”); T. Leigh Anenson, Alex Slabaugh & Karen Eilers Lahey, *Reforming Public Pensions*, 33 YALE L. & POL’Y REV. (forthcoming 2014) (manuscript at 19) (“[W]hile legislatures

Additionally, under state constitutional home rule amendments, state government may be limited in dictating how local government officials operate their local pension plans.⁶⁹ Finally, at least at the local level, bankruptcy proceedings may also come into play if a municipality is permitted to seek protection from its creditors under the Bankruptcy Code.⁷⁰

In all, a whole different litany of considerations apply when considering public pension-reform options, as well as litigation theories that might be successful in counteracting pension-reform proposals. The next three Parts, discussing federal, state, and local pension design and litigation in more detail, show just exactly how different and varied public pension litigation can look from one level of American government to the next. Such findings also suggest that any solution to this haphazard public pension world must begin with steps to harmonize the discordant aspects of these systems so greater predictability, consistency, and uniformity can be fostered going forward.

II. THE FEDERAL PENSION SYSTEM IN THE UNITED STATES AND THE CURRENT ABSENCE OF LITIGATION

Civilian federal employees take part in a complex retirement system that features two distinct DB plans, one DC plan, and Social Security benefits.⁷¹ In light of significant funding issues, Congress has recently enacted new legislation that has dramatically increased the level of contributions that some federal employees are required to make to the pension trust fund.⁷²

in property states [including Connecticut and Maine] do not have an unfettered power of revocation, employees not yet retired or eligible for retirement are protected against purely arbitrary revisions.”); *see also infra* Section III.C (discussing the failure of the due process argument in Wisconsin public pension litigation).

69. *See infra* Section III.A.

70. *See infra* Part IV.

71. *See* KATELIN P. ISAACS, CONG. RESEARCH SERV., 98-810, FEDERAL EMPLOYEES’ RETIREMENT SYSTEM: BENEFITS AND FINANCING 1-2 (2014).

72. *See* Alan Fram, *Congress Targets Fed Workers’ Pensions for Savings*, ASSOCIATED PRESS (Dec. 16, 2013, 1:08 PM), <http://bigstory.ap.org/article/federal-workers-pensions-targeted-budget-deal>.

A. Federally Sponsored Pension Plans

Federal employees and members of the uniformed services receive pension benefits through either the Civil Service Retirement Service (CSRS), established by the Civil Service Retirement Act of 1920 (CSRA),⁷³ or the Federal Employees' Retirement System Act of 1986 (FERS), a law modeled after ERISA.⁷⁴ Federal employees who were hired after 1984, and employees who voluntarily switched from CSRS, also participate in the FERS.⁷⁵ Employees covered by the FERS also receive Social Security Benefits and have the option to participate in the Thrift Savings Plan (TSP).⁷⁶ The TSP is administered by the Federal Retirement Thrift Investment Board and is a well-run DC plan that "offers its participants the same type of savings and tax benefits that are offered under private-sector 401(k) plans."⁷⁷

Employees who participate in the CSRS plan are generally not entitled to Social Security Benefits, and while these employees may be able to participate in the TSP, they are not eligible to receive a matching contribution from their employing agency.⁷⁸ FERS employees eligible to participate in TSP "can deposit up to a maximum of \$17,500 in 2014" to their accounts with their employing agency matching up to 5% of pay.⁷⁹

73. Civil Service Retirement Act of 1920, Pub. L. No. 66-215, 41 Stat. 614.

74. Federal Employees' Retirement System Act of 1986, Pub. L. No. 99-335, 100 Stat. 514 (codified primarily at 5 U.S.C. § 8351 and §§ 8401-8479).

75. See *Nielsen v. Dep't of the Interior*, 198 F. App'x. 953, 954-55 (Fed. Cir. 2006).

76. ISAACS, *supra* note 71, at 1.

77. See Statement of Greg Long, Executive Director, Federal Retirement Thrift Investment Board, before Advisory Council on Employee Welfare and Pension Benefit Plans, Employee Benefits Security Administration (Aug. 21, 2014), available at <http://www.dol.gov/ebsa/pdf/AClong082114.pdf> ("Individual accounts are maintained for more than 4.6 million Federal and Postal employees, members of the uniformed services, retirees, and spousal beneficiaries. As of May 31, 2014, the TSP held approximately \$412.5 billion in retirement savings."); KATELIN P. ISAACS, CONG. RESEARCH SERV., RL30631, RETIREMENT BENEFITS FOR MEMBERS OF CONGRESS 3, 7 (2014); Hicks, *supra* note 12 ("Financial experts cite the TSP as a model for 401(k) plans because of its simplicity, low fees and diverse investment options, among other benefits.")

78. See Tammy Flanagan, *CSRS vs. FERS*, GOV'T EXECUTIVE (Mar. 31, 2006), <http://www.govexec.com/pay-benefits/retirement-planning/2006/03/csrs-vs-fers/21480/>; see also ISAACS, *supra* note 71, at 1.

79. ISAACS, *supra* note 77, at 3.

B. Changes to Employee Contributions to Federal Pensions

Participants of both CSRS and FERS plans contribute a percentage of their income to the Civil Service Retirement and Disability Fund (CSRDF), the civil service trust fund.⁸⁰ The CSRDF is a communal trust fund from which the defined benefits of both the CSRS and the FERS systems are invested and eventually paid out.⁸¹ In September 2011, CSRDF had an unfunded actuarial liability of \$761.5 billion, of which \$741.4 billion was attributable to CSRS and \$20.1 billion was attributable to FERS.⁸²

In large part, this liability can be attributed to a major flaw in the design of the CSRS. In designing this plan, Congress failed to take into account future employee pay raises and cost-of-living adjustments (COLAs), which then required the federal government to contribute additional funds to cover the shortfall.⁸³ Moreover, while private employers are required to pre-fund their DB plans under ERISA,⁸⁴ the federal government was not required to pre-fund its pension liability.⁸⁵ In light of this significant unfunded liability, Congress acted to increase the funding to the CSRDF.

80. See Ralph Smith, *How Much Do You Know About Funding of the Federal Retirement System?*, FEDSMITH (Nov. 14, 2012), <http://www.fedsmith.com/2012/11/14/how-much-do-you-know-about-funding-of-the-federal-retirement-system>.

81. See *id.*; see also KATELIN P. ISAACS, CONG. RESEARCH SERV., RL30023, FEDERAL EMPLOYEES' RETIREMENT SYSTEM: BUDGET AND TRUST FUND ISSUES I (2014).

82. ISAACS, *supra* note 71, at 13.

83. See Stephen Losey, *Federal Pension Systems' Unfunded Liabilities Skyrocket*, FED. TIMES (Feb. 20, 2013, 8:47 AM), <http://www.federaltimes.com/article/20130220/BENEFITS02/302200001/Federal-pension-systems-8217-unfunded-liabilities-skyrocket> ("Much of the multibillion-dollar deficit in the government's pension fund is left over from a major flaw when Congress designed the generous CSRS pension. All of CSRS's future costs were not covered by the combination of agencies' contributions and employee's contributions, which amount to 14 percent of payroll.")

84. See 29 U.S.C. §§ 1081-1085 (2012) (minimum funding rules).

85. See Dennis Cauchon, *Federal Retirement Plans Almost as Costly as Social Security*, USA TODAY (Sept. 29, 2011, 6:21 PM), <http://usatoday30.usatoday.com/news/washington/story/2011-10-11/federal-retirement-pension-benefits/50592474/1> ("Private employers are legally required to put money into pension funds to match retirement promises. Private pensions have \$2.3 trillion in stocks, bonds, real estate and other assets. State and local governments have \$3 trillion in retirement funds. The federal government has nothing set aside.")

In December 2013, Congress passed the Bipartisan Budget Act of 2013.⁸⁶ This Act increased the required employee contribution for new employees first hired (or rehired with less than five years of service) after December 2013 to 4.4% of pay.⁸⁷ This increase did not affect employees first hired before 2013, who contribute 0.8% of pay to the CSRDF, or employees first hired in 2013, who contribute 3.1% of pay to the CSRDF.⁸⁸ This agreement was viewed as “a partial victory for federal employee unions and Democrat[s]” who had feared that current workers would be faced with increased pension contributions under the new budget deal with Republicans.⁸⁹

More recently, the House, based on Republican support only, passed a non-binding FY2015 budget resolution that would call for even greater increases in employee contributions to federal pensions.⁹⁰ Under this resolution, new federal workers would be placed in a DC plan, and current federal and congressional employees would be required to increase their contributions to the CSRDF.⁹¹ The Senate, however, is not expected to take up this resolution.⁹²

C. Other Recently Proposed Public Pension Reforms

In the 113th Congress (2013–2014), several other pieces of legislation have been introduced that propose significant changes to federal retirement benefits and financing. Two of these bills propose significant reforms to the federal retirement system.

86. Bipartisan Budget Act of 2013, Pub. L. No. 113-67, 127 Stat. 1165.

87. See Lunney, *supra* note 6.

88. See ISAACS, *supra* note 71, at 10; see also Associated Press, *Federal Workers' Pensions Targeted in Budget Deal*, POLITICO (Dec. 16, 2013, 6:20 AM), <http://www.politico.com/story/2013/12/budget-deal-federal-workers-pensions-101186.html>.

89. See Sean Reilly, *Pension Costs for New Feds Would Increase Under Budget Deal*, FED. TIMES (Dec. 10, 2013, 6:00 AM), <http://www.federaltimes.com/article/20131210/CONGRESS/312100011/Pension-costs-new-feds-would-increase-under-budget-deal>.

90. Louis C. LaBrecque, *House OKs Budget Plan that Would Increase Retirement Contributions by Federal Workers*, BLOOMBERG BNA PENSION & BENEFITS DAILY (Apr. 10, 2014), <https://www.bloomberglaw.com/search/results/5816c30ab2535ae40a42f893e40c52e9/document/XD98AFO4000000?search32=DPNLUQBDE1FN0Q31C5PMASPT64>.

91. *Id.*

92. *Id.*

First, the Sequester Replacement and Spending Reduction Act of 2013⁹³ proposes to increase employee contributions to CSRS and FERS over the course of three years for a cumulative increase of 2.3%.⁹⁴ Second, the Public-Private Employee Retirement Parity Act⁹⁵ would end coverage under the FERS for prospective employees and convert these employees to Social Security and TSP benefits.⁹⁶

Third, and finally, the Provide for the Common Defense Act of 2013⁹⁷ proposed significant changes to federal retirement programs, including an increase in employee contributions to the CSRS and FERS by 1.2% over three years and the implementation of a new method of calculating COLAs for beneficiaries of CSRS and FERS.⁹⁸

D. The Lack of Federal Pension Litigation

As of the writing of this Article, there has not been any litigation resulting from any recent federal employee pension reform. This is hardly surprising, given that the only recent changes to the federal pension system have required newly hired employees in 2013 and 2014 to pay additional contributions to CSRDF. These reforms do not impact current employees, and thus, a lack of interference with current pension benefits best explains the lack of litigation.

On the other hand, if Congress enacts any of the proposals discussed above which require current federal employees to contribute more to the federal pension trust, it would be more likely there would be litigation involving constitutional impairment of contract claims, much like the claims discussed in the next Part. But for the time being, all is quiet on the federal employee pension litigation front.

93. S. 18, 113th Cong. (2013).

94. ISAACS, *supra* note 71, at 17.

95. S. 1678, 113th Cong. (2013).

96. See Ian Smith, *Senators Propose to End Defined Benefit Pensions for New Federal Employees*, FEDSMITH (Nov. 13, 2013), <http://www.fedsmith.com/2013/11/13/senators-propose-to-end-pensions-for-new-federal-employees>; see also Stephen Losey, *Obama Budget Proposes Hike in Pension Contributions for Feds*, FED. TIMES (Apr. 10, 2013, 12:44 PM), <http://www.federaltimes.com/article/20130410/BENEFITS02/304100004/Obama-budget-proposes-hike-pension-contributions-feds>.

97. H.R. 3639, 113th Cong. (2013).

98. Eric Katz, *GOP Lawmakers: Cut Fed Benefits, Not Defense Spending*, GOV'T EXECUTIVE (Dec. 3, 2013), <http://www.govexec.com/management/2013/12/gop-lawmakers-cut-fed-benefits-not-defense-spending/74807>; see also ISAACS, *supra* note 71, at 18.

III. STATE AND LOCAL PENSION LITIGATION CASE STUDY: THE BATTLE OVER INCREASING PENSION CONTRIBUTIONS IN WISCONSIN

The value of many public pension funds decreased dramatically during the global recession of 2008.⁹⁹ Although securities have rebounded to a large extent since that time,¹⁰⁰ the losses suffered then are still being felt now. Indeed, many estimates suggest that public pension funds in the United States are still running at a deficit similar to the deficit that existed during the beginning of the global recession over five years ago.¹⁰¹ The problem is no longer the recession, but the fact that politicians continue, maddeningly, to choose not to fund public pensions as they are required to do under state law (even sometimes under state constitutional law).¹⁰²

To put the extent of the public pension underfunding issue in some perspective, consider that private-sector DB pension plans under ERISA are subject to certain minimum funding rules to keep

99. See Stockdale, McIntyre & Sauter, *supra* note 36 (“During a period like the market collapse of 2008, the value of many large pension funds plunged.”).

100. See Bradford, *supra* note 1 (“Wilshire Consulting . . . found the aggregate funding ratio of 134 state defined benefit plans reached 75% in the fiscal year ended June 30, thanks largely to strong global equity markets that saw pension fund assets growing faster than liabilities.”).

101. See Carl A. Hess, Thomas J. Healey & Kevin Nicholson, *Public Pension Reform: Benefit Design as the Key to Sustainability*, PUB. SECTOR INC. (Jan. 7, 2014), <http://www.publicsectorinc.org/2014/01/public-pension-reform-benefit-design-as-the-key-to-sustainability/> (“[E]stimates of the nationwide public pension deficit range from \$730 billion to \$4.4 trillion”); Selway, *supra* note 33 (finding that as of June 2014, “U.S. state and local government pensions have at least \$1.1 trillion less than they need for promised retirement benefits, even after stock-market gains and increased contributions boosted the funds”).

102. See Monahan, *supra* note 34 (manuscript at 4) (“For a politician, it may be unwise to spend scarce budgetary dollars on a pension plan contribution, which will help provide benefits decades in the future, compared to spending those budgetary dollars on something that provides immediate returns to the constituents that the politician relies upon to be reelected.”). For a recent example of this failure to fund current public pension obligations, see Michael Symons, *Gov. Christie Cuts N.J. Pension Payments*, USA TODAY (May 20, 2014, 2:59 PM), <http://www.usatoday.com/story/news/nation/2014/05/20/chris-christie-new-jersey-pension-payments/9333971/> (“Gov. Chris Christie is slashing the contributions scheduled to be made to New Jersey public workers’ pension funds by nearly \$2.5 billion over the next 14 months to deal with a revenue shortfall facing the state budget.”).

them from becoming too underfunded.¹⁰³ ERISA considers private-sector DB plans healthy, or least not “at risk,” if they are at least 80% funded.¹⁰⁴ Under 80% funding, “no benefit increases may be granted, and any lump sum benefits are limited to 50% of the value of a retiring employee’s pension benefit. Under 60% funding, the plan must freeze benefit accruals, and all lump sum payouts are prohibited.”¹⁰⁵ Using these pension funding benchmarks, many state and local pension plans would be considered significantly at-risk based on the extent of their current level of underfunding.¹⁰⁶ This is hardly surprising given how commonplace it has become that states and localities do not contribute to their pension plans as required on a timely basis.¹⁰⁷

The current underfunded status of many state public pension plans has caused the predictable finger-pointing concerning the seemingly generous employee benefits public employees receive (though a number of studies show that public employees do not receive lavish pensions and other employee–retiree benefits as some critics charge).¹⁰⁸ In the meantime, almost all state legislatures have

103. See Charles J. Ford, Mark M. Glickman & Charles A. Jeszeck, *Weaknesses in Defined Benefit Pension Funding Rules: A Look at the Largest Plans, 1995-2002*, 44 BRANDEIS L.J. 351, 356 (2006).

104. See I.R.C. § 436 (2012).

105. See Ilana Boivie, Research Economist, Comm’n Workers of Am., Testimony to the U.S. Department of Labor’s Advisory Council on Employee Welfare and Pension Benefit Plans at the Meeting on Private Sector Pension Derisking and Participant Protections 4 (June 5, 2013), available at <http://www.dol.gov/ebsa/pdf/CWA060513.pdf>.

106. Twenty states have funding levels below 80%. See PEW CTR. ON THE STATES, *supra* note 2, at 4; see also Andrew Bary, *State of the States*, BARRON’S (Aug. 27, 2012), http://online.barrons.com/news/articles/SB50001424053111904881404577603301566976464?mod=BOL_archive_twm_ls#articleTabs_article%3D1 (“[A] study by the Center for Retirement Research of Boston College found that 126 state and local plans were only 75% funded as of June 2011.”).

107. Andrew Bary, *Munis on the Mend*, BARRON’S (Oct. 14, 2013), http://online.barrons.com/article/SB50001424053111903891504579121802222118332.html#articleTabs_article%3D1 (“What separates most states with strong pension funding from those with deep deficits is a willingness to fund their plans consistently at the actuarially required contribution level.”).

108. Compare Jeffrey H. Keefe, *Are Wisconsin Public Employees Over-Compensated?*, ECON. POL’Y INST. BRIEFING PAPER #290 (Feb. 10, 2011), available at http://epi.3cdn.net/9e237c56096a8e4904_rkm6b9hn1.pdf (finding public sector workers in Wisconsin are not overpaid), and ALICIA H. MUNNELL, STATE AND LOCAL PENSIONS: WHAT NOW? 140 (2012) (“[P]ension and retiree health benefits for state and local workers roughly offset the wage penalty, so that, taken as a whole, compensation in the two sectors is roughly comparable.”), with John O. McGinnis &

implemented different pension-reform options to counteract pension underfunding.¹⁰⁹ For instance, no fewer than seventeen states have passed legislation that has either reduced or eliminated the COLA for retirees currently receiving public pensions.¹¹⁰ Because such legislation significantly diminishes the amount of retirement benefits these individuals will receive, much COLA litigation has ensued, with the retirees largely being unsuccessful in invalidating these reforms.¹¹¹

On the other hand, municipal employees had at least initial success in pushing back against non-COLA pension reforms instituted in Wisconsin in 2011.¹¹² Although Wisconsin maintains one of the healthiest state pension plans in the country, the 2011 pension reforms required most public employees to contribute to their pensions for the first time.¹¹³ The effect of this provision on the

Max Schanzenbach, *The Case Against Public Sector Unions*, POL'Y REV., Aug. 1, 2010, at 1, available at <http://www.hoover.org/publications/policy-review/article/43266> (arguing that public-sector employees, especially union-represented public-sector employees, are paid higher wages than their private-sector counterparts).

109. See Miller, *supra* note 1 (“Since the financial crash of 2008-2009, 45 states have changed their pension plans, a new study by the National Association of State Retirement Administrators (NASRA) and the Center for State & Local Government Excellence (SLGE) reports.”).

110. See Munnell, Aubry & Cafarelli, *supra* note 4, at 2.

111. See *id.* at 4 (“Of the 17 states that changed their COLA, 12 have been challenged in court.”). Of those twelve challenges, courts have ruled in favor of the government in eight states, and only one group of plaintiffs (Washington) has been successful. *Id.* at 4-5.

112. See *Madison Teachers, Inc. v. Walker*, No. 2012-AP-2067, 2013 WL 1760805, at *1, *3 (Wis. Ct. App. Apr. 25, 2013) (stating that the trial court upheld Contract clause and Home Rule clause challenges to Wisconsin pension contribution changes).

113. For instance, a recent report on the financial health of the Wisconsin Retirement System concluded that “Wisconsin’s pension system is on excellent financial footing and among the healthiest in the nation, according to multiple independent reports and an analysis by COWS [Center on Wisconsin Strategy] and CEPR [Center for Economic and Policy Research].” See CTR. ON WIS. STRATEGY, *THE WISCONSIN RETIREMENT SYSTEM IS ONE OF THE HEALTHIEST IN THE COUNTRY* (2011), available at <http://www.cows.org/the-wisconsin-retirement-system-is-one-of-the-healthiest-in-the-country>. It appears that requiring pension contributions was part of a larger political battle over the future of public-sector collective bargaining rights and reducing the size of the budget deficit. See *Secunda*, *supra* note 16, at 296-97. The pension contribution increase measure can be viewed at the very least as an easy way for the then-new Republican Governor Scott Walker to cut government operating expenses through a government-wide, disguised pay cut. See CTR. ON WIS. STRATEGY, *supra*.

pension rights of Milwaukee city employees was dramatic. For instance, “[a] contribution [requirement] of 5.5 percent of an employee’s pay would be equivalent to 114.4 hours of pay . . . [or] equivalent to loss of 14.3 days of pay, assuming an eight-hour day.”¹¹⁴

Public laborers in the City of Milwaukee responded to these reforms in *Madison Teachers, Inc. v. Walker*¹¹⁵ by seeking to invalidate the pension-reform measure under § 62.623¹¹⁶ on three grounds: (1) the City of Milwaukee’s home rule authority;¹¹⁷ (2) the contract clause of the Wisconsin Constitution;¹¹⁸ and (3) the due process clause of the Wisconsin Constitution.¹¹⁹ The treatment of these legal claims by the Wisconsin trial court will be analyzed to understand the nature of these claims and their viability outside of Wisconsin (though these claims ended up failing in Wisconsin itself).

A. Home Rule Amendment

The plaintiffs argued that the violation of the Wisconsin Constitution’s Home Rule Amendment stems from the fact that the pension-reform provision (§ 62.623) requires a 5.5% salary contribution from Milwaukee employees¹²⁰ to the Milwaukee

114. See, e.g., Letter from Grant F. Langley, City of Milwaukee Attorney, to Alderman Joseph A. Dudzik 11 (Feb. 28, 2011), available at <http://lawprofessors.typepad.com/files/langleyletter.pdf>.

115. 2014 WI 99, 851 N.W.2d 337.

116. WIS. STAT. § 62.623 (2014) (enacted under 2011 Wisconsin Acts 10 and 32).

117. WIS. CONST. art. XI, § 3(1).

118. *Id.* art. I, § 12.

119. *Id.* art. I, § 1.

120. That section states in pertinent part:

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

A.B. 11, 2011 Leg., Spec. Sess. § 167.62.623 (Wis. 2011). Section 62.623 only applies to Wisconsin municipal employees in cities of the first class, which only includes Milwaukee. See *Madison Teachers, Inc. v. Walker*, No. 2012-AP-2067, 2013 WL 1760805, at *8 (Wis. Ct. App. Apr. 25, 2013). However, similar provisions exist for other cities and villages in Wisconsin, as well as for state employees. See *id.* at *1 (“This appeal involves municipal employees, but the statutory provisions at issue here have direct counterparts in a separate statutory

Employee Retirement System (Milwaukee ERS) and forbids the city from agreeing to make that pension contribution on the employee's behalf.¹²¹ This provision was thought to directly conflict with § 36-08-07-a-1 of the City of Milwaukee's Charter Ordinances.¹²² That Charter Ordinance provision requires the city to make the employee's share of pension contributions for those employees hired before January 1, 2010.¹²³ The legal question thus came down to whether the state pension-reform provision could supplant Milwaukee's Charter Ordinance.¹²⁴

Although it might seem obvious that a state legislative enactment should supersede a contrary local ordinance, such conflicts are analyzed under the Home Rule Amendment. That amendment gives municipalities the right to "determine their local affairs and government, subject only to this constitution and to such enactments of the legislature of statewide concern as with uniformity shall affect every city or . . . village."¹²⁵ Courts have interpreted this language to mean that state legislation concerning local affairs is only permitted as long as the legislation affects every city and village in Wisconsin uniformly.¹²⁶ The issue is whether the legislation is about local affairs or state-wide concerns. If the former, the state cannot legislate in that area; if the latter, the legislation is valid.¹²⁷ In making this distinction, the term "local affairs" is subject to liberal interpretation, but the legislature's determination that a matter is of "state-wide concern" is afforded great weight.¹²⁸

The plaintiffs argued that the Charter ordinance concerning pension contributions was a matter of local concern.¹²⁹ In support of

subchapter that applies to state employees. Thus, a decision on the provisions affecting municipal employees would appear to be dispositive with respect to state employees.").

121. *Madison Teachers, Inc. v. Walker*, No. 11-CV-3774, 2012 WL 4041495, at *9 (Wis. Cir. Ct. Sept. 14, 2012), *rev'd*, 2014 WI 99, 851 N.W.2d 337.

122. *Id.*

123. *Id.*

124. *See id.* at *11.

125. WIS CONST. art. XI, § 3(1). "The Home Rule Amendment is a constitutional limitation on the power of the Legislature. It both directly grants legislative power to municipalities and limits the legislature's exercise of its legislative power." *Madison Teachers, Inc.*, 2012 WL 4041495, at *9 (citing *State ex rel. Michalek v. LeGrand*, 253 N.W.2d 505, 506-07 (Wis. 1977)).

126. *See Van Gilder v. City of Madison*, 267 N.W. 25, 34 (Wis. 1936).

127. *Madison Teachers, Inc.*, 2012 WL 4041495, at *9.

128. *Id.* (citing *Van Gilder*, 267 N.W. at 30-31).

129. *Id.*

this argument, they cited to a 1947 provision in the Milwaukee ERS, which states:

“For the purpose of giving to cities of the first class the largest measure of self-government with respect to pension annuity and retirement systems compatible with the constitution and general law, it is hereby declared to be the legislative policy that all future amendments and alterations to this act are matters of local affair and government and shall not be construed as an enactment of statewide concern.”¹³⁰

Because the state pension reform initiated in § 62.623 did not contain the legislature’s express intent that the legislation was a matter of state-wide concern and based on the express intent of the Charter Ordinance that pension provision should be considered a matter of local concern, the trial court concluded that § 62.623 violated the Home Rule Amendment by interfering with Milwaukee “local affairs” and, thus, was declared null and void.¹³¹

The Wisconsin Supreme Court recently overturned the trial court’s holdings concerning the Home Rule Amendment, and found that the pension contributions changes were a matter of state-wide concern and, therefore, did not violate the Amendment.¹³² However, the use of the Home Rule Amendment illustrates how state constitutional provisions, not duplicated in the federal constitution, can play a pivotal role in deciding the fate of pension-reform legislation.¹³³ That being said, the use of this device to find pension-reform legislation invalid in the future appears to be somewhat limited, especially based on the Wisconsin Supreme Court’s recent interpretation of pension-reform legislation. In fact, unlike Milwaukee, not every municipality is likely to have a charter ordinance that seeks to unsuccessfully establish the pension system

130. *Id.* (quoting Act of July 23, 1947, ch. 441, § 31, 1947 Wis. Sess. Law 772, 789-90).

131. *See id.* at *10-11 (“[T]he court finds that the allocation of responsibility for contributions to the Milwaukee ERS between the City and its employees is a ‘local affair’ for purposes of the Home Rule Amendment under *Michalek*. A statute that alters it is an unconstitutional intrusion into a matter reserved to the City of Milwaukee.”).

132. *See* *Madison Teachers, Inc. v. Walker*, 2014 WI 99, ¶ 123, 851 N.W.2d 337 (“We find that, given the facts presented in this case, the conflicting state and local regulations are of more paramount concern within the state as a whole than in the City of Milwaukee. Accordingly, we conclude that Wis. Stat. § 62.623 and related statutes are primarily a matter of statewide concern.”).

133. And most states have home rule constitutional provisions. *See* Kenneth E. Vanlandingham, *Municipal Home Rule in the United States*, 10 WM. & MARY L. REV. 269, 277-78 (1968) (finding thirty-three states have constitutional home rule amendments).

as a matter of local control (although larger cities may be more sophisticated in this regard). In any event, one suspects that future pension-reform efforts in Wisconsin will have express language stating that the legislation is of state-wide concern, and such statements will be given great weight under current legal precedent in Wisconsin. Finally, Home Rule Amendment provisions only apply to local pension plans, not to state pension plans, for the straightforward reason that state plans do not involve the exercise of control over “local affairs.”¹³⁴

B. Contract Clause Analysis

The Milwaukee public employee laborers were initially successful at the trial court level in challenging the increased pension contribution under the Wisconsin Constitution’s contract clause, though that determination was also overturned by the Wisconsin Supreme Court.¹³⁵ Because of the complexity of contract clause analysis, this Section is divided into a general overview of contract clause analysis and then a discussion of the trial court’s and Wisconsin Supreme Court’s finding in the *Madison Teachers* case.

1. General Overview of Contract Clause Legal Analysis

The federal version of the Contract Clause, in pertinent part, provides that “[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts.”¹³⁶ Similarly, the Wisconsin state constitution states, “No . . . law impairing the obligation of contracts, shall ever be passed.”¹³⁷ Even though the respective legislatures wrote these provisions in unambiguous language, they have been interpreted to mean that they do not “make unlawful every state law that conflicts with any contract.”¹³⁸ Instead, a court is tasked with

134. See *Madison Teachers*, 2014 WI 99, ¶ 121 (noting that Act 10, without legal challenges “addresses a broad range of subjects, including . . . retirement contributions for public employees statewide”).

135. See *id.* ¶ 150 (“[W]e find nothing to suggest that the City of Milwaukee intended to classify contribution rates as a contractually protected ‘benefit.’ Consequently, there is no indication the Common Council, and by extension the State, bound itself to never modifying the contribution rates that fund the Milwaukee ERS.”).

136. U.S. CONST. art. I, § 10, cl. 1.

137. WIS. CONST. art. I, § 12.

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

“reconcil[ing] the strictures of the Contract Clause with the ‘essential attributes of sovereign power’ necessarily reserved by the States to safeguard the welfare of their citizens.”¹³⁹

Based on this guidance, Contract Clause claims are analyzed either under a two- or three-pronged test.¹⁴⁰ The first question is “whether the state law has . . . operated as a substantial impairment of a contractual relationship.”¹⁴¹ This first question is sometimes divided into two questions (including in Wisconsin): (1) has the contract been impaired and (2) if so, is the impairment substantial?¹⁴² In any event, if the court concludes that contract was substantially impaired, the court next considers whether the impairment was “reasonable and necessary to serve an important [government] purpose.”¹⁴³ Where the State is alleged to have impaired a public contract to which it is a party, “less deference to a legislative determination of reasonableness and necessity is required, because ‘the State’s self-interest is at stake.’”¹⁴⁴

Wisconsin courts interpret the contract clause in the Wisconsin Constitution in the same manner as its counterpart in the federal Constitution.¹⁴⁵ As in all constitutional challenges, when a law is challenged under the contract clause, there is a strong presumption that the law is constitutional.¹⁴⁶ As far as the burden of proof, Wisconsin courts hold that the challenging party has the burden to prove beyond a reasonable doubt that the law is unconstitutional.¹⁴⁷

Although the language of the Wisconsin contract clause appears mandatory, it is not absolute¹⁴⁸ and must sometimes yield to

139. *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 21 (1977) (citation omitted) (quoting *Home Bldg. & Loan Ass’n v. Blaisdell*, 290 U.S. 398, 435 (1934)); *see also* *Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 410 (1983).

140. *See Parella v. Ret. Bd. of R.I. Emps.’ Ret. Sys.*, 173 F.3d 46, 59 (1st Cir. 1999).

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

142. *See Reserve Life Ins. Co. v. La Follette*, 323 N.W.2d 173, 176 (Wis. Ct. App. 1982) (adopting a three-part inquiry to determine whether a state law was unconstitutional under the contract clause).

143. *See* *U.S. Trust*, 431 U.S. at 25.

144. *Parella*, 173 F.3d at 59 (quoting *U.S. Trust*, 431 U.S. at 26; *Parker v. Wakelin*, 123 F.3d 1, 5 (1st Cir. 1997)) (internal quotation marks omitted).

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

146. *Id.* at 573.

147. *Id.* at 573-74.

148. *Id.* at 571, 574.

the state's police power.¹⁴⁹ Nevertheless, the contract clause still imposes some limits on the ability of a state to interfere with existing contractual relationships despite its police power.¹⁵⁰

First, under this three-part contract clause test, Wisconsin courts have long held that contractual rights conferred pursuant to a municipal pension system are subject to the Wisconsin constitution's contract clause and that a state law that alters the contract is impairing an existing contractual relationship.¹⁵¹ Second, courts consider whether the impairment is substantial.¹⁵² A party must show that the law interferes with the parties' "expectations" to prove a substantial impairment.¹⁵³ In this regard, a court should consider whether the law was foreseeable or even plausible at the time the contract was made.¹⁵⁴ There is therefore a factual element to determining whether impairment is substantial.¹⁵⁵ Arguing that the new statutory obligation itself is a substantial impairment is not sufficient; rather, the party must provide evidence showing the effect of the impairment.¹⁵⁶

Courts outside of Wisconsin have found that a law substantially impairs a contractual obligation when it unilaterally reduces "contractually established, future state employee salary obligations."¹⁵⁷ In this vein, courts have noted that interfering with employee pay creates a "financial hardship" and "is not an insubstantial impairment to one confronted with monthly debt payments and daily expenses for food and the other necessities of life."¹⁵⁸ Furthermore, when the state is faced with a budgetary

149. See *State ex rel. Bldg. Owners & Managers Ass'n of Milwaukee, Inc. v. Adamany*, 219 N.W.2d 274, 280 (Wis. 1974).

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

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

152. See *Reserve Life Ins. Co. v. La Follette*, 323 N.W.2d 173, 176 (Wis. Ct. App. 1982).

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

154. See *id.*

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

156. See *id.*

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

158. See *id.* at 1105 (quoting *Malahoff v. Saito*, 140 P.3d 401, 407, 428 (Haw. 2006); *Ass'n of Surrogates & Supreme Court Reporters v. State*, 588 N.E.2d 51, 54 (N.Y. 1992)) (internal quotation marks omitted).

deficit, the legislature has many alternatives available to it, such as reducing state services not governed by contract and raising taxes.¹⁵⁹

If the court determines that a contractual impairment is substantial, the third and final step is to examine the purpose of the state legislation to determine whether the impairment is justified¹⁶⁰ and serves a significant and legitimate public interest.¹⁶¹ To determine whether a law is justified, the court balances the extent of impairment against the public purpose the law purportedly serves.¹⁶² In turn, the severity of impairment impacts the level of the court's scrutiny.¹⁶³ Under this sliding scale approach, the court applies a low level of scrutiny when the impairment is insubstantial and stricter scrutiny when the impairment is more severe.¹⁶⁴

2. Contract Clause Analysis in *Madison Teachers*

In *Madison Teachers*, the plaintiff city laborers claimed that the required pension contribution under § 62.623 substantially impaired, without justification, a contractual right they had under the Milwaukee ERS.¹⁶⁵ More specifically, they pointed to Milwaukee Charter Ordinance § 36-13-3-g, which provides that all pension plan participants have a “vested and contractual right to the benefits in the amount and on the terms and conditions as provided in law on the date the combined fund is created.”¹⁶⁶

Such benefits, terms, and conditions under the Charter Ordinance, plaintiffs argued, included the city's obligation to pay the employee's share of retirement contributions.¹⁶⁷ Accordingly, “§ 63.623 alters that contractual right by prohibiting the City of Milwaukee from making those contributions.”¹⁶⁸

159. See *id.* at 1106 (citing Opinion of the Justices (Furlough), 609 A.2d 1204, 1211 (N.H. 1992)).

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

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

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

163. See *Chappy*, 401 N.W.2d at 575.

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

165. *Madison Teachers, Inc. v. Walker*, No. 11-CV-3774, 2012 WL 4041495, at *1 (Wis. Cir. Ct. Sept. 14, 2012), *rev'd*, 2014 WI 99, 851 N.W.2d 337.

166. *Id.* at *11 (internal quotation marks omitted) (quoting Milwaukee, Wis., Employees' Retirement System Ordinance 36-13-2(g) (Jan. 19, 2001)).

167. *Id.*

168. *Id.*

Applying the three-part contract clause analysis to the *Madison Teachers* case, the trial court first asked if the pension-reform law impaired a contract.¹⁶⁹ Although the state maintained that “the relevant section of the charter ordinance does not create a contractual right to employer ‘contributions,’” the court agreed with the plaintiffs that the pension-reform measure impaired the city employees’ contractual rights under the Milwaukee ERS to have the city pay their pension contributions because “increasing the amount the employee is required to contribute diminishes the value of the benefit for which the employee has contracted.”¹⁷⁰

Having found a contractual impairment, the court next considered whether the impairment was substantial.¹⁷¹ The State argued that it was not a substantial impairment both because municipal employee pension plans have been heavily regulated and because the impairment served a legitimate public purpose.¹⁷² The court disagreed and based its finding of substantiality on the unforeseeability of the state’s action.¹⁷³ According to the court, the impairment was not foreseeable, and therefore substantial for three reasons:

First, because of the express language against retroactive impairment found in the ordinance. Second, because the state had not been involved regulating the Milwaukee ERS in the 64 years between Ch. 441 and Act 10. Third, because the Home Rule Amendment and Ch. 441 barred the state from altering the Milwaukee ERS.¹⁷⁴

The third and final step of the contract clause analysis required the court to examine whether the substantial impairment was justified.¹⁷⁵ This part of the test amounts to balancing the

169. *Id.*

170. *Id.*

171. *Id.* at *12.

172. *Id.*

173. *Id.*

174. *Id.* Indeed, other cases from other courts stand for the proposition that state legislation that has the effect of reducing the pension rights of public employees to this magnitude would satisfy the requirement that the contractual impairment in question is substantial. *See, e.g., Univ. of Haw. Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1099, 1108 (9th Cir. 1999) (finding that statute delaying payment of wages for a six day period constituted a substantial impairment); *Ass'n. of Surrogates & Supreme Court Reporters v. New York*, 940 F.2d 766, 772 (2d Cir. 1991) (holding that statute that provided for withholding of ten days’ pay prior to retirement constituted substantial impairment); *Mass. Cmty. Coll. Council v. Commonwealth*, 649 N.E.2d 708, 710-11 (Mass. 1995) (finding that between two and fifteen day furloughs of public employees constituted a substantial impairment).

175. *Madison Teachers, Inc.*, 2012 WL 4041495, at *11.

substantiality of the contract impairment against the interest that the state is seeking to serve by passing the legislation.¹⁷⁶

Here, the court found persuasive a California Supreme Court case, *Abbott v. City of Los Angeles*,¹⁷⁷ which held a similar increase in pension contributions to be an unjustified, substantial impairment of employee pension rights.¹⁷⁸ In particular, the *Abbott* court found that neither the rising costs to the city nor speculation about future effects on taxpayers were enough to permit the contractual impairment.¹⁷⁹ The California Supreme Court also found a lack of evidence that the new legislation was necessary for “the preservation or protection of the pension program.”¹⁸⁰

The trial court in *Madison Teachers* came to the same conclusion, finding the substantial impairment of city employee pension rights unjustified based on budget concerns¹⁸¹ or the current health of the Milwaukee ERS.¹⁸² As already discussed, the Wisconsin Retirement System is one of the healthiest in the country and has not been significantly underfunded in the last twenty-five years.¹⁸³ Moreover, pension plans are not generally funded by general tax revenue, but by compensation commitments to employees in the

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

177. 326 P.2d 484 (Cal. 1958).

178. *Id.* at 494.

179. *Id.* at 493-94.

180. *Id.* at 493.

181. *Madison Teachers, Inc.*, 2012 WL 4041495, at *12. Wisconsin courts have limited the acceptable reasons for substantially impairing a pension contract to those dealing with the financial stability of the plan and do not consider other reasons, such as the need of the state to balance its budget. See *Ass'n of State Prosecutors v. Milwaukee Cnty.*, 544 N.W.2d 888, 893-94 (Wis. 1996) (“[L]egislature[s] should retain a limited power to adjust or amend a retirement plan in certain situations, such as when it is necessary to preserve the actuarial soundness of a plan or to salvage financially troubled funds.”); *Milwaukee Police Ass'n v. City of Milwaukee*, 588 N.W.2d 636, 639 (Wis. Ct. App. 1998) (not permitting the abrogation of vested pension rights for other purposes than those mentioned in *Association of State Prosecutors*: “[A]lthough the state has ‘a limited power to adjust or amend a retirement plan in certain situations,’ and may intervene to ‘preserve the actuarial soundness of a plan or to salvage’ it if it is financially strapped, it may not raid it, even by a little bit.” (quoting *Ass'n of State Prosecutors*, 544 N.W.2d at 893))).

182. *Madison Teachers, Inc.*, 2012 WL 4041495, at *12 (“[T]he defendants do not meet plaintiffs’ *prima facie* case with any evidentiary facts or expressions of legislative intent which would support a finding that the challenged change was necessary for the preservation of the Milwaukee ERS.”).

183. See *supra* note 15 and accompanying text.

form of deferred compensation.¹⁸⁴ Consequently, the court concluded that the plaintiffs had established beyond a reasonable doubt that the pension-reform legislation amounts to a substantial impairment of their contractual rights without justification.¹⁸⁵

The Wisconsin Supreme Court reversed the trial court's contract clause decision.¹⁸⁶ More specifically, the Wisconsin Supreme Court did not even undertake the substantiality or justification aspects of the contract clause test, but agreed with the State that the relevant section of the charter ordinance did not create a contractual right to employer contributions, and thus, there was no contractual impairment.¹⁸⁷ Nevertheless, what can be gleaned from the trial court's analysis is that such findings are highly fact-specific and turn on factors such as charter amendments and even the financial health of the pension system, which might make state action more necessary and justified. In any event, this contract clause analysis provides a useful example for how other contract clause challenges have been mounted, fought, and decided across different state pension systems.

C. Due Process Analysis

The last claim brought by the Milwaukee city employees in the *Madison Teachers* case alleged that the required contribution to the Milwaukee ERS amounted to a deprivation of their property without due process.¹⁸⁸ Such claims require that a property interest be identified,¹⁸⁹ and then only if a property interest is found does the court inquire whether the property interest was taken without due process.¹⁹⁰

184. See Rick Ungar, *The Wisconsin Lie Exposed—Taxpayers Actually Contribute Nothing to Public Employee Pensions*, FORBES (Feb. 25, 2011, 11:56 AM), <http://blogs.forbes.com/rickungar/2011/02/25/the-wisconsin-lie-exposed-taxpayers-actually-contribute-nothing-to-public-employee-pensions> (“The pension plan is the direct result of deferred compensation—money that employees would have been paid as cash salary but choose, instead, to have placed in the state operated pension fund where the money can be professionally invested (at a lower cost of management) for the future.”).

185. *Madison Teachers, Inc.*, 2012 WL 4041495, at *12.

186. *Madison Teachers, Inc. v. Walker*, 2014 WI 99, ¶ 163, 851 N.W.2d 337.

187. See *id.* ¶¶ 149-55.

188. *Madison Teachers, Inc.*, 2012 WL 4041495, at *13.

189. *Id.*

190. *Id.*

As to the first question, the court found the city employees had a property interest in their pension benefits because they had a legitimate claim of entitlement to such benefits.¹⁹¹ More specifically, “[t]he ordinance . . . created an entitlement to a certain benefit of employment with the City of Milwaukee: payment by the city of the employee’s share of contributions to the pension plan.”¹⁹²

The court, however, did not find that this property interest had been deprived without due process of law.¹⁹³ This is because, generally speaking, “legislative determination[s] provide[] all the process that is due.”¹⁹⁴ Although irrational and/or arbitrary legislation may still be found to violate due process, the court found that the plaintiffs had not provided evidence that the pension-reform legislation at issue in the case met that criterion and, therefore, dismissed the due process claim.¹⁹⁵

It might be said with regard to due process claims that although it is relatively straightforward finding a property interest in pension benefits, it is much harder to show the legislature acted irrationally in passing pension-reform legislation, especially when the reasons concern budget deficits, underfunded pensions, or related matters.

On the other hand, it is interesting that the plaintiffs in *Madison Teachers* did not attempt to bring a takings clause claim.¹⁹⁶ The absence of this claim may be based on the belief that takings claims, whether based on federal or state constitutional provisions, largely rise or fall on the same basis as contract clause claims, and so an independent taking claim was not necessary.¹⁹⁷ In any event, such takings claims have had limited success in public pension litigation historically.¹⁹⁸

191. *Id.* (citing *Bd. of Regents v. Roth*, 408 U.S. 564, 577 (1972)).

192. *Id.*

193. *Id.*

194. *Id.* (quoting *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 433 (1982)).

195. *Id.*

196. *See* U.S. CONST. amend. V (“[N]or shall private property be taken for public use, without just compensation.”).

197. *See* Beerman, *supra* note 34, at 63-64 (“With regard to state and local reforms, the Takings Clause is unlikely to add much to claims under the Contract Clause because a participant’s interest in pension promises is unlikely to be property unless it is found to be a contractual promise protected under the Contract Clause or state law pension doctrine.”); Anenson, Slabaugh & Lahey, *supra* note 68 (manuscript at 19) (“These [Takings] challenges are largely, but not entirely, derivative of the Contract Clause jurisprudence.”).

198. *See* Monahan, *supra* note 68, at 637 (“To date such challenges have been uniformly unsuccessful.”). However, “[p]resumably changes to participants

Moreover, this due process claim does not appear to have been appealed to the Wisconsin Supreme Court, and so of the three claims, it is the only one whose determination is final.

IV. A LOCAL PENSION CASE STUDY: THE DETROIT BANKRUPTCY LITIGATION

Not all local public pension issues concern state pension-reform efforts. A number of municipalities have turned to the Bankruptcy Code to help alleviate the massive amounts of money owed to their retirement and other benefit plans.¹⁹⁹ Of course, the most well-known example of this phenomenon involves the City of Detroit.²⁰⁰ When Detroit filed for bankruptcy protection in the summer of 2013, it was the largest municipal bankruptcy filing in American history.²⁰¹

One of the more complicated issues surrounding the Detroit bankruptcy was the degree to which the bankruptcy court could cut back on pension benefits owed to employees and retirees given specific provisions in the Michigan State Constitution providing

already receiving benefits could be successfully challenged under the takings clause.” *Id.* at 637 n.29.

199. That being said, pre-Detroit, only thirteen localities had actually sought bankruptcy protection over the past five years in the United States. See Mike Maciag, *How Rare Are Municipal Bankruptcies?*, GOVERNING (Jan. 24, 2013), <http://www.governing.com/blogs/by-the-numbers/municipal-bankruptcy-rate-and-state-law-limitations.html>.

200. Although Detroit is the most-well known municipal bankruptcy, there have been a number of others, especially in California in the past few years. In the Stockton, California bankruptcy, it is estimated that retirees lost, or will lose, anywhere from 30% to 70% of their pension and medical benefits through the restructuring process (though contributions to the California Public Employees’ Retirement System (CalPERS) have not been cut yet). See Laura Mahoney, *Stockton Poised to Approve Ch. 9 Plan, Ask Bankruptcy Court for Approval*, BLOOMBERG BNA PENSION & BENEFITS DAILY (Oct. 3, 2013), http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=36982339&vname=pbnotallissues&jd=a0e2e0g8b0&split=0. But see Ed Mendel, *Bankruptcy Judge May Rule Pensions Can Be Cut*, CALPENSIONS (July 9, 2014), <http://calpensions.com/2014/07/09/bankruptcy-judge-may-rule-pensions-can-be-cut/> (“A federal judge handling the Stockton bankruptcy may be moving toward a landmark ruling that CalPERS pensions can be cut . . .”).

201. It is estimated that Detroit has 700,000 citizens, and that there are some 23,000 pension recipients and 9,000 current public employees. See Editorial, *For Detroit Retirees, Michigan’s Pension Promise Must Be Kept*, DETROIT FREE PRESS (Aug. 1, 2013, 12:50 PM), <http://www.freep.com/article/20130801/OPINION/01/308010019>.

protections against diminishment of pension rights.²⁰² Going in to the Detroit bankruptcy litigation, it was unclear what protections, if any, Detroit public employees had under the U.S. Bankruptcy Code with regard to their pension rights because of the lack of precedent in this area.²⁰³ Although the Detroit bankruptcy proceedings have not yet concluded as of the writing of this Article, the bankruptcy court has made a number of important rulings concerning the relationship between state constitutional provisions protecting pension rights and the Bankruptcy Code, and a number of other important developments have also occurred.

This Part discusses these developments in two Sections. The first Section provides a brief overview of American municipal bankruptcy law, with emphasis on creditor priority rights. The second Section then seeks to show how this aspect of municipal bankruptcy law has been applied, both formally and informally, to the pension claims of city employees and retirees in Detroit.

A. Overview of American Municipal Bankruptcy Law

Chapter 9 of the United States Bankruptcy Code governs insolvencies involving municipalities.²⁰⁴ Municipalities cannot be forcibly liquidated, only required to restructure their debt.²⁰⁵

202. The Michigan Constitution states, “The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby.” MICH. CONST. art. IX, § 24. Six other states provide similar protections for pension in their state constitutions. See Richard M. Hynes & Steven D. Walt, *Pension and Property Rights in Municipal Bankruptcy*, 33 REV. BANKING & FIN. L. 609, 639 (2014) (citing ALASKA CONST. art. XII, § 7; ARIZ. CONST. art. XXIX, § 1, cl. C; HAW. CONST. art. XVI, § 2; ILL. CONST. art. XIII, § 5; LA. CONST. art. X, pt. III, § 29; N.Y. CONST. art. V, § 7).

203. Municipal bankruptcies are still very rare in the United States. See *Bankrupt Cities, Municipalities List and Map*, GOVERNING (Dec. 3, 2013), <http://www.governing.com/gov-data/municipal-cities-counties-bankruptcies-and-defaults.html> (“Overall bankrupt municipalities remain extremely rare. A *Governing* analysis estimated only one of every 1,668 eligible general-purpose local governments (0.06 percent) filed for bankruptcy protection over the past five years.”).

204. 11 U.S.C. §§ 901-946 (2012). States, on the other hand, cannot declare bankruptcy. States are not currently eligible for bankruptcy under Chapter 9. See *id.* § 109 (not listing states as entities permitted to seek bankruptcy protection).

205. See KRISTEN DEJONG & BETH DOUGHERTY, NUVEEN ASSET MGMT., *MUNICIPAL BANKRUPTCY: A PRIMER ON CHAPTER 9*, at 1, 4 (2014), available at <http://www.nuveen.com/Home/Documents/Viewer.aspx?fileId=48362>; see also 11 U.S.C. §§ 301, 904 (prohibiting involuntary bankruptcies of municipalities).

Importantly, states have to pass legislation providing that they assent to their municipalities seeking bankruptcy protection under Chapter 9.²⁰⁶ Even if a state has given such assent,²⁰⁷ there is a very time-consuming eligibility process where the federal bankruptcy court determines whether a municipality can actually go through the Chapter 9 process.²⁰⁸

Even if assent and eligibility are present, there are necessarily different considerations at play during a municipal bankruptcy than with a corporate one. For instance, there are issues concerning the need to continue to provide essential public services (like police, fire, sanitation, and utilities),²⁰⁹ and there are issues concerning municipalities' ability to generate additional revenue through tax levies (as opposed to becoming more profitable through corporate reorganization).²¹⁰

Municipal bankruptcy proceedings, however, do share some similarities with corporate bankruptcy proceedings. Of course,

206. See 11 U.S.C. § 109(c)(2) (requiring explicit state government authorization for a local government to proceed as a debtor in bankruptcy). A significant number of states, as many as half, have not given their assent to allow municipalities to file for bankruptcy under Chapter 9. See PEW CHARITABLE TRUSTS, THE STATE ROLE IN LOCAL GOVERNMENT FINANCIAL DISTRESS 4 (2013), available at http://www.pewtrusts.org/~media/Assets/2013/07/23/Pew_State_Role_in_Local_Government_Financial_Distress.pdf. “These statutes [permitting Chapter 9 bankruptcies] vary from states that give broad authority to municipalities to file (currently ten states) to those states that place restrictions on the right to file such as seeking the governor’s approval.” Sandrelli & Cross, *supra* note 22, at 405. The following twenty-two states do not appear to permit municipal bankruptcies: Alaska, Georgia, Hawaii, Iowa, Indiana, Kansas, Maine, Maryland, Massachusetts, Mississippi, Nevada, New Hampshire, New Mexico, North Dakota, South Dakota, Tennessee, Utah, Vermont, Virginia, West Virginia, Wisconsin, and Wyoming. See Maciag, *supra* note 199.

207. See Daniel J. Freyberg, Comment, *Municipal Bankruptcy and Express State Authorization to Be a Chapter 9 Debtor: Current State Approaches to Municipal Insolvency—and What Will States Do Now?*, 23 OHIO N.U. L. REV. 1001, 1008-16 (1997) (providing a list of states that currently permit municipal bankruptcies).

208. 11 U.S.C. § 109(c) (setting out five eligibility factors for Chapter 9 bankruptcy); see also Sandrelli & Cross, *supra* note 22, at 402 (“The process to establish eligibility has proven lengthy and costly, often taking over a year, with the result that a municipality may not always qualify for Chapter 9 relief.”).

209. See Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 483-89 (1993) (discussing extent of a municipality’s residual obligations in bankruptcy).

210. See Kevin A. Kordana, *Tax Increases in Municipal Bankruptcies*, 83 VA. L. REV. 1035, 1104-07 (1997) (evaluating effectiveness of tax increases arising out of municipal bankruptcy).

municipalities do have bondholder creditors and other lenders just like private companies.²¹¹ The other similarity is that both private companies and municipalities have employees and retirees who have pension and other benefit claims that may be substantially impacted when their employers seek bankruptcy protection.²¹² While pension claims receive some preference or “priority” among competing creditors under Chapter 11 corporate reorganizations,²¹³ such claims do not receive priority treatment under Chapter 9.²¹⁴

The lack of priority for employee–retiree creditors during the Chapter 9 bankruptcy process has significant implications. Priority creditor claims are given preference over other creditor claims and are satisfied first among the various claims.²¹⁵ The concept of priority

211. See *id.* at 1046-47 (discussing the status of municipal bondholders in Chapter 9 bankruptcy proceedings); see also McConnell & Picker, *supra* note 209, at 429 (comparing creditor claims in private versus public bankruptcies).

212. See Hynes & Walt, *supra* note 202, at 611 (“[T]he current batch of municipal bankruptcies is complicated by the presence of another type of major creditor: the retiree.”).

213. See 11 U.S.C. § 507(a)(4)-(5) (assigning “unsecured claims for contributions to an employee benefit plan” fifth priority). Combined with wages, these pension claims receive preferred status up to a capped amount (\$12,475 as of April 1, 2013). See Bob Eisenbach, *Going Up: Bankruptcy Dollar Amounts Will Increase on April 1, 2013*, IN THE (RED) THE BUS. BANKR. BLOG (Feb. 26, 2013), <http://bankruptcy.cooley.com/2013/02/articles/business-bankruptcy-issues/going-up-bankruptcy-dollar-amounts-will-increase-on-april-1-2013>. Legislation has been recently introduced to provide private-sector employees a greater priority in bankruptcy when their companies become bankrupt. See Diane Davis, *Bill Requires Corporations to Give Workers, Retirees Fair Treatment in Bankruptcy*, BLOOMBERG BNA PENSION & BENEFITS DAILY (July 11, 2014), http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=49583977&vname=pbdnotallissues&fcn=3&wsn=488414000&fn=49583977&split=0 (“The bill, S. 2589, ‘Protecting Employees and Retirees in Business Bankruptcies Act of 2014,’ would make several changes to Chapter 11 and put workers’ interests near the top when companies file for Chapter 11 protection.”). The proposed law does not apply to municipal workers.

214. See Hynes & Walt, *supra* note 202, at 613-14 (“The [Bankruptcy] Code does not single out pensioners for priority in municipal bankruptcy [T]he pensioners have unsecured claims against the municipality to the extent that its pension obligations exceed the value of the assets held by the pension fund.”). Indeed, at least one state has gone out of its way to make sure retirees are subordinated to the interests of municipal bondholders. See *id.* at 612 (“Most notably, the Rhode Island legislature recently took steps to ensure that bondholders would have priority over retirees in municipal bankruptcy.”) (citing R.I. GEN. LAWS § 45-12-1 (2011)).

215. 1 BANKRUPTCY LAW FUNDAMENTALS § 8:10 (2014), available at Westlaw. There are three ways in which claims come to enjoy priority:

First, the Bankruptcy Code . . . sometimes grants some creditors priority over others. For example, the Code grants domestic support obligations

is important because of the insolvent municipalities' limited assets.²¹⁶ Only those creditors who have the highest priorities are likely to have any of their claims against the municipality satisfied.²¹⁷ Thus, if a pension claim is given no priority among a municipality's creditors, there is every chance that the employee will receive little to none of her pension payments.²¹⁸ This is because underfunded municipal pension liabilities are considered unsecured and have the lowest priority among creditors.²¹⁹ Indeed, absent bankruptcy-specific priorities in Chapter 9 itself, employees and retirees would have to point to some state-based property right guarantee in order to be entitled to priority treatment in a bankruptcy proceeding.²²⁰

The lack of employee priority for their pension claims is problematic, but even with a greater creditor right, the bankruptcy process does not favor public employee pension claims. This is because employees are less likely, given the amount of money involved, the complexity of the process, and their lack of knowledge, to take advantage of whatever priority they receive for their

priority over general creditors. Second, the Code recognizes contractual priority rights established between creditors. If one creditor agrees to subordinate its interest to another, bankruptcy gives effect to this agreement. Third, the Code recognizes non-bankruptcy law (typically state law) property rights that grant some creditors priority over others. For example, the Code recognizes the priority of a secured creditor over a general creditor with respect to its collateral.

Hynes & Walt, *supra* note 202, at 613 (footnotes omitted).

216. See Gordon W. Johnson, *Insolvency and Social Protection: Employee Entitlements in the Event of Employer Insolvency*, in ORGANISATION FOR ECON. CO-OPERATION & DEV., ASIAN INSOLVENCY SYSTEMS: CLOSING THE IMPLEMENTATION GAP 223, 227-28 (2007).

217. See 1 BANKRUPTCY LAW FUNDAMENTALS, *supra* note 215, § 8:10.

218. See *id.*

219. See Hynes & Walt, *supra* note 202, at 613-14 (“[P]ensioners have unsecured claims against the municipality to the extent that its pension obligations exceed the value of the assets held by the pension fund.”).

220. See *id.* at 616-17 (adopting “the assumption under current law that, absent a bankruptcy-specific priority, priority requires an enforceable property right”). That being said, Hynes and Walt do not believe the Michigan state constitutional provisions protecting against diminishment of pensions qualifies as such a property right that requires priority protection for Detroit employees’ pension rights. *Id.* at 616 (“The most plausible interpretation of these provisions is that they provide nothing more than a contract right similar to a municipal bond that everyone agrees can be modified in bankruptcy. . . . They implicitly rely on the principle that bankruptcy law must respect priority rights established outside bankruptcy by state law. However, current law does not adopt this principle. Although bankruptcy law once explicitly recognized state law priority rights, Congress amended the Bankruptcy Act in 1938 to largely displace state law priorities.”).

employment claims.²²¹ Not only that, but even if employees do manage to negotiate the process, file a timely claim, and receive a fairly large portion of what they are owed, they will likely not receive it for many years given how long it takes the bankruptcy process to be completed.²²² Thus, if the aim of the social protection system is to protect already-earned employee pensions when their public employer becomes insolvent in a more timely and efficient manner, the granting of a priority alone may not be the best method for doing so.²²³ The Detroit municipal bankruptcy highlights the current unsatisfactory nature of the American municipal bankruptcy system when it comes to employee pensions.

221. See Johnson, *supra* note 216, at 229. Even if employees are represented by a union, unions do not have a formal role to play under current bankruptcy law. See Andrew B. Dawson, Labor Activism in Bankruptcy (Feb. 18, 2014) (unpublished manuscript) (manuscript at 27) (on file with author), available at <http://ssrn.com/abstract=2397911> (observing, in the Chapter 11 context, that unions have little formal role to play in bankruptcy reorganization proceedings). Nevertheless, Professor Dawson maintains that “[l]abor unions, bargaining on behalf of these workers, can offer [the workers’ insider] perspective and experience to other stakeholders and potential purchasers who may lack the monitoring power but who have the power to use that monitoring knowledge.” *Id.* (manuscript at 27-28). Similarly, unions can, and have, played a similar role in municipal bankruptcies. For instance, “[t]he biggest unions, including the American Federation of State, County and Municipal Employees and the United Auto Workers, negotiated deals that reduced the size of proposed pension cuts” in the Detroit bankruptcy negotiations. See Steven Church, *Detroit Workers, Retirees Endorse City’s Benefit Cutting-Bankruptcy Plan*, BLOOMBERG BNA PENSION & BENEFITS DAILY (July 22, 2014), http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=50355375&vname=pbdnotallissues&jd=a0f3q7w1x7&split=0.

222. See Johnson, *supra* note 216, at 229 (noting the long, drawn-out nature of liquidation in bankruptcy where even employees who have priority rights will still be subject to a drawn out wait for their claim to be realized, as opposed to guarantee schemes where there can be immediate payment while the guarantor—who is better situated to handle the time delay—is subrogated to insolvency claim).

223. Indeed, because of this dynamic, many countries in the private sector provide for guarantee funds or insurance schemes. The United States has such an insurance scheme for DB pension plans in the private sector through the Pension Benefit Guaranty Corporation (PBGC). See 29 U.S.C. §§ 1301-1461 (2012). Although the payments available under such guarantee funds are limited to certain amounts for specified time periods prior to the insolvency filing, *see, e.g.*, 11 U.S.C. § 507(a)(4)-(5) (limiting U.S. claims to within 180 days of insolvency through PBGC), they do provide a timelier and surer method for protecting the already-earned pension claims of employees, *see* Johnson, *supra* note 216, at 229. Unfortunately, no such guarantee schemes exists for public pension claims in the United States. *Id.* at 227-28.

B. The Detroit Bankruptcy Litigation

Detroit Emergency Manager Kevyn Orr, with the acquiescence of Michigan Governor Rick Snyder, filed for bankruptcy in the summer of 2013, claiming that the city had a deficit of \$18 billion, of which \$5.7 billion represented retiree healthcare liabilities and \$3.5 billion represented pension liabilities.²²⁴ Even before the bankruptcy petition was filed, public employee unions and the pension funds went on the offensive to protect city employee pensions from the bankruptcy process.²²⁵ Citing the Michigan State Constitution provisions that protect pension obligations from diminishment,²²⁶ the plaintiffs argued that the Chapter 9 bankruptcy proceeding had to be stopped before it interfered with these state constitutional rights.²²⁷ Although the unions and pension funds were initially able to get a state court judge to stay the bankruptcy proceedings until the scope of the constitutional provision could be determined,²²⁸ that victory was short-lived. A couple of days later, a state court of appeals vacated that stay order and allowed the bankruptcy proceeding to go forward.²²⁹

224. See Bernie Woodall & Joseph Lichterman, *Detroit Manager Scores First Win over Unions in Bankruptcy Bid*, REUTERS (July 24, 2013, 6:57 PM), <http://www.reuters.com/article/2013/07/24/us-usa-detroit-idUSBRE96N05Z20130724>.

225. See Stephanie Francis Ward, *Detroit Bankruptcy Unconstitutional, Judge Rules in Pension Case*, ABA J. (July 19, 2013, 10:59 PM), http://www.abajournal.com/news/article/judge_grants_pension_lawyers_motion_detroit_bankruptcy/ (“During the hearing the judge said she planned to issue an order blocking the bankruptcy filing. However Rick Snyder, the governor of Michigan, and Kevyn Orr, Detroit’s emergency manager, filed the bankruptcy petition five minutes before the Thursday hearing began.”).

226. MICH. CONST. art. IX, § 24 (“The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby.”).

227. Ward, *supra* note 225.

228. *Id.* (“[Governor] Snyder and [Emergency City Manager] Orr violated the constitution by proceeding with the bankruptcy filing, because they knew it would reduce pension benefits, [Judge] Aquilina said.”).

229. See Martha Neil, *Appeals Court Puts Brakes on State Judge’s Order Derailing Detroit Bankruptcy*, ABA J. (July 23, 2013, 8:30 PM), http://www.abajournal.com/news/article/appeals_court_puts_brakes_on_state_judges_order_derailing_detroit_bankruptcy/ (“Injunctive relief granted Friday by a Michigan judge who ordered the city of Detroit to withdraw its Chapter 9 bankruptcy filing was stayed Tuesday by the state court of appeals.”).

From there, Bankruptcy Judge Steven Rhodes found that he had jurisdiction over all Detroit city assets, including its pension funds, stayed all related state court proceedings against state officials who filed the bankruptcy, and ruled that all objections concerning the bankruptcy processes' impact on pension claims had to be heard in bankruptcy court.²³⁰ He then held the necessary eligibility hearings under Chapter 9, and over the vehement objections of the city unions and pension funds, found that Detroit was eligible for bankruptcy.²³¹ A number of public unions and pension funds responded by filing appeals in federal appellate court to stop the bankruptcy process from going forward.²³²

At the same time, Judge Rhodes concluded that the Michigan State Constitution did not prevent pension obligations from being subject to the bankruptcy process.²³³ He concluded that pension obligations were essentially contractual in nature and subject to adjustment under the Bankruptcy Code like any under contractual obligation.²³⁴ He came to this conclusion notwithstanding that "DB pensions are a form of deferred compensation that offsets lower salaries in the public sector, especially in highly skilled professional occupations."²³⁵ Perhaps even more worrisome for public employees

230. See Woodall & Lichterman, *supra* note 224 ("Judge Steven Rhodes ordered three lawsuits filed by city workers, retirees and pension funds be halted and extended that stay to suits against Michigan's governor, treasurer and Detroit's emergency manager. Rhodes' action ensures that the only path to fight the city's Chapter 9 bankruptcy petition runs through his courtroom in downtown Detroit.").

231. See Nathan Bomey, Brent Snavelly & Alisa Priddle, *Judge Rules Detroit Eligible for Historic Chapter 9 Bankruptcy, Says Pensions Can Be Cut*, DETROIT FREE PRESS (Dec. 3, 2013, 2:22 PM), <http://www.freep.com/article/20131203/NEWS01/312030084/Detroit-bankruptcy-eligibility-Steven-Rhodes-Chapter-9-Kevyn-Orr> ("Rhodes—in a surprise decision this morning—also said he'll allow pension cuts in Detroit's bankruptcy. Rhodes emphasized that he won't necessarily agree to pension cuts in the city's final reorganization plan unless the entire plan is fair and equitable.").

232. *Id.*; see *In re City of Detroit*, 504 B.R. 97 (Bankr. E.D. Mich. 2013), *appeal docketed*, No. 14-1211 (6th Cir. Feb. 21, 2014).

233. *In re Detroit*, 504 B.R. at 154.

234. See *id.* ("Because under the Michigan Constitution, pension rights are contractual rights, they are subject to impairment in a federal bankruptcy proceeding."). At the same time, the bankruptcy court also stated that "[n]o one should interpret this holding . . . to mean that the Court will necessarily confirm any plan of adjustment that impairs pensions." *Id.*

235. See Miller, *supra* note 1. It is not at all clear that Judge Rhodes's reasoning that employee pensions are mere contractual obligations subject to impairment in bankruptcy represents a proper understanding of pensions as already earned, vested property rights. See Lorraine A. Schmall, *Keeping Employer*

and retirees, Judge Rhodes also concluded that pension claims had no priority under Chapter 9 and thus would be treated as unsecured claims.²³⁶

These legal conclusions appeared to have spurred various public employees and retirees to bargain in the shadow of the formal bankruptcy process²³⁷ and engage in informal mediation to come up with an agreement that would permit the bankruptcy process to go forward,²³⁸ while sparing large parts of the pension obligations owed to employees and retirees.²³⁹ For instance, under an agreement between the city and groups representing retired police and firefighters, “[p]olice and firefighter retirees would see no cuts in their monthly pensions, while cost-of-living increases would be

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

236. See Brent Snively, Joe Guillen, Eric D. Lawrence & Alisa Priddle, *Retirees Brace for Pension Cuts in Wake of Detroit Bankruptcy Ruling*, Detroit Free Press (Dec. 3, 2013, 10:36 PM), <http://archive.freep.com/article/20131203/NEWS01/312030159/Detroit-pensions-Judge-Rhodes-Kevyn-Orr> (“‘Pension benefits are a contractual obligation of a municipality and not entitled to any heightened protection in bankruptcy,’ Rhodes said.”).

237. See Hynes & Walt, *supra* note 202, at 633 (“Even if creditors routinely consent to plans of reorganization, it is likely that they bargain in the shadow of what would happen in the absence of their consent.”).

238. *But see* Appellants’ Brief at 10, Mich. Council 25 v. City of Detroit, No. 14-1211 (6th Cir. Apr. 24, 2014) (arguing that Chapter 9 does not comply with the requirements of the federal Constitution’s Contract Clause). The unions have argued that Chapter 9, in and of itself, violates the Federal Constitution, as the point of municipal bankruptcy law is

to give the States a federal license and a federal vehicle to accomplish indirectly a result—the adjustment of their municipalities’ contract debts in a federal bankruptcy proceeding in accordance with a state-authorized and state-proposed plan of adjustment—that the Contract Clause in Article I, § 10 of the Federal Constitution prohibits the States from accomplishing directly through state legislation.

Id. This claim was dismissed at the trial court level and has yet to be decided by the Sixth Circuit (and may not be if a bankruptcy compromise goes through). See *In re Detroit*, 504 B.R. at 147. It does, however, present a potential avenue to be explored by unions and other pension beneficiaries seeking to protect their benefits.

239. See Steven Church, *Detroit Reaches Accord on Health Benefits, Pensions with Police, Firefighter Retirees*, BLOOMBERG BNA PENSION & BENEFITS DAILY (Apr. 15, 2014), http://news.bna.com/pdln/PDLNWB/split_display.asp?fedfid=44880369&vname=pbdnotallissues&jd=a0e9c4p3j1&split=0.

reduced by more than half.”²⁴⁰ The deal was helped by pledges by private foundations and the state of Michigan to kick in almost one billion dollars to both continue to pay active retirees and to make sure current employees also will have pensions when they retire.²⁴¹ Almost simultaneously with the retired police and firefighters, the city reached deals with two major pension funds.²⁴² These compromises require the pension plans to drop pending appeals concerning the impact of the Michigan Constitution on the bankruptcy process.²⁴³ In late July 2014, impacted city employees and retirees voted overwhelmingly in favor of these compromises.²⁴⁴ On November 7, 2014, after a two-month trial, the bankruptcy court approved the city’s plan of adjustment, allowing Detroit to exit from bankruptcy.²⁴⁵

240. *Id.*

241. *Id.* (“The deal, reached April 15, can go through only if the city wins approval of a proposal from the state and private foundations, who offered \$816 million to bolster the city’s pension systems in exchange for a plan that would shield Detroit’s art collection from a forced sale.”); Mary Williams Walsh, *Detroit Bankruptcy Deadline May Be Missed, Imperiling State Funds*, N.Y. TIMES, May 16, 2014, at B3 (“The grand bargain calls for \$466 million from private foundations and the Detroit Institute of Arts and a \$350 million appropriation from the state.”).

242. See Steven Church, *Detroit Pension Fund for General Employees Reaches Tentative Deal with City on Cuts*, BLOOMBERG BNA PENSION & BENEFITS DAILY (Apr. 16, 2014), http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=44949719&vname=pbdnotallissues&fcn=4&wsn=489405500&fn=44949719&split=0 (“General employees’ pensions would [shrink] by 4.5 percent, instead of the 26 percent initially proposed by . . . emergency manager [Kevyn Orr], according to a person familiar with the settlement. They would lose an annual cost-of-living adjustment . . .”).

243. Nora Macaluso, *Judge Approves Detroit Adjustment Plan; State Aid, Creditors’ Votes Awaited*, BLOOMBERG BNA PENSION & BENEFITS DAILY (May 6, 2014), http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=46049895&vname=pbdnotallissues&fcn=7&wsn=489182000&fn=46049895&split=0 (“As part of the ‘grand bargain’ with the state and foundations, pensioners and city employees will have to give up their rights to sue to block the bankruptcy proceedings.”).

244. See Church, *supra* note 221 (“About 82 percent of the current and retired police and firefighters voted for the proposal, while about 73 percent of general city workers and retirees supported it.”).

245. See Nathan Bomey, Matt Helms & Joe Guillen, *Judge Oks Bankruptcy Plan; A “Miraculous Outcome,”* DETROIT FREE PRESS (Nov. 7, 2014), <http://www.freep.com/story/news/local/detroit-bankruptcy/2014/11/07/rhodes-bankruptcy-decision/18648093/> (“Judge Steven Rhodes ruled that Detroit’s comprehensive restructuring plan is fair and feasible, providing the legal authority for the city to slash more than \$7 billion in unsecured liabilities and reinvest \$1.4 billion over 10 years in public services and blight removal.”).

In all, the lesson appears to be that even with specific state constitutional language seeking to protect against pension cutbacks, no pension rights are safe from diminishment once the bankruptcy process commences.²⁴⁶ Although the bankruptcy process eventually led to relatively minimal cuts in pension benefits for both employees and retirees in Detroit,²⁴⁷ it should be remembered that without the state and private foundations providing money to the pension funds, the outcome of this process could have been very different. That being said, it should also be re-emphasized that municipal bankruptcies cannot even take place in many states that have not passed legislation authorizing municipal bankruptcies.²⁴⁸ In states where municipal bankruptcies are permitted, it would appear that to provide priority protection to pension claims it would be necessary to amend Chapter 9 of the Code to provide such a priority (an unlikely scenario),²⁴⁹ or states would have to specifically designate pensions as a property right, which could then receive a non-bankruptcy priority under the Code (perhaps more likely at least in some states).²⁵⁰ In the meantime, because of the current uncertainty surrounding the municipal bankruptcy process, municipalities and their employees would do well to pass comprehensive pension reform, which will allow them to address current pension underfunding and thereby help avoid the need to resort to bankruptcy proceedings.

V. A HYBRID APPROACH TO PUBLIC PENSION REFORM IN THE UNITED STATES: LIMITED ERISA EXPANSION AND UNIFORM LAW ADOPTION

Of course, the best way to avoid bankruptcy and other forms of litigation discussed in this Article is not just by trying to harness

246. See Hynes & Walt, *supra* note 202, at 639 (“[B]ankruptcy law displaces priorities established by state law, treating pension obligations as unsecured debt entitled to no special priority.”).

247. See Bomey, Helms & Guillen, *supra* note 245.

248. See *supra* note 206 (identifying states that do not permit municipal bankruptcies).

249. See Hynes & Walt, *supra* note 202, at 660 (“One approach would be to provide pensions priority status with the priority the Bankruptcy Code currently gives to certain other sorts of unsecured claims.”).

250. See *id.* at 651 (“Either of two property rights can be created by legislation: a statutory lien or a statutory trust. Properly designed, both can give pension obligations priority in payment over general creditors and even secured creditors of a municipality.”) (footnote omitted).

better arguments for future public pension litigation. The best strategy moving forward is to eliminate the root causes behind the various forms of public pension litigation in the first place. And given that most litigation, bankruptcy or otherwise, is caused by underfunding of public pension funds,²⁵¹ there needs to be a fundamental reassessment of how government entities fund, govern, and legally protect public pension rights.

A. Previous Attempts to Harmonize American Public Pension Law

Commentators in the past have remarked on at least two potential methods for providing more consistent and uniform standards for public pension plans across the board²⁵²: expand ERISA's funding, fiduciary, and other provisions to all public pension plans²⁵³ and/or provide a model uniform public pension law with many of the same ERISA provisions that states could adopt with additional emphasis on issues unique to public pension plans.²⁵⁴

Each of these approaches has already been attempted or contemplated to one degree or another. In fact, when ERISA was first enacted in 1974, Congress considered covering governmental plans along with private-sector plans.²⁵⁵ As discussed above, this proposal was rejected both because it was thought that taxpayers would back underfunded pension plans if states or municipalities became financially distressed²⁵⁶ and because of federalism concerns that the federal government would trench upon traditional areas of

251. See *supra* notes 7-9 and accompanying text.

252. A third way has been recently advanced by Professor O'Reilly, which would have the federal government bail out insolvent state and local pension plans using its Spending Clause authority to impose ERISA-type regulation. See O'Reilly, *supra* note 34 (manuscript at 2-3). Because I think a federal bailout of public pension plans is highly unlikely in the current political environment, I focus here instead on expanding ERISA to federal pension plans and using a uniform law approach to provide the necessary regulation for state and local pension plans. See also Monahan, *supra* note 34 (manuscript at 41-47) (describing how more effectively written and enforced funding provisions in state constitutions could help correct public pension underfunding issues).

253. See Monahan & Thukral, *supra* note 24, at 292.

254. See Mendales, *supra* note 24, at 509-11.

255. See Monahan & Thukral, *supra* note 24, at 297 ("When ERISA was being debated by Congress, active consideration was given to including governmental plans within its reach."); Mendales, *supra* note 24, at 508-09 ("Congress itself believed that it could not apply ERISA to the states based on these issues when it originally enacted the legislation in 1974.").

256. See *supra* note 41 and accompanying text.

state law concern.²⁵⁷ Two other reasons were advanced for not applying ERISA to governmental plans: “Congress thought private pension plans were more likely than public pension plans to incorporate unduly restrictive and unfriendly provisions that prevented employees from vesting,”²⁵⁸ and “Congress was worried that imposing minimum funding and similar standards would have ‘entail[ed] unacceptable cost implications to governmental entities.’”²⁵⁹ Since that time, although a provision was placed in ERISA to study the possibility of expanding the law to governmental plans²⁶⁰ and a number of pieces of legislation were introduced to do just that every year between 1978 and 1984,²⁶¹ no such law eliminating the governmental plan exemption has ever been enacted.²⁶²

On the other hand, the National Conference of Commissioners on Uniform State Laws put forward in 1997 a uniform public pension law: the Uniform Management of Public Employee Retirement Systems Act (UMPERSA).²⁶³ This uniform law seeks to: (1) ensure all pension assets are held in trust; (2) impose prudent investment rules; (3) establish trustee liability for fiduciary breaches;

257. See Monahan & Thukral, *supra* note 24, at 297; see also *Gualandi v. Adams*, 385 F.3d 236, 243 (2d Cir. 2004) (“One Senator commented that ‘State and local governments must be allowed to make their own determination of the best method to protect the pension rights of municipal and state employees.’” (quoting 119 CONG. REC. 7422 (1973) (statement of Sen. Lloyd Bensten))); *Roy v. Teachers Ins. & Annuity Ass’n*, 878 F.2d 47, 50 (2d Cir. 1989) (“We think it clear that the congressional goal of preserving federalism requires that when a pension plan has been established by a governmental entity for its employees and the governmental entity’s status as employer has not changed, the plan must be exempt from ERISA as a governmental plan.”).

258. See Monahan & Thukral, *supra* note 24, at 297 (citing *Rose v. Long Island R.R. Pension Plan*, 828 F.2d 910, 914 (2d Cir. 1987); H.R. REP. NO. 93-533, at 43 (1974), reprinted in 1974 U.S.C.C.A.N. 4639, 4667).

259. *Id.* (quoting H.R. REP. NO. 93-807, at 165 (1974), reprinted in 1974 U.S.C.C.A.N. 4670, 4830); see also H.R. REP. NO. 93-533, at 44, reprinted in 1974 U.S.C.C.A.N. 4639, 4668.

260. 29 U.S.C. § 1231 (2012).

261. See Monahan & Thukral, *supra* note 24, at 297 (citing Ridgeley A. Scott, *Misuse of Public Pension Assets: White Collar Crimes and Other Offenses*, 26 IND. L. REV. 589, 590 (1993)).

262. See O’Reilly, *supra* note 34 (manuscript at 16).

263. NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS, UNIFORM MANAGEMENT OF PUBLIC EMPLOYEE RETIREMENT SYSTEMS ACT 1 (1997), available at

http://www.uniformlaws.org/shared/docs/management_public_employee_retirement_systems/mpersa_final_97.pdf.

(4) set up required disclosures to plan participants; and (5) establish an enforcement schemes for violation of the Act.²⁶⁴ UMPERSA establishes important new rules concerning disclosure and fiduciary issues, where the thought was that significant “shortcomings in the operation of these plans . . . could be fixed at no appreciable cost.”²⁶⁵

The reporter and other drafters of UMPERSA made the considered decision not to draft a more comprehensive uniform law, which would have also covered funding standards and termination insurance.²⁶⁶ There was a fear that state legislatures would not enact anything that would have restricted their budgetary freedom.²⁶⁷

Since its drafting, only two states, Wyoming and Maryland, have adopted UMPERSA.²⁶⁸ This may be because the law is the classic “political orphan,” with no interest group caring enough to overcome legislative inertia. In any event, given the continued unwillingness of politicians to fund their public pension plans, and with public awareness about these issues at an all-time high, the time has come to revisit uniform public pension laws and consider expanding UMPERSA to provide funding standards and other provisions that respond more directly to the current public pension funding crisis.²⁶⁹

264. See *Management of Public Employee Retirement Systems Act Summary*, UNIFORM L. COMMISSION, <http://www.uniformlaws.org/ActSummary.aspx?title=Management%20of%20Public%20Employee%20Retirement%20Systems%20Act> (last visited Dec. 29, 2014). See generally Steven L. Willborn, *Public Pensions and the Uniform Management of Public Employee Retirement Systems Act*, 51 RUTGERS L. REV. 141 (1998) (providing a summary of UMPERSA by its reporter).

265. See E-mail from John H. Langbein, Sterling Professor of Law, Yale Law School, one of the drafters of UMPERSA, to author (June 6, 2014) (on file with author).

266. See *id.*

267. See *id.* Of course, the underfunding of public pension funds had not reached public awareness in 1997 when the reporters drafted the uniform law and would not become a national issue until after the global recession commenced in 2009. *Id.*

268. See *Legislative Enactment Status: Management of Public Employee Retirement Systems Act*, UNIFORM L. COMMISSION, <http://www.uniformlaws.org/LegislativeMap.aspx?title=Management%20of%20Public%20Employee%20Retirement%20Systems%20Act> (last visited Dec. 29, 2014).

269. See Anenson, Slabaugh & Lahey, *supra* note 68 (manuscript at 39, 52) (continuing to advocate for adoption of UMPERSA, but also for guarantee fund in case of public plan insolvency).

B. Hybrid Approach for Standardizing American Public Pension Law

This Article proposes a hybrid approach to standardize the best public pension law practices at all levels of American government, largely in accordance with pension principles established under ERISA. This Section is further divided into an exploration of expanding ERISA to cover federal pension plans and an examination of formulating a new and improved uniform public pension law for adoption by the states.

1. *Expanding ERISA Coverage to Federal Pension Plans*

To avoid the federalism problem associated with having the federal government take over state and local pension regulation and also to avoid a cumbersome vast expansion of ERISA and PBGC insurance coverage, the first part of the hybrid proposal is to limit ERISA expansion only to federal employee pension plans.

This approach makes sense when one reconsiders each of the reasons Congress chose not to subject public pension plans to ERISA in the first place. First, and most obviously, arguments about federalism have no role to play if the federal government moves to regulate federal benefit plans under ERISA. Second, Congress mistakenly believed in the 1970s that underfunded public pension plans would be bailed out by taxpayers if they encountered financial problems.²⁷⁰ But with the recent spate of municipal bankruptcies and the significant underfunding of federal, state, and local pension funds, history has shown that the federal government and states are either unwilling or incapable of raising tax revenue to bail out failing pension plans.²⁷¹ Third, Congress was worried that imposing ERISA minimum funding requirements would cause the financial burden of those requirements to fall on taxpayers.²⁷² Yet again, history has proven that without effective minimum funding standards, public pension funds have become significantly underfunded (as federal pension plans are right now),²⁷³ and the taxpayers (or employees if state and local government are unwilling or unable to raise taxes) will take an even a greater financial hit as a result.

270. See Monahan & Thukral, *supra* note 24, at 297.

271. See *supra* note 102 and accompanying text.

272. See *supra* note 256 and accompanying text.

273. See *supra* text accompanying note 82.

In all, none of the justifications for excluding governmental plans *in toto* from ERISA coverage seem to apply with any force to excluding federal pension plans alone. It may be argued that, generally speaking, federal plans are not in as bad of shape as state and local plans, and that the laws regulating federal plans are more in keeping with the strict regulations of ERISA. Yet, as described above, the federal pension trust became underfunded in the first place both because the CSRA did not take into account employee pay raises and COLAs, and because Congress failed to pre-fund these funds on an actuarial sound basis.²⁷⁴ This dynamic has led the federal pension trust to have an actuarial liability of \$761.5 billion.²⁷⁵ Surely, additional reporting, participation, eligibility, benefit accrual, funding, fiduciary, and enforcement mechanisms provided by ERISA would go a long way in reducing the pension underfunding that the federal system now faces and ensuring that such financial issues do not recur in the future.

Logistically, federal legislation should be passed to partially lift the governmental plan exemption so that federal employee pensions under the FERS, CSRA, and TSP would be subject to the various ERISA pension plan requirements (and also subject to plan qualification under the Internal Revenue Code).²⁷⁶ There might need to be additional provisions added as well considering the employer providing pension benefits is the federal government. So, for instance, provisions would be required to permit federal employee participants and beneficiaries to sue the federal government under ERISA, special fiduciary and conflict-of-interest rules might be needed for federal employees operating these plans (though such rules could be modeled on those in place already under FERS and the CSRA), and some consideration should be given to the type of glide path or transitional rules that should be instituted to allow the current federal employee pension plans to meet the minimum funding requirements of ERISA.

In any event, this would be a relatively modest expansion of ERISA as far as employees covered, as there are about 2.7 million

274. See *supra* notes 83-85 and accompanying text.

275. See *supra* text accompanying note 82.

276. See Monahan & Thukral, *supra* note 24, at 294 (“In addition to ERISA requirements, retirement plans also must comply with provisions in the Internal Revenue Code of 1986 (the Code) in order to receive certain tax benefits. While ERISA exempts governmental plans entirely from its reach, the Code still imposes some, though significantly reduced, requirements on governmental plans.”).

federal employees in the United States.²⁷⁷ On the other hand, given recent congressional bills to require federal employees to contribute to their pensions and/or to migrate to a DC plan,²⁷⁸ ERISA might provide the necessary protective framework under which such pension plan design implementations could occur.

2. Construction of a Uniform, State-Wide Public Pension Law for State and Local Pension Plans

Whereas federal employee pension plans would be subject to ERISA, state and local pension plans would continue to be exempt under this hybrid proposal. Instead, and in place of the current UMPERSA uniform law, this Article proposes adopting a far more comprehensive model law that would require each state to have one public pension system for the entire state; contain ERISA-like provisions concerning reporting and disclosure requirements, fiduciary requirements, and meaningful remedial provisions; and also contain provisions specifically suited to address unique issues surrounding public pension plans. In thinking about what such a uniform law should look like, this Article borrows liberally from the recent scholarship of Professor Mendales on a new uniform public employee benefit law.²⁷⁹

First, Professor Mendales' uniform law proposal requires that "all benefit funds maintained by a state, its subdivisions, and instrumentalities be subsumed under common administration by state agencies selected in a nonpolitical way and be subject to uniform rules on financing and accountability."²⁸⁰ Such a state-wide uniform law would have a number of advantages. A state-wide plan that covers all state and local employees would provide uniform funding, fiduciary, and enforcement mechanisms applicable to all public employees in the state and would ensure that local plans would not

277. See Floyd Norris, *Bloated Government? Federal Employment at 47-Year Low*, NY TIMES (Oct. 22, 2013, 10:32 AM), http://economix.blogs.nytimes.com/2013/10/22/bloated-government-federal-employment-at-47-year-low/?_php=true&_type=blogs&_r=0.

278. See *supra* notes 90-98 and accompanying text.

279. Whereas the focus of this Article's proposal is on public pensions, Professor Mendales' proposal more broadly seek to cover all public employee benefit plans sponsored by states and municipalities. See Mendales, *supra* note 24, at 522.

280. *Id.* at 510.

have different or inconsistent provisions.²⁸¹ It would also likely make it easier to “pass the model act without separately drafting and wrangling over individual programs for different groups of employees.”²⁸² Having all public pension plans in one state pension fund would also have the advantages that come with economies of scale, including access to more sophisticated financial advisors and actuaries, more competitively priced investment products, and the ability to diversify pension assets among a larger group of investments.²⁸³ Indeed, recognizing these advantages, some local pension plans are already looking to merge into large state-wide plans.²⁸⁴ Finally, Mendales proposes compacts or more informal arrangements be entered into by states that adopt the uniform code to “address common problems faced by states in administering their respective codes and for coordinating state efforts to keep their codes uniform on important issues.”²⁸⁵ In contrast, this Article favors the more incremental approach based on informal arrangements between the states, as interstate compacts would require federal involvement, which would complicate state pension plan regulation unnecessarily.²⁸⁶

281. Having state-wide plans operating under a uniform code, in turn, “would provide a template to assist legislatures in dealing with difficult issues such as funding, investing and administering trust funds, structuring benefits, and ensuring the integrity of benefit funds.” *Id.* at 514. It would also help overcome local pension plans’ vulnerability to political pressure, which causes local plans “to underestimate the long-term costs of benefits and, in turn, required employer and employee contributions.” *Id.* at 518.

282. *Id.* at 511.

283. *Id.* at 512 (arguing for “common funding, investment, and administration of state and municipal funds,” which would “permit local funds to employ more sophisticated financial personnel, would permit greater diversification of investments, and would enhance bargaining power vis-à-vis securities issuers and intermediaries”).

284. See, e.g., Rick Baert, *Legislation Opens Door for Duluth Teachers to Join Minnesota Teachers Pension Fund*, PENSIONS & INVESTMENTS (May 27, 2014, 4:23 PM), <http://www.pionline.com/article/20140527/ONLINE/140529887/legislation-opens-door-for-duluth-teachers-to-join-minnesota-teachers-pension-fund> (“The \$210 million Duluth (Minn.) Teachers’ Retirement Fund Association could be merged into the \$18 billion Minnesota Teachers Retirement Association, St. Paul, as a result of legislation signed last week by Minnesota Gov. Mark Dayton.”). Part of the reason for the merger was that “[t]he Duluth board wanted the merger to reduce its liabilities.” *Id.*

285. See Mendales, *supra* note 24, at 539. For further discussion of interstate compacts for pooling resources for benefit funds, see generally *id.* at 546-47.

286. *Id.* at 546 n.167 (“Article I, Section 10, Clause 3 of the federal Constitution allows states to enter compacts with each other if specifically permitted by Congress.”).

Second, such model legislation would provide for adequate funding provisions and ensure that the promised benefits were paid on a timely basis.²⁸⁷ Many of the funding requirements would be drawn directly from the ERISA context, while other provisions would require plans to engage in internal de-risking strategies. One example of an internal approach is “hedging” against interest rate changes,²⁸⁸ while another example is “[l]iability-driven invest[ing],” in which an effort is made to match the characteristics of the investment assets underlying the pension promise with payout obligations to pensioners.²⁸⁹ Such hedging or liability-driven investing would reduce the risks associated with plan investment.²⁹⁰ Similarly, strong fiduciary language, combined with minimum pre-funding requirements, would make it more difficult for politicians and bureaucrats to kick the public pension funding can down the block.²⁹¹ Of course, a number of the basic ERISA provisions involving eligibility, vesting, and benefit accruals would also be added.²⁹² Perhaps down the line, even a public-based PBGC insurance scheme could be put into place when a pension plan is terminated for lack of funding or because of the insolvency of a municipality.²⁹³

287. *Id.* at 511.

288. See Alex Pekker & Meghan Elwell, *Pension Funds Should Derisk Now*, PENSION & INVESTMENTS (Mar. 11, 2014, 10:02 PM), <http://www.pionline.com/article/20140311/ONLINE/140319974/pension-funds-should-derisk-now>.

289. See Jayne Gest, *How to Reduce Your Defined Benefit Risk, Even After Freezing the Plan*, SMART BUS. (Jan. 1, 2013, 1:27 AM), <http://www.sbnonline.com/article/how-to-reduce-your-defined-benefit-risk-even-after-freezing-the-plan-tegrit/>.

290. See Mendales, *supra* note 24, at 511-12 (maintaining that uniform law should require using “qualified actuaries to match contributions and investment returns with predicted payouts to beneficiaries”).

291. See *id.* at 512, 518. Mendales also argues for the model law to have an Office of the Inspector General “to police the integrity of plan fiduciaries and their advisors.” *Id.* at 512, 538-39 (footnote omitted). Professor David Webber, for his part, argues that many public pension plans already have many of the same fiduciary obligations imposed on them that currently apply in the ERISA context. See generally David H. Webber, *The Use and Abuse of Labor’s Capital*, 89 N.Y.U. L. REV. (forthcoming 2014) (manuscript at 12-13) (on file with author). To the extent that state pension codes already apply ERISA fiduciary duties, it will be easier to transition to the proposed uniform law.

292. See Mendales, *supra* note 24, at 512-13 (laying out ERISA provisions that model law would borrow).

293. See Paul M. Secunda, *An Analysis of the Treatment of Employee Pension and Wage Claims in Insolvency and Under Guarantee Schemes in OECD Countries: Comparative Law Lessons for Detroit and the United States*, 41 FORDHAM URB. L.J. 867, 936 (2014) (arguing, based on comparative study, for

On the other hand, it would probably be better to keep the model law as a framework and not seek to push public plans into deciding whether to maintain a DB structure, as opposed to taking on DC plan or cash balance plan alternatives. Plans could also decide within the strictures of this model law whether to offer public pension plan participation to private-sector workers currently without employer-sponsored plans. Those types of decisions would still be left to decision makers within individual states.²⁹⁴

This type of flexibility is important given that states may have different finances that might justify different funding levels and different pension regimes. So perhaps a state like Florida, with a large elderly population, would want one type of pension scheme, while Alaska, with its oil money and sovereign wealth fund, might choose a different pension structure altogether. Although this proposal believes one state-wide scheme for each state makes the most sense for the reasons discussed above, different states, playing off the uniform law, could still have different variations (just as is possible under ERISA today for private-sector plans). And of course, even if states have substantially similar public pension schemes on paper, state courts are likely to interpret those rules differently (though the same is true with interpretation of other uniform rule schemes like the Uniform Commercial Code or the Uniform Trade Secret Act).

Finally, the model law should have provisions that ERISA does not have that are specifically focused on the needs of public employees and employers. For instance, Professor Mendales identifies the following issues that need to be addressed by a uniform public pension law, which are not covered by ERISA: “adequate public funding, protecting state credit, and states’ ability to offer attractive benefit packages to their employees.”²⁹⁵ Additionally, the uniform law should have more extensive disclosure requirements, providing plan participants with information regarding the cost, risk, and expected returns on investments.²⁹⁶ This more extensive disclosure could then also help “reduce the cost of borrowing funds

establishment of federal pension and wage guarantee fund covering both public-sector and private-sector employees). Mendales contemplates a similar PBGC-like insurance scheme in cases of public benefit plan emergencies, *see Mendales, supra* note 24, at 539-43, as does Anenson and her co-authors, *see Anenson, Slabaugh & Lahey, supra* note 68 (manuscript at 52-53).

294. *See supra* text accompanying note 62.

295. *See Mendales, supra* note 24, at 508.

296. *Id.* at 514.

by states and their instrumentalities by giving prospective purchasers of municipal securities improved information on the risks underlying such securities.²⁹⁷ Other public employee-specific provisions could address: (1) the need for greater transparency given that governmental decision making is involved; (2) state budgeting processes and state-specific accounting standards; (3) the lack of Social Security coverage for some public employees; and (4) mandatory retirement ages for police and firefighters.

In all, such a uniform code could provide the necessary funding mechanism for public pension plans, the wherewithal to enforce those funding promises, and disclosures that would keep public employees and municipal investors informed about the financial status of the pension plan. Although some kinks would inevitably need to be worked out, and interest groups assuaged, before implementation of such a uniform public pension law could occur, such legislation would provide an important step forward in avoiding expensive and time-consuming state and local public pension litigation.

CONCLUSION

The purpose of this Article has been to highlight the plight of American public pension plans. The public is demanding significant public pension reform thanks to lax legal regimes that have permitted significant pension underfunding. Pension underfunding exists at all levels of American government and inevitably leads to litigation concerning various pension-reform measures that seek either to require additional employee contributions or to cut back on benefits for retirees. As a result, government officials, employees, and retirees are in the midst of litigating for the future of American public pensions. In the end, society as a whole loses regardless of the outcome of the litigation because either employees and retirees lose hard-earned pension benefits (and, thus, become destitute and must rely on government welfare programs), or states and municipalities, without needed pension cuts, spiral further out of financial control and, perhaps, even into bankruptcy.

The start of a solution lies with harmonizing and standardizing the existing muddle of American public pension law. Although ERISA is far from perfect in regulating private-sector pension plans in the United States, it nevertheless has provided uniform standards

297. *Id.*

for management and administration of occupational retirement plans. In order to replicate that same consistency, this Article proposes a hybrid approach, which seeks to avoid some of the federalism pitfalls of previous public pension-reform proposals. By applying ERISA only to federal pension plans, and by permitting the states to adopt comprehensive uniform public pension legislation, public pension plans can take advantage of a reliable and stringent pension framework that will make future underfunding and fiduciary lapses less likely.

