IN THE CIRCUIT COURT FOR THE SEVENTH JUDICIAL CIRCUIT,
SANGAMON COUNTY, ILLINOIS

IN RE: PENSION REFORM LITIGATION	)	No. 2014 MR 1
	)	Hon. John W. Belz
DORIS HEATON, *et al.*,	)	
Plaintiffs,	)	Originally Filed as
v.	)	Cook County Case
PAT QUINN, Governor of Illinois, *et al.*,	)	No. 2013 CH 28406
Defendants.	)	
RETIRED STATE EMPLOYEES ASS'N RETIREES, *et al.*,	)	
Plaintiffs,	)	Originally Filed as
v.	)	Sangamon County Case
PATRICK QUINN, Governor of Illinois, *et al.*,	)	No. 2014 MR 1
Defendants.	)	
ILLINOIS STATE EMPLOYEES ASS'N, *et al.*,	)	
Plaintiffs,	)	
v.	)	Originally Filed as
BOARD OF TRUSTEES OF STATE EMPLOYEES RETIREMENT SYSTEM OF ILLINOIS, *et al.*,	)	Sangamon County Case
	)	No. 2014 CH 3
Defendants.	)	
GWENDOLYN A. HARRISON, *et al.*,	)	
Plaintiffs,	)	Originally Filed as
v.	)	Sangamon County Case
PATRICK QUINN, Governor of Illinois, *et al.*,	)	No. 2014 CH 48
Defendants.	)	
STATE UNIVERSITIES ANNUITANTS ASS'N, *et al.*,	)	
Plaintiffs,	)	Originally Filed as
v.	)	Champaign County Case
STATE UNIVERSITIES RETIREMENT SYSTEM, *et al.*,	)	No. 2014 MR 207
Defendants.	)	

MEMORANDUM IN SUPPORT OF DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

Introduction and Summary of Argument

The Great Recession caused a severe fiscal crisis for the State and its pension systems. An extraordinary series of adverse events preceded the General Assembly's enactment of Public Act 98–599. The most significant event was the Great Recession, which severely depleted the state pension systems' assets, significantly increased their liabilities, dramatically reduced current and projected state tax revenues, and lowered inflation below the systems' annual cost-of-living adjustments for annuitants. Before the Great Recession, the State was on track to pay down the systems' unfunded liabilities over the next 40 years pursuant to a funding schedule established under the 1994 pension funding law. The Great Recession caused an unanticipated economic crisis of a size and duration not seen since the 1930s, which derailed the State's post-1994 funding plan.

The Great Recession caused a dramatic squeeze on the State's finances from three different directions. First, it caused a drastic and extended decrease in the funds — primarily tax revenue — available to the State. Second, the Great Recession greatly increased the need for critical State-funded services. Third, the Great Recession caused large, unforeseen increases in the systems' unfunded liabilities, triggering an unanticipated and substantial increase in the State's statutorily mandated pension contributions. The larger mandatory pension contributions further shrunk the general revenue funds available for other State spending. In response, the State changed pension benefits for new employees, made deep cuts in its discretionary spending, and increased income taxes while Illinois' economy was still struggling to recover. But, despite those actions, the State still faced the prospect of having to dramatically increase the share of general state revenues it would need to devote to payments to the State-funded retirement systems — from under 6% to almost 25% of general revenues — in order to meet statutory requirements. These events also led to a progressive deterioration in the State's credit rating, resulting in higher financing costs for its debt in the bond market and the loss of billions more in state funds. To respond to the severe financial

impacts of the Great Recession, the State is fully justified in exercising its reserved sovereign powers to enact modest reductions in future benefit increases for system members.

The pension reforms target only the unanticipated underfunding caused by the Great Recession, not historic contribution shortfalls. It is inaccurate to conclude that the systems' current underfunding is attributable entirely to the State's longtime practice of making lower annual contributions than necessary to put them in a fully funded condition. (For many years even before 1970, the State would, for example, contribute half of the amount that would have fully funded the systems.) That practice — which the Supreme Court repeatedly upheld as constitutionally permissible, see *McNamee v. State of Illinois*, 173 Ill. 2d 433, 446 (1996); *People ex rel. Ill. Fed'n of Teachers v. Lindberg*, 60 Ill. 2d 266, 275 (1975) — does account for a major portion of the systems' unfunded liability. Critically, however, Public Act 98-599 (the "Act") does not ask the system members to shoulder the burden of paying for *any* of the systems' unfunded liabilities attributable to those longstanding contribution shortfalls. That burden remains a State obligation imposed on taxpayers. Separately, however, there is a distinct portion of the unfunded liability — in the tens of billions of dollars — that resulted directly from the impacts of the Great Recession. For that unanticipated portion of the underfunding, the Act still requires the State's taxpayers to shoulder most of the burden to pay for that liability. But the Act also justifiably requires the systems' members to assume a portion of that burden — consistent with the plaintiff labor unions' public acknowledgement that the situation called for "truly shared sacrifice" — mostly by receiving modestly lower future *increases* in their benefits. Those reductions covered by the Act represent only a small fraction of the systems' unintended liabilities that resulted from the unexpected impacts of the Great Recession.

The benefit modifications are modest and equitably allocated. Unfortunately, the Act's benefit changes often have been mischaracterized and exaggerated. Under the Act, no retiree's

pension is reduced in absolute terms, much less eliminated. And no person retiring after the Act becomes effective will receive a smaller pension than if that person retired before that time. The Act's principal change is to lower the rate of *future increases* in annuities for most members, primarily by reducing the size of future automatic annual annuity increases (often referred to as "COLAs"). In addition to this modest impact, the changes are equitably allocated. Those members with the smallest pensions will experience no reduction of their benefits. For others, the reductions are proportionately lower for members with smaller pensions and the longest period of public service, as well as for those who are already retired or closest to retirement. At the same time, the Act gives active members a benefit — a reduction in their contributions — which has the greatest value for members furthest from retirement. The Act further benefits all members because it commits the State to achieve 100% funding by 2044 and includes a continuing appropriation and a judicial enforcement mechanism for the State's contributions.

Reductions in future COLAs justifiably address unexpected windfall benefits. Significantly, for most retired members, their future COLAs — even after the future reductions under the Act — will be higher compared to actual inflation than was reasonably expected when those COLAs were enacted a quarter century ago. At the time the legislature changed the COLA to 3% compounded, inflation was well above that level. But inflation has been substantially lower than 3% in recent years and is expected to stay lower in the coming years. The unanticipated result — members receiving 3% compounded COLAs when inflation is less than 3% — has contributed heavily to the systems' liabilities. Thus, the *legislature's response* directly and narrowly targets the primary *cause* of this portion of the systems' underfunding — the unintended and unaffordable windfall generated by the COLAs.

Long-established precedent supports the State's exercise of its police power to make modest, reasonable and necessary modifications in benefits to address the State's fiscal crisis. Under the established principles governing claims under the Contracts Clause and Pension Clause of the Illinois Constitution, the Court must give deference to the General Assembly's determination that the Act was justified, and that determination should be upheld if any substantial impairment of the members' contractual benefits is reasonable and necessary to further an important governmental purpose. See *Sanelli v. Glenview State Bank*, 108 Ill. 2d 1, 19-29 (1985); see also *U.S. Trust Co. of New York v. New Jersey*, 431 U.S. 1, 25 (1977). In similar circumstances, courts have upheld modifications to the government's contractual obligations, including pension obligations. That precedent provides strong support for sustaining the provisions of Public Act 98–599 challenged in this case.

In evaluating Plaintiffs' claims, the Court must determine whether the economic benefits that plaintiffs claim the Act impairs were "'reasonably to be expected from the contract' when it was adopted," excluding "unforeseen and unintended . . . windfall benefits." *U.S. Trust Co.*, 431 U.S. at 31 (quoting *City of El Paso v. Simmons*, 379 U.S. 497, 515 (1965)). In this case, those reasonably expected benefits do not include the unexpected and unintended increase in real purchasing-power the COLAs generated for retirees as a result of inflation declining since the COLAs were last increased in 1989. Thus, even if the Act's reductions in future benefit increases could be considered substantial, the General Assembly validly adopted those reductions based on its findings that the reductions were a necessary and reasonable response to the dire financial circumstances facing the systems and the State.

The limited extent of the Act's reductions in future benefit increases has two significant legal consequences. First, it lowers the standard for finding these changes reasonable and necessary. See *Sanelli*, 108 Ill. 2d at 27; see also *Felt v. Board of Trustees of Judges Ret. Sys.*, 107 Ill. 2d 158, 166

(1985). Second, it supports the conclusion that these reductions were necessary, in the sense that they do not impose a greater sacrifice on system members than required to meet this crisis. The legislature's determination that these benefit changes were necessary is also supported by the many other difficult measures it had already taken to grapple with the fiscal crisis triggered by the Great Recession, including both raising taxes and significantly cutting spending on critical state programs. Thus, the Act does not reflect mere financial expedience, and the legislature did not prioritize other spending categories over pension benefits.

The legislature's conclusion that these benefit changes were reasonable is also valid. While the net effect of the benefit and contribution changes for system members has a present value of about $20 billion, that amount is much less than the unforeseen and unintended amount of the systems' unfunded liabilities. And, because the compounded COLAs have given retirees more purchasing power compared to actual inflation than was reasonably expected when the latest COLA increases were enacted, the net impact of the benefit changes on the members is an even smaller percentage of the unanticipated unfunded liabilities. Finally, the equitable manner in which the General Assembly allocated these benefit changes provides an additional reason to uphold this landmark legislation. The legislature deliberately imposed the least impact (or none at all) on members with the smallest pensions and the longest period of public service, and imposed a reduced impact on members who already retired or are closest to retirement.

Plaintiffs' other claims, including claims that the Act violates the Equal Protection Clause and Takings Clause of the Illinois Constitution, and that it infringes rights based on promissory estoppel principles, are also without merit for the reasons discussed below.[1]

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[1] Defendant, Illinois Comptroller Judy Baar Topinka, is a nominal party to this litigation. While recognizing the authority and representation of the Office of the Attorney General, Comptroller Topinka does not join the arguments in this memorandum of law. Comptroller Topinka will abide by any ruling of this court or by any reviewing court.

Factual Background

The facts relevant to the parties' claims in this case are extensive. To keep this memorandum to a reasonable length, therefore, they are set forth in Defendants' separate Statement of Material Facts, and this memorandum, which includes specific references to that statement ("Facts"), highlights only some of the most significant items, including the following.

History of State's Insufficient Funding of Pension Systems

- For many years, starting before the Pension Clause was included in the 1970 Constitution, the State did not make sufficient annual contributions to the systems to fund them fully (i.e., to have assets that, with expected investment earnings, are enough to pay actuarially estimated benefits for services already provided by active and retired members. These contribution shortfalls were a substantial cause — but not the only cause — of the systems' underfunding levels when Public Act 98–599 was enacted in 2013. Facts, ¶ 90.

History of Changes in Pension Code COLAs

- As inflation substantially increased in the decades starting in the 1960's, the General Assembly added the Pension Code on successive occasions to provide annual cost-of-living adjustments, starting at 1.5% in 1969, then increased to 2% in 1978, to 3% in 1978, and to 3% compounded (based on the prior year's annuity rather than the original annuity) in 1989. Facts, ¶¶ 14, 18, 21. When the last of these increases was enacted, inflation was above 4.5% and expected to continue between 4% and 4.5%. Facts, ¶ 25.

The 1994 Funding Law

- The systems' funding ratio increased from below 40% in the early 1970's to almost 70% in the mid-1980's, but by 1994 was back down to a point where the funding ratio was approximately 55% of the $36 billion needed to pay promised benefits. Facts, ¶ 23.[2] To address this situation in a manageable way, in 1994 the legislature passed a law (the "1994 Funding Law") mandating a 50-year contribution schedule that would bring the systems to a 90% funding level in 2045. Facts, ¶ 24. The 1994 Funding Law included an initial 15-year phase-in period — or "ramp" — during which annual contributions would progressively

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[2] The State and the systems have fiscal years that end on June 30, so for each, references to specific years are to the fiscal year ending at that time (e.g., 2005 means the year ending June 30, 2005).

increase until they reached a level that, measured as a constant percentage of payroll, would pay down all but 10% of the systems' unfunded liabilities by 2045. Facts, ¶ 24.

- When the 1994 Funding Law was enacted, the legislature's official economic forecasting body (now known as the Commission on Government Forecasting and Accountability, or "COGFA") made projections of the State's annual contributions through 2045. Facts, ¶ 25. Those projections for the period following the initial ramp anticipated annual contribution increases mostly in the range of about 4.5% to 5%. Facts, ¶ 25. At that time, COGFA's baseline projection anticipated growth over the next five years in the State's general funds revenue (which include sales and income taxes, its largest sources of state-generated revenue) in a range between 4.0% and 5.7%. Facts, ¶ 26. Six years later, COGFA's baseline projection for annual general funds revenue growth over the next five years was "between 3.5% to 5.6%." Facts, ¶ 26.

- With the exception of temporary adjustments to the 1994 Funding Law's contribution schedule made in the mid-2000's (relating to "pension obligation bonds" authorized in 2003, which resulted in a one-time additional contribution of $7.3 billion to the systems, and reductions in 2006 and 2007 connected to prospective benefit reforms for SURS and TRS), the State has adhered to the 1994 Funding Law schedule. Facts, ¶ 40.

Events in Late 1990's and Early 2000's

- During a generally favorable economic climate, the systems' combined funding ratio in 1997 was above 70%. Facts, ¶ 27. At about the same time, the Systems converted to a fair-market-value method of valuing their assets, and their actuaries reset their actuarial assumptions, including with respect to inflation, investment returns, and member demographic data. Facts, ¶ 28. Over the next several years, the systems' funding ratio continued to rise, reaching about 75% in 2000. Facts, ¶ 32.

- In the decades before the 2001 recession, the State's revenues increased each year. Facts, ¶ 34. They suffered a modest decline in 2002. Facts, ¶ 34. Following the 2001 recession, the systems' assets also declined in value, but they regained their previous value after several years. Facts, ¶ 34.

- In 2005, the General Assembly, with the support of public sector unions, made certain prospective changes to the Pension Code (including the elimination of the "money-purchase" benefit formula for future SURS members) and temporarily lowered the State's contribution

under the 1994 Funding Law. Facts, ¶¶ 39-40.

- In 2006, COGFA updated its funding projections for the 1994 Funding Law and compared them with the original projections made a decade earlier, which, for the period after the ramp, showed roughly equivalent funding ratios and only modestly higher annual contributions. Facts, ¶ 44.

- As of 2007, the funds reached a combined funding ratio of more than 60%. Facts, ¶ 47. A year earlier, the systems projected that the State's 2013 contribution would total $ 3.77 billion — only about 6.6% higher than projected in 1994 (and slightly lower than projected in 2005). Facts, ¶¶ 44-45.

The Great Recession

- As late as mid-2007 the consensus among economists, policymakers, and market participants was that the U.S. economy would continue to experience robust growth. Facts, ¶ 42.

- The Great Recession began in late 2007 and, following a financial crisis that distinguished it from a typical business-cycle recession, worsened dramatically in late 2008. It was more severe and prolonged, and followed by a weaker recovery, than any recession since the Great Depression of the 1930's. Facts, ¶¶ 48-51.

- The Great Recession had profound and lasting effects on the nation's economy, Illinois' economy and finances, and on the systems' assets and liabilities. Facts, ¶¶ 51-55, 68-71. For the country as a whole, the Great Recession:

  - precipitated an 8% decline in real (inflation-adjusted) median household income from 2007 to 2012, to a level that was below any time since 1996 and was effectively unchanged since 1990, 22 years earlier. Facts, ¶ 53.

  - led to substantially lower projections for real economic growth, which the Congressional Budge Office expects to settle at about 2.2% annually over the next 10 years, compared to a previous real growth rate above 3%. Facts, ¶ 52.

  - produced a fundamental and lasting change in the climate for investments, the returns on which are anticipated to be significantly lower than during the decades before the Great Recession. Facts, ¶ 55.

  - caused a significant decline in long-term projections for inflation — which had declined

to an average of about 3% from 1989 to 2007 — to about 2.3 %. Facts, ¶ 55.

- For Illinois' economy and state finances, the Great Recession:

  - caused unemployment in Illinois that was substantially higher than the nation as a whole, that declined more slowly during the recovery, and still lags behind the national rate. Facts, ¶ 56.

  - The loss of revenue associated with the Great Recession was made worse by an increased, unprecedented demand for government services, many of which are mandatory. Facts, ¶ 107. For example, since FY 08, Medicaid eligibility has grown from 2.3 million to 2.95 million (a 28.2% increase), and eligibility for need-based college assistance ("MAP") has increased by over 50%. Facts, ¶ 107. The need for services from FY 2009-FY 2014 for Temporary Assistance for Needy Families ("TANF") has increased 78%. Facts, ¶ 109. During the same period, the need for food stamps is up over 116%. Facts, ¶ 109. The waiting list for services for developmentally disabled individuals has increased. Facts, ¶ 109.

  - Changes in the State's economy following the Great Recession have caused Illinois' tax revenues to decline. Facts, ¶ 103. For the fiscal year ended June 30, 2008, income taxes of $13.4 billion accounted for approximately 45 percent of total revenues in the State's general revenue fund. Facts, ¶ 103. However, income tax revenues declined by nearly 20 percent, to $11.1 billion, over the ensuing two years. Facts, ¶ 103. Total State revenues (excluding Federal stimulus money) from FY08 through FY10 declined more than 20%, from approximately $30.867 billion to $24.518 billion. Facts, ¶ 103.

  - led to substantially lower projections for revenue growth. For example, in March 2013, COGFA projected that over the next decade GRF revenues would grow about 2.3% annually, much lower than in the past (independent of any continuation of the 2011 temporary income tax increase, described below). Facts, ¶ 101.

- For the Systems, the Great Recession:

  - caused a massive depletion of the systems' assets, which lost more than 25% of their value over the two-year period from 2007 to 2010, as well as a large decline in their funding ratios, which over the same period declined from about 63% to 38.5% and, even four years later, had risen only to 41%. Facts, ¶ 61, 71. From 1997 to 2013, the systems'

unfunded liabilities increased by more than 760%, from about $13 billion to about $99 billion. Facts, ¶ 60.

- led the systems' actuaries to significantly lower their assumed rates of future returns on investments and their assumed rate of future inflation. Facts, ¶ 76-77.

- In light of the stresses on the State's revenues and spending needs, in 2010 and 2011 the State covered its $7.2 billion in contributions due under the 1994 Funding Law by issuing public bonds (referred to as the "pension obligation notes"), rather than using current revenues. Facts, ¶ 111.

- The severe decline in the systems' asset values, along with the decreases in their assumed rates of future return on investments, had the effect of substantially increasing their unfunded liabilities. Facts, ¶ 85-89. This also led to sharp increases in the amounts the State was required to contribute to the systems under the 1994 Funding Law. For example, in 2006 the systems projected that the State's contributions in 2013 would total $3.8 billion. Facts, ¶ 96. In fact, the actual contributions for 2013 totaled $5.7 billion, an increase of 50%, or almost $2 billion. Facts, ¶ 96. Much of this increase in contributions under the 1994 Funding Law occurred after the General Assembly had enacted the temporary tax increase, and it had the effect of preventing the State from being able to use of many of the additional revenues for other purposes, including fully paying down the State's backlog of unpaid bills and providing funds for public education and other services. Facts, ¶ 125-126.

- Unexpected changes in the life expectancy of System members also increased the systems' liabilities by billions of dollars. Facts, ¶ 81-84.

Net Effect on the Systems of the Great Recession and other Unanticipated Events

- In 2013, the value of the systems' assets was reduced by $26 billion (increasing their unfunded liability by that amount) due to unexpected and unanticipated events, principally as a result of the Great Recession. Facts, ¶ 72.

- In 2013, the systems' liabilities (and unfunded liabilities) were $17 billion higher due to unexpected and unanticipated reductions in the systems' assumed rate of return on investments, principally as a result of the Great Recession. Facts, 78-79.

- In 2013, the systems' liabilities were $9 billion higher, and their unfunded liability was higher by that amount, due to unexpected and unanticipated increases in the members' life

expectancy that were not previously factored into liability calculations by the systems. Facts, ¶ 84.

- In addition, approximately $21 billion of the systems' unfunded liability corresponds to the extent to which the 3% compounded COLAs have, through 2013, exceeded the purchasing-power protection expected by those COLAs when they were enacted. Facts, ¶ 127. Another $15 billion of the systems' liabilities represent the difference in future years between those COLAs and that expected degree of purchasing-power protection. Facts, ¶ 127.

State's Responses to Great Recession

- In response to the fiscal difficulties brought by the Great Recession, the State undertook a variety of measures. These measures, which would have been even more severe if not for more than $8 billion in additional funds provided by the federal government in 2009 through 2011, Facts, ¶ 124, included:

  - enacting a separate program of less generous pension benefits for persons who became system members after 2010 (identified as "Tier II" members), Facts, ¶¶ 139-141;

  - significantly reducing public spending on other programs, including Medicaid, health insurance benefits for current and retired state employees, and other social services for Illinois residents, Facts, ¶¶ 142-156;

    ◊ The SMART Act, reforming the State's Medicaid program, (P.A. 097-0689), cut provider rates by 2.7% across the board with certain exceptions. Facts, ¶ 147.

    ◊ The state has eliminated or reduced funding for Fast Growth Grants, homeless education, High Priority School Intervention, Reading Improvement Block Grant, security for schools, and the School Breakfast Incentive Program. Facts, ¶ 148.

    ◊ From 2001 to 2013, the percentage of grants made to eligible applicants for need-based college tuition under the Monetary Award Program ("MAP") program declined by about half, from 70.5% to only 37.4%. Facts, ¶¶ 150.

    ◊ Large funding cuts have been implemented to the Division of Alcohol and Substance Abuse (18%), Division of Mental Health (29%), the Department of Public Health (grants reduced 73%), and the Department of Child and Family Services (6%), among other Illinois agencies and programs. Facts, ¶ 151.

- ◊ The number of state police officers declined by about 20% over the last decade. Facts, ¶ 219. Generally, Illinois' state employee headcount has decreased significantly since 2002. Over the last 12 years, the number of state employees has dropped 27.5%, from 81,680 in 2002 to 59,254 in 2014 (based on the number of active members of the State Employees Retirement System). Facts, ¶ 155.

- ◊ State has closed several juvenile detention facilities as a cost-saving measure. The most recent facility closures include Joliet Youth Center and Murphysboro Youth Center in early 2013. Facts, ¶ 153.

- eliminating many educational programs. Facts, ¶ 148-150.

- adopting a significant, temporary increase in income taxes through 2014, even though unemployment was still unusually high and household incomes were substantially below where they were before the Great Recession. Facts, ¶¶ 100, 104.

- deferring billions of dollars in payments owed to state vendors and other creditors, resulting in a backlog of more than $9 billion in unpaid bills in 2010 (compared to about $320 million in 2000), and in 2013 it remained at $7 billion. Facts, ¶ 143.

Effect of Pension Crisis on State's Credit Rating and Financing Costs

- Following the Great Recession, the credit rating agencies that publish ratings for bonds issued by the State focused substantially more negative attention on the systems' financial condition. Citing these concerns, they repeatedly downgraded Illinois' bonds, and the rate of interest it had to pay above the benchmark rate for public bonds — referred to as the "spread" — increased significantly in comparison to other governments. The spread on Illinois bonds reached about 150 basis points in late 2013 and then dropped by about one-fifth, to 116 basis points, after Public Act 98–599 was passed. This spread has already required the State to incur hundreds of millions in additional interest cost on bonds it has already issued. Facts, ¶¶ 115-120.

Effect of Pension Crisis on State's General Revenues

- In 1994, the Systems' actuaries projected contributions for the next 25 years (starting in 2014) under the 1994 Funding Law. These projected contributions are in the range of 10-17% of current projected general revenues (assuming the temporary tax increases remain permanent). Facts, ¶ 97. In 2006, the Systems' actuaries updated their projected contri-

butions under the 1994 Funding Law. Facts, ¶ 97. These projected contributions are in the range of 13-17% of current projected general revenue. Facts, ¶ 97. The Systems' 2013 projected contributions under the 1994 Funding Law are in the range of 23-27% even if the temporary tax rate that began in 2011 was made permanent — and are projected to be about 27% of general revenues if this tax increase expired. Facts, ¶ ¶ 94, 97. This represented billions of dollars each year in additional, unexpected contributions.

Evaluation of Pension Reform Options

- In light of the extraordinary difficulties facing the systems and the State, the Governor and the General Assembly began examining ways to respond to the situation.

- The General Assembly looked at a variety of options to establish the long-term soundness of the systems and maintain a schedule of contributions that avoided a massive cut to state spending on other essential programs. Facts, ¶ 158. These options included ones that:

  - increased active member contributions, Facts, ¶ 158;

  - reduced state subsidies for retiree health care coverage and gave members a choice to forego certain pension benefits, including full COLA increases, in exchange for a guarantee of future inclusion in a program of health care benefits for retirees. Facts, ¶ 162.

  The systems' actuaries analyzed the anticipated effects of these proposals, as well as variations and combinations of them, and concluded that most of these proposals would not have a substantial effect on the systems' liabilities and the State's contributions necessary to eliminate their unfunded liabilities. Facts, ¶¶ 159-166. These analyses demonstrated that because the 3% compounded annual COLA is such a significant driver of the systems' total liabilities, the only realistic way to reduce those liabilities to a level at which the State's contributions necessary to achieve a fully funded status would avoid devoting a much larger share of general revenues than anticipated just a few years earlier required making prospective changes in the COLA formula that lessened the rate of future increases. Facts, ¶ 162.

Public Act 98–599

- Public Act 98–599 was passed with bipartisan support in both houses of the General Assembly in November 2013 and signed into law by Governor Quinn in December 2013.

Facts, ¶ 167.

- The Act includes the following legislative findings:

> "Illinois has both atypically large debts and structural budgetary imbalances that will, unless addressed by the General Assembly, lead to even greater and rapidly growing debts and deficits. Already, Illinois has the lowest credit rating of any state, and it faces the prospect of future credit downgrades that will further increase the high cost of borrowing.
>
> "The State has taken significant action to address these fiscal troubles, including, but not limited to, increasing the income tax and reducing pension benefits for future employees. Further, the State has enacted a series of budgets over the last several fiscal years that resulted in deep cuts to important discretionary programs that are essential to the people of Illinois.
>
> . . .
>
> "[W]ithout significant pension reform, the unfunded liability and the State's pension contribution will continue to grow, and further burden the fiscal stability of both the State and its retirement systems.
>
> "Having considered other alternatives that would not involve changes to the retirement systems, the General Assembly has determined that the fiscal problems facing the State and its retirement systems cannot be solved without making some changes to the structure of the retirement systems. As a result, this amendatory Act requires more fiscal responsibility of the State, while minimizing the impact on current and retired State employees." Facts, ¶¶ 168-170.

- Under the Act, no retiree's pension is reduced in absolute terms. No member retiring after the Act became effective will receive a lower pension than if the member retired before that time. And members with the lowest pensions will experience no lessening of their benefits. Facts, ¶ 173.

- Public Act 98–599 contains the following key changes to the benefit formulas:

  - prospective reductions in future increases in annual annuity adjustments, or COLAs, and in the frequency of such increases, subject to criteria designed to produce the

least impact on (1) members with the lowest salaries, (2) members who put in the most years of public service, and (3) members who retired before July 1, 2014. Specifically, for most system members, the new COLA rate equals $30 for each year of service (e.g., $ 750 for 25 years of service), adjusted annually by the consumer price index. For active members only (not current retirees), the law requires up to five non-consecutive years without a COLA based on how close they are to retirement age (with members closer to retirement skipping fewer COLAs). (Specifically, members over age 49 miss just one COLA, and members under age 44 have five skip years.) Facts, ¶¶ 171-172.

- Increases in the retirement age at which active members below age 46 are entitled to retire and receive a pension. Those increases, in four-month increments up to a maximum of five years, are the smallest for the systems' oldest active members and are progressively greater for younger active members. Facts, ¶¶ 171-172.

- The pension modifications provided in the Act also include a cap on the pensionable salary of active members with a salary presently above about $110,600, and a change in the method for determining the "effective rate of interest" used to calculate pensions for members under the money-purchase formula for SURS members. Facts, ¶¶ 171-172.

- The cumulative effect of these reductions in future benefit increases is proportionately lower for those with the lowest pensions and longest period of public service, as well as for those who already retired or are closest to retirement.

- The Act also reduces active members' payroll contributions by 1%. Facts, ¶ 171.

- The Act commits the State to a funding schedule, subject to continuing appropriations, necessary to achieve 100% funding by 2044, and it includes a judicial enforcement mechanism for those required contributions. Facts, ¶ 171.

Economic Effects of the Act's Benefit Changes

- The present value of the net benefit and contribution changes for members provided by the Act (including the reduction in future benefit increases and lower member contributions) is about $20 billion. Facts, ¶ 175. This represents less than one-fifth of the systems' unfunded actuarial liability in 2013, according to their actuaries. Facts, ¶ 60.

- That $20 billion is much less than the $43 billion in unforeseen and unintended increases in the systems' unfunded liability that was realized after the Great Recession and is attributable to historically unprecedented declines in asset values and expected future investment returns. Facts, ¶ 80.

- That $20 billion is also substantially less than the $36 billion share of the systems' unfunded liability that corresponds to the extent to which the 3% compounded COLAs exceed the reasonable purchasing-power expectations of those COLAs when they were enacted in 1989. Facts, ¶ 138.

- Under the Act, paying for these portions of the systems' unintended and unforeseen unfunded liabilities in excess of that $20 billion in net benefit reductions to members, as well as the rest of the systems' unfunded liabilities (including the unfunded liabilities attributable to historic contribution shortfalls by the State), continues to be the exclusive responsibility of taxpayers, not the members. The Act's schedule of required State contributions to achieve 100% funding by 2044 does not require any benefit reductions for members to eliminate those parts of the systems' prior liabilities.

- For a large majority of system members, the reductions in future benefit increases roughly approximate, or are even less than, the extent to which their COLAs exceed the actual purchasing-power protection reasonably expected from those annual increases when they were enacted 25 years ago. Facts, ¶ ¶ 220-226. For the other members, that increase above the purchasing-power protection reasonably expected from the COLAs when they were enacted greatly mitigates the economic effect of the Act's reduction in future benefit increases. Facts, ¶ ¶ 220-226.

- At the same time, active members benefit from reduced employee contribution levels, and that benefit has the greatest value for members furthest from retirement. Facts, ¶ 171.

Consequences If the Act Is Declared Invalid

- If the benefit changes in the Act are declared invalid, the State and its citizens would suffer significant adverse consequences. In particular,

  - If the savings under the Act were replaced by higher taxes, the anticipated annual cost to the State would be an additional $1.3 billion, on top of the billions in contributions required each year to pay off the rest of the systems' unfunded liabilities, none of which

provides current services to Illinois residents. Facts, ¶¶ 178, 188.

- Such tax increases would economically disadvantage Illinois and worsen its competitive position compared to surrounding States, leading to an estimated negative 1.1% impact on business activity in Illinois, equivalent to about 64,000 jobs (and about 38,000 jobs using more conservative economic estimates). Facts, ¶¶ 185, 192.

- If, in the alternative, the savings under the Act were replaced by other spending cuts, they would most likely fall on the categories of discretionary — education, health care, and human services — that provide critical resources and support for the neediest and most vulnerable persons in the State. Facts, ¶ 214.

- A major potential candidate for such cuts is support for public education, which in recent years has already seen substantial declines in real, per-student support. For support to students in kindergarten through high school, the least affluent school districts depend the most on state educational support, and such cuts would have the greatest adverse effect on the least privileged students. Facts, ¶¶ 148-150, 216.

- If Public Act 98–599 is declared invalid, the State also can expect to pay an additional $1.6 billion in interest over the lifetime of the bonds it is expected to issue over the next five years, in addition to the $1 billion in extra interest cost attributable to the State's pension problems that it is already committed to pay over the lifetime of the bonds issued in the last five years. Facts, ¶ 120.

Argument

For the following reasons, the Court should enter summary judgment in Defendants' favor on all claims in this case.

I. Standards Governing Summary Judgment

"Summary judgment is proper if, when viewed in the light most favorable to the nonmoving party, the pleadings, depositions, admissions, and affidavits on file demonstrate that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Peck v. Froehlich*, 367 Ill. App. 3d 225, 227-28 (4th Dist. 2006). A party seeking to avoid summary judgment for a claim on which it bears the burden of proof must present a factual basis that

would justify judgment in its favor on that claim. *Billman v. Frenzel Constr. Co.*, 262 Ill. App. 3d 681, 686-87 (1st Dist. 1993). Thus, "[s]ummary judgment in favor of a defendant is proper when a plaintiff has not established an essential element of a cause of action." *Rogers v. Clark Equip. Co.*, 318 Ill. App. 3d 1128, 1131-32 (2d Dist. 2001).

II. Principles Relevant to Constitutional Challenges to a Statute

All legislative enactments enjoy a "strong presumption of constitutionality," and courts must resolve all reasonable doubts in favor of a statute's constitutionality. *People v. Dabbs*, 239 Ill. 2d 277, 291 (2010). Accordingly, "[t]he party challenging the statute . . . bears the burden of rebutting the presumption by clearly demonstrating the statute's constitutional infirmity." *In re Marriage of Miller*, 227 Ill. 2d 185, 195 (2007) (internal quotation marks and citations omitted); *Napleton v. Vill. of Hinsdale*, 229 Ill. 2d 296, 306 (2008). As explained below, that principle applies to claims that an impairment of contractual obligations is not a valid exercise of the State's police powers.

III. Public Act 98–599 Constitutes a Valid Exercise of the General Assembly's Reserved Sovereign Power to Modify Contractual Obligations and Therefore Does Not Violate the Pension Clause or Contracts Clause of the Illinois Constitution.

Defendants agree that pension benefits specified in the Pension Code are not just statutory rights that the legislature may change at will. Instead, such benefits are part of a constitutionally protected "contractual relationship" grounded in the Pension Clause that the General Assembly may not simply change as it sees fit. Nonetheless, the State's reserved sovereign powers, often referred to as its "police powers," permit it to modify those protected contractual rights in limited circumstances, notwithstanding the Pension Clause and Contracts Clause of the Illinois Constitution. *Felt*, 107 Ill. 2d at 166; *Sanelli*, 108 Ill. 2d at 23-24. As described below, the General Assembly properly determined that Public Act 98–599 falls within that limited range of circumstances, and for that reason the Court should enter summary judgment against Plaintiffs on their Pension Clause and Contracts Clause challenges to the Act.

A. **Reserved Sovereign Powers Limits on the Contracts Clause and Pension Clause.**

A State's reserved sovereign power constitutes "an essential attribute of its sovereignty." *U.S. Trust Co.*, 431 U.S. at 23. That sovereign power affects the State's authority regarding contractual obligations in two principal ways. *First*, it prohibits a State from even making certain types of contracts or commitments. See *U.S. Trust Co.*, 431 U.S. at 23-24 & nn.20-21 (describing contracts that are invalid "*ab initio*" as an infringement of State's police powers); *West River Bridge Co. v. Dix*, 47 U.S. 507 (1848) (holding contract invalid to extent it prohibited State from exercising power of eminent domain). *Second*, in certain circumstances, it permits the State to affect or modify contractual obligations, including its own contractual obligations, notwithstanding constitutional restraints on laws impairing the obligation of contracts. *U.S. Trust Co.*, 431 U.S. at 25-26; *Felt*, 107 Ill. 2d at 166. The second aspect of the police powers doctrine is the one relevant here.

The Contracts Clause of the Illinois Constitution states: "No . . . law impairing the obligation of contracts . . . shall be passed." Ill. Const. art. I, § 16. It provides the same protection as its counterpart in the U.S. Constitution, U.S. Const. art. I, § 5, which prohibits States from passing any law "impairing the Obligation of Contracts." See *Dowd & Dowd Ltd. v. Gleason*, 181 Ill. 2d 460, 482 (1998); *George D. Hardin, Inc. v. Village of Mount Prospect*, 99 Ill. 2d 96, 103 (1983). That same degree of protection applies to contractual rights covered by the Pension Clause, which provides: "Membership in any pension or retirement system of the State . . . shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired." Ill. Const. art. XIII, § 5; see *Felt*, 107 Ill. 2d at 166; see also *Buddell v. State Univ. Ret. Sys.*, 118 Ill. 2d 99, 102 (1987).[3] For purposes of this motion, therefore, Defendants treat the Contracts Clause and Pension

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[3] As explained more fully in Defendants' response to Plaintiffs' motions for judgment as a matter of law, the Pension Clause changed the pre-1970 legal status of public pensions, under which most pension systems were held not to give rise to contractual rights, by making membership in all public pension systems a "contractual relationship." See *Buddell*, 118 Ill. 2d at 102.

Clause of the Illinois Constitution as providing the same degree of protection as the Contracts Clause of the U.S. Constitution. See *People ex rel. Sklodowski v. State of Illinois*, 162 Ill. 2d 117, 147 (1994) (Freeman, J., concurring in part and dissenting in part) ("The protection against impairment of State pension benefits is co-extensive with the protection afforded all contracts under article I, section 16, of the constitution.").

"Although the Contract Clause appears literally to proscribe 'any' impairment, . . . 'the prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula.'" *U.S. Trust Co.*, 431 U.S. at 21 (quoting *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 428 (1934)). Thus, "the contract clause does not immunize contractual obligations from every conceivable kind of impairment or from the effect of a reasonable exercise by the States of their police power." *George D. Hardin, Inc.*, 99 Ill. 2d at 103; see also *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 241 (1978) ("it is to be accepted as a commonplace that the Contract Clause does not operate to obliterate the police power of the States"); *Meegan v. Village of Tinley Park*, 52 Ill. 2d 354, 357-58 (1972) ("rights granted by contracts . . . are subject to the reasonable and legitimate exercise of the police power by the State").

B. Standards Governing Exercise of Police Powers Affecting Contract Rights.

1. Threshold Requirement of Substantial Impairment.

When a party alleges an unconstitutional impairment of a contractual obligation, the initial inquiry is "whether the change in state law has 'operated as a *substantial* impairment of a contractual relationship.'" *General Motors Corp. v. Romein*, 503 U.S. 181, 186 (1992) (emphasis added) (quoting *Spannaus*, 438 U.S. at 241); see also *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411 (1983) (citation and internal quotation marks omitted); *Baltimore Teachers Union*, 6 F.3d at 1015; *Sanelli*, 108 Ill. 2d at 21; *Dowd & Dowd Ltd.*, 181 Ill. 2d at 482 (holding that change in law invalidating noncompetition covenants in employment agreements did not rise to level

of "a substantial impairment of the parties' contracts"). That inquiry depends on "whether there is a contractual relationship, whether a change in law impairs that contractual relationship, and whether the impairment is substantial." *General Motors Corp.*, 503 U.S. at 186. Defendants do not dispute the first two criteria because the Act's provisions prospectively change the level of pension benefits for some Tier I members. An impairment is not substantial, however, when it limits a party to the economic benefits "'reasonably to be expected from the contract' when it was adopted," excluding "unforeseen and unintended . . . windfall benefits." *U.S. Trust Co.*, 431 U.S. at 31 (quoting *City of El Paso*, 379 U.S. at 515); see also *Energy Reserves Group, Inc.*, 459 U.S. at 411; *City of El Paso*, 379 U.S. at 515 ("Laws which restrict a party to those gains reasonably to be expected from the contract are not subject to attack under the Contract Clause . . . .").

2. Validity of Substantial Contract Impairments that Are Reasonable and Necessary to Promote an Important Public Purpose.

Even when a law effects a substantial impairment, it represents a valid exercise of the State's police powers "if it is reasonable and necessary to serve an important public purpose." *U.S. Trust Co.*, 431 U.S. at 25; see also *Baltimore Teachers Union*, 6 F.3d at 1015. That is true for both private contracts and contracts with the State itself. *U.S. Trust Co.*, 431 U.S. at 22-24; see also *id.* at 25 ("The Contract Clause is not an absolute bar to subsequent modification of a State's own financial obligations."); *Meegan*, 52 Ill. 2d at 357-58; *Sanelli*, 108 Ill. 2d at 23-24. The Court must consider the severity of the impairment: the less severe the impairment, the more readily the Court should uphold the State's action. *Felt*, 107 Ill. 2d at 166 ("The severity of the impairment measures the height of the hurdle the state legislation must clear.") (quoting *Spannaus*, 438 U.S. at 245); see also *Sanelli*, 108 Ill. 2d at 21.

3. Deference to Legislative Judgment, and Burden of Proof.

Impairments of private and public contracts, respectively, correspond to different levels of

deference to the legislature's decision to enact the challenged law. See *Sanelli*, 108 Ill. 2d at 27. "[C]ourts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure." *U.S. Trust Co.*, 431 U.S. at 22-23. When a law impairs the State's own financial obligations, though, "*complete deference* to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake." *U.S. Trust Co.*, 431 U.S. at 25-26 (emphasis added). "[L]ess deference does not imply *no* deference," however. *Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362, 370 (2d Cir. 2006); see also *Sanelli*, 108 Ill. 2d at 27 (explaining that in *U.S. Trust Co.*, "[s]ince the State's self-interest was at stake, the Supreme Court gave *less deference* than normal to the legislature's assessment of the reasonableness and necessity of the repealing legislation") (emphasis added). Thus, even where the State has impaired its own obligations, courts should not "reexamine all the factors underlying the legislation at issue and . . . make a *de novo* determination whether another alternative would have constituted a better statutory solution to a given problem." *Buffalo Teachers Fed'n*, 464 F.3d at 370-71; accord, *Local Div. 589, Amalgamated Transit Union v. Com. of Mass.*, 666 F.2d 618, 642 (1st Cir. 1981) (Breyer, J.) "Not only are [courts] ill-equipped even to consider the evidence that would be relevant to such conflicting policy alternatives; [they] have no objective standards against which to assess the merit of the multitude of alternatives." *Baltimore Teachers Union*, 6 F.3d at 1022; see also *Maryland State Teachers Ass'n, Inc. v. Hughes*, 594 F. Supp. 1353, 1361 (D. Md. 1984) (stating that a court does not "sit as a super legislature, making its own totally independent assessment of reasonableness and necessity").

Because a party challenging the constitutionality of a statute bears the burden of establishing its invalidity, Plaintiffs here have the ultimate burden of proving that the Act does not represent a constitutional exercise of the State's police powers — i.e., that it was not reasonable and necessary to advance an important public purpose. *United Auto., Aerospace, Agric. Implement Workers of*

America Int'l Union v. Fortuno, 633 F.3d 37, 42-45 (1st Cir. 2011); *Catawba Indian Tribe v. City of Rock Hill*, 501 F.3d 368, 371 (4th Cir. 2007) ("[A] claimant must show" that a challenged statute is "not a legitimate exercise of state power."); *Buffalo Teachers Fed'n*, 464 F.3d at 365; see also *Council 31, AFSCME, Council 31 v. Quinn*, 680 F.3d 875, 885 n.4 (7th Cir. 2012).

a. Important Public Purpose

An important public purpose includes remedying a "general social or economic problem rather than providing a benefit to special interests." *Buffalo Teachers Fed'n*, 464 F.3d at 368 (citation and internal quotation marks omitted). "One legitimate state interest is the elimination of unforeseen windfall profits." *Energy Reserves Group, Inc.*, 459 U.S. at 412. "[T]he public purpose need not be addressed to an emergency or temporary situation." *Id.*, 459 U.S. at 412; see also *U.S. Trust Co.*, 431 U.S. at 22. N.19. Nor is a valid public purpose "limited to health, morals, and safety. It extends to economic needs as well.'" *Sanelli*, 108 Ill. 2d at 23 (quoting *Veix v. Sixth Ward Bldg. & Loan Ass'n*, 310 U.S. 32, 38-39 (1940)). Thus, "[e]nsuring the financial integrity of the [government] is a significant public purpose." *Baltimore Teachers Union*, 6 F.3d at 1019; see *Buffalo Teachers Fed'n*, 464 F.3d at 369 ("[T]he legislative interest in addressing a fiscal emergency is a legitimate public interest."). That is also true for measures designed to assure the "actuarial soundness" of a pension plan for public employees. *Maryland State Teachers Ass'n*, 594 F. Supp. at 1368.

b. Necessity of Police Power Exercise

Whether a measure is necessary depends on both the degree of the impairment and how it compares with alternatives not adopted. *U.S. Trust Co.*, 431 U.S. at 29; *Buffalo Teachers Fed'n*, 464 F.3d at 371; *Maryland State Teachers Ass'n*, 594 F. Supp. at 1371. Limited modifications of contractual obligations are more likely to be found necessary to achieve a valid purpose than complete abrogation or "total repeal" of the obligations. *U.S. Trust Co.*, 431 U.S. at 29-30; see also

Dowd & Dowd Ltd., 181 Ill. 2d at 482. That a modification is mostly prospective also supports a finding that the modification is necessary. See, e.g., *Exxon Corp. v. Eagerton*, 462 U.S. 176, 194 (1983); *Local Div. 589*, 666 F.2d at 639, 643; *Maryland State Teachers Ass'n*, 594 F. Supp. at 1360-61; cf. *Buffalo Teachers Fed'n*, 464 F.3d at 371-72 (holding that law's prospective aspect supports finding of reasonableness).

When a challenged law affects a public contract, it must be evaluated in light of other options not adopted. A State's reserved sovereign power does not permit it to "consider impairing the obligations of its own contracts on a par with other policy alternatives." *U.S. Trust Co.*, 431 U.S. at 30; see also *Buffalo Teachers Fed'n*, 464 F.3d at 372. This does not mean, however, that an impairment is unnecessary if some other alternative, no matter how unattractive, could have been adopted. Thus, for example, in *Buffalo Teachers Federation*, in the context of a fiscal crisis, plaintiffs contended that the law impairing their contract rights by imposing a wage freeze "was unnecessary because other alternatives existed," in that "taxes could have been raised or other programs and services could have been eliminated or burdened." 464 F.3d at 372. Disagreeing, the court stated: "[I]t is always the case that to meet a fiscal emergency taxes conceivably may be raised. It cannot be the case, however, that a legislature's *only* response to a fiscal emergency is to raise taxes." *Id.* (emphasis in original). The court added that, in light of the deference owed to the legislative judgment, it would not "second-guess the wisdom of picking the wage freeze over other policy alternatives, especially those that appear more Draconian, such as further layoffs or elimination of essential services." *Id.* The court in *Baltimore Teachers Union* similarly held:

> It is not enough to reason . . . that the [State] *could have* shifted the burden from another governmental program or that it *could have* raised taxes. Were these the proper criteria, no impairment of a governmental contract could ever survive constitutional scrutiny, for these courses are always open, no matter how unwise they may be.

6 F.3d at 1019-20 (emphasis in original). Thus, a State may not "impose a drastic impairment when an evident and more moderate course would serve its purposes equally well." *U.S. Trust Co.*, 431 U.S. at 30.

c. Reasonableness of Police Power Exercise

The reasonableness of a law reducing a State's own contractual commitments depends on: (1) the "extent of impairment," including whether the impairment affects "gains reasonably to be expected from the contract when it was adopted" or "eliminat[es] unforeseen windfall benefits," *U.S. Trust Co.*, 431 U.S. at 27, 31 & n.30; see also *Baltimore Teachers Union*, 6 F.3d at 1017-18; (2) whether the events prompting the law were "unforeseen and unintended," *U.S. Trust Co.*, 431 U.S. at 31; see also *City of El Paso*, 379 U.S. at 515; *Maryland State Teachers Ass'n*, 594 F. Supp. at 1362; (3) whether the impairment "was reasonable in light of the surrounding circumstances," *U.S. Trust Co.*, 431 U.S. at 31; (4) whether the challenged law targets the specific problems prompting its passage, *Felt*, 107 Ill. 2d at 166; see also *Maryland State Teachers Ass'n*, 594 F. Supp. at 1366-70; and (5) whether the burden of the impairment is fairly allocated among affected parties, *Maryland State Teachers Ass'n*, 594 F. Supp. at 1358, 1371; see also *U.S. Trust Co.*, 431 U.S. at 25. Given the deference owed to legislative judgments, the relevant circumstances for the Court to consider are those that existed and were reasonably known to the legislature when it acted. *Maryland State Teachers Ass'n*, 594 F. Supp. at 1369-70. Moreover, that the State was aware of *some* fiscal difficulties when it entered into a contractual obligation does not mean the State should have been aware of *all* such difficulties, however large and foreseen, automatically rendering a change in contractual obligations unreasonable. *Baltimore Teachers Union*, 6 F.3d 1012 at n.13.

C. Public Act 98–599 Constitutes a Valid Exercise of the State's Police Powers.

Since the Pension Code was changed in 1989 to provide 3% compounded annual COLAs, inflation has significantly declined. As a result, the Act's prospective reductions in future benefits

largely bring those benefits back in line with the reasonable economic expectations justified by the COLA increases in 1989. (See below at 33.) Given that the Act's prospective changes bring the COLA benefits back in line with reasonable economic expectations, it is questionable whether the changes are "substantial." Even assuming those reductions are substantial, however, the extraordinary series of adverse events leading up to passage of the Act — including the dramatic depletion of the systems' assets and increase in their liabilities, as well as the State's severe fiscal crisis, triggered by the Great Recession — fully justify the General Assembly's determination that the Act was reasonable and necessary to further an important public purpose.

1. Relevant Case Law

In several cases addressing similar situations, courts have upheld impairments of public contract obligations where they were necessary and reasonable to further an important public purpose. That case law — including *Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362 (2d Cir. 2006); *Baltimore Teachers Union v. Mayor & City Council of Baltimore*, 6 F.3d 1012 (4th Cir. 1993); and *Maryland State Teachers Ass'n, Inc. v. Hughes*, 594 F. Supp. 1353 (D. Md. 1984) — is directly relevant here. There are, of course, other cases in which the government, defending against a claim that it violated the constitutional protection of contract obligations, invoked its police powers without a meaningful basis for doing so, and the courts found the relevant facts to be insufficient as a matter of law to justify the impairment. See, e.g., *Felt*, 107 Ill. 2d at 166; *Faulkenbury v. Teachers' & State Employees' Ret. Sys. of N.C.*, 483 S.E.2d 422, 427 (N.C. 1997). Each case turns on its specific facts. But the General Assembly's express findings in Public Act 98–599, and the extensive factual basis for those findings, make the Act most comparable to the laws upheld in *Buffalo Teachers Federation*, *Baltimore Teachers Union*, and *Maryland State Teachers Association*.

a. *Baltimore Teachers Union*

In *Baltimore Teachers Union v. Mayor and City Council of Baltimore*, 6 F.3d 1012 (4th Cir.

1993), the City of Baltimore lost a significant portion of its expected revenue when the State of Maryland unexpectedly cut its financial support. *Id.* at 1014. Following an initial reduction, the City responded "with a variety of measures, such as layoffs, elimination of positions, and early retirements," only to have the State announce a second major reduction two months later. *Id.* Having already taken less drastic steps to meet its obligations, Baltimore reduced its employees' annual salaries, contrary to the terms of their labor contracts. *Id.* at 1020. Under those circumstances, the Fourth Circuit held that the City's reduction of its own contractual obligations was "'reasonable and necessary to serve an important public purpose.'" *Id.* at 1018-19 (quoting *U.S. Trust Co.*, 431 U.S. at 25).

In reaching this conclusion, the court held that "ensuring the financial integrity of the City is a significant public purpose," and that "*some* degree of deference is appropriate even where a state acts to impair its own contracts." *Id.* at 1019 & n.10 (emphasis in original). It concluded, therefore, that "[i]t is not enough to reason . . . that the City *could have* shifted the burden from another governmental program or that it *could have* raised taxes. Were these the proper criteria, no impairment of a governmental contract could ever survive constitutional scrutiny, for these courses are always open, no matter how unwise they be." *Id.* at 1019-20 (emphasis in original). Instead, because Baltimore did not "'consider impairing the obligations of [its] contracts on a par with other policy alternatives' or 'impose a drastic impairment when an evident and more moderate course would serve its purposes equally well,' . . . nor act unreasonably 'in light of the surrounding circumstances,'" the modification represented a valid exercise of the City's reserved sovereign powers. *Id.* at 1020 (quoting *U.S. Trust Co.*, 431 U.S. at 30-31). The court also emphasized that the City did not resort to pay modifications until it had taken other steps and "concluded that it had no better alternative," and that the plan's "careful tailoring" was designed to respond to the size of the deficit. *Id.* at 1020-21.

b. ***Buffalo Teachers Federation***

In *Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362 (2d Cir. 2006), the New York State Assembly, following several years of steadily rising deficits in the City of Buffalo's budget, created an oversight board authorized to monitor, approve, and, where necessary, modify the City's financial arrangements. *Id.* at 366. At that point, the City "had already laid off 800 teachers and 250 assistant teachers over a four year period," and the board promptly ordered the City to "institute a hiring freeze," "exclude . . . wage increases that were not contractually required," and "approve[] a tax increase." *Id.* Even with all those steps, the City still had not meaningfully reduced its deficits. *Id.* The board then imposed a freeze on wage increases, which "effectively prohibited members of the plaintiff unions from enjoying a two percent wage increase that the unions had negotiated as part of their labor contracts with the city." *Id.* at 366-67. Rejecting a claim that this violated the constitutional protection of contracts, the Second Circuit held that the wage freeze was "reasonable and necessary." *Id.* at 372-73.

The Second Circuit noted, in particular, the deference owed to the board, cautioning that proper deference prevented courts from acting as superlegislatures, overturning laws when they 'believed the legislature acted unwisely.'" *Id.* at 371 (quoting *Ferguson v. Skrupa*, 372 U.S. 726, 730 (1963)). Applying the standard articulated in *U.S. Trust*, the court held that the impairment was valid because, among other things, "the board imposed the freeze only after other alternatives had been considered and tried." *Id.* The court also rejected the unions' claim that "the wage freeze was unnecessary because . . . taxes could have been raised or other programs and services could have been eliminated or burdened," explaining that "it is always the case that to meet a fiscal emergency taxes conceivably may be raised" but that "[i]t cannot be the case . . . that a legislature's *only* response to a fiscal emergency is to raise taxes." *Id.* at 372.

c. *Maryland State Teachers Ass'n*

In *Maryland State Teachers Association v. Hughes*, 594 F. Supp. 1353, 1370 (D. Md. 1984), the Maryland legislature received evidence that the state retirement systems faced great fiscal stress, much of which "can be attributed to the COLA." *Id.* at 1366. Specifically, the legislature determined that higher than expected inflation and an actuarial error related to the cost of the statutory COLA combined to "'cause[] the contract to have a substantially different impact in [1984] than when it was adopted in [1979].'" *Id.* at 1366, 1370 (quoting *U.S. Trust Co.*, 431 U.S. at 32). The rising cost of pension funding led a bond rating agency to "express[] serious concern regarding Maryland's financial position." *Id.* at 1369. In response, the legislature imposed a cap on the size of the COLA that was contributing to Maryland's financial problems. The Court held that this new statute was a necessary modification of the State's contractual obligations where it could not "conclude that an evident and more moderate course was available to the legislature." *Id.* at 1371. Noting that the plaintiffs had attempted to identify alternative means of addressing the rising costs of COLAs, the court found that they had not met their burden of proving that their proposed alternatives would achieve the legislature's aims through a means that would be "less drastic." *Id.* The court accordingly "defer[red] to the legislative judgment that there existed no alternative means of accomplishing the legislature's goal," explaining that it could not "outguess the legislature in this area" as it did "not have resources to do so nor . . . could it do so without overstepping the proper bounds of its power." *Id.*

Evaluated under the relevant legal standards, as illustrated by these cases, Public Act 98–599 falls well within the range of deference properly extended to legislative determinations in this area.

2. The Act Serves an Important Public Purpose.

The Act undoubtedly serves an important public purpose. It does so first by placing the systems back on a sound financial footing, with an enforceable commitment to achieve 100%

funding by 2044. Second, it enables the State to meet its citizens' critical needs in extremely difficult fiscal conditions without imposing a higher tax burden that could cost Illinois jobs and erode Illinois' competitive position relative to other States.

When it passed Public Act 98–599, the General Assembly stated that the Act promoted the critical goal of restoring "financial stability for the State and its pension systems." Courts have consistently sustained such goals as a valid basis to exercise police powers regarding public contracts. In *Baltimore Teachers Union*, 6 F.3d at 1019, the Fourth Circuit affirmed that ensuring the government's "financial integrity . . . is a significant public purpose." And in *Buffalo Teachers Federation*, 464 F.3d at 369, the Second Circuit likewise held that "the legislative interest in addressing a fiscal emergency is a legitimate public interest." The same is true for measures designed to assure the "actuarial soundness" of a pension plan for public employees. See *Maryland State Teachers Ass'n*, 594 F. Supp. at 1368. Avoiding "windfall" benefits is also recognized as a "legitimate state interest." *Energy Reserves Group, Inc.*, 459 U.S. at 412. Those important interests are all present here.

The legislature passed the Act in response to extreme events that severely stressed the systems' financial condition and the State's ability to provide critical services to the neediest and poorest citizens. Making matters worse, the systems' problems compounded the State's challenges. The unanticipated surge in the systems' unfunded liabilities significantly increased the States' annual contributions mandated under the 1994 Funding Law (which, starting in 2010, had to be made on a constant level-percentage-of-payroll basis through 2045, Facts, ¶ 24) just as the State's deteriorating finances — decreasing revenues and increased demand for services — made it even more difficult to make the previously anticipated level of contributions to the systems. And the rating agencies' increased focus on the systems' financial troubles contributed to successive downgrades in the State's credit rating, thereby increasing the State's borrowing costs and further

reducing the share of revenues it could devote to funding social services. See *Maryland State Teachers Ass'n*, 594 F. Supp. at 1369 ("the financial soundness of a state's pension system is directly related to the bond rating"). The Act responded to all of these concerns.

That the State is itself a party to the obligations affected by its actions does not prevent the State from legally taking steps to further an important purpose. Otherwise, such State actions would always be unconstitutional. As the U.S. Supreme Court explained in *U.S. Trust Co.*,

> The Contract Clause is not an absolute bar to subsequent modification of a State's own financial obligations. As with laws impairing the obligations of private contracts, an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose.

431 U.S. at 25. All of those elements — necessity, reasonableness, and an important public purpose — are present in this case.

3. The General Assembly Properly Concluded that the Act Was a Necessary Response to the Financial Crisis Affecting the Systems' and the State.

The extraordinary conditions the General Assembly was facing support its determination that the Act was a necessary response to those conditions.

a. The Act imposed only moderate reductions in future benefit increases.

That the Act made only limited reductions in future benefits also supports the conclusion that the Act is constitutional. Those reductions are relatively modest, especially when considered in light of the enormity of the problem that had to be addressed. No pension is reduced below what it was before the Act took effect, much less eliminated. Many pensions will experience no future reductions. And, in the aggregate, the net value of all reductions in future benefit increases is less than one-eighth of the systems' total liabilities.

In addition, the future COLA reductions still leave most retirees with as much or more purchasing power compared to inflation than what was reasonably expected when the COLA rate

was last increased. That is because of the significant decline in inflation — below 2% in recent years and projected to remain below 2.5% in future years — while under the pre-Act law the COLAs would continue at a 3% compounded rate. Thus, the modest scale of the modifications supports the conclusion that those modifications are necessary. And, that the modifications are modest also lessens the level of scrutiny in applying the relevant constitutional standard. See *Sanelli*, 108 Ill. 2d at 21; *Felt*, 107 Ill. 2d at 166.

b. The General Assembly Adopted Many Difficult Measures Before Enacting Public Act 98–599.

The long list of difficult steps the State previously took to deal with the systems' declining financial condition and the State's fiscal crisis caused by the Great Recession further establishes that the Act's benefit changes were necessary. It cannot reasonably be said that the State put its pension obligations "on a par" with other objectives. See *U.S. Trust Co.*, 431 U.S. at 30. Nor is there any basis to dispute the legitimacy of the General Assembly's conclusion that, under the circumstances, there were no *better* alternatives — i.e., that a legislative response to the post-recession crisis that included no impairment at all, or an appreciably smaller one, would not "serve its purposes *equally* well." *U.S. Trust Co.*, 431 U.S. at 31 (emphasis added); see also *Baltimore Teachers Union*, 6 F.3d at 1020 (upholding contractual impairment pursuant to police powers where extensive budget cuts imposed before adoption of reductions in contractual salary levels revealed an "obvious reluctance to resort to the plan" and justified the public body's "conclu[sion] that it had no *better* alternative") (emphasis added).

Having originally agreed that the State's fiscal crisis warranted "truly shared sacrifice," Plaintiffs now insist that, no matter how much hardship Illinois' other citizens face, the State cannot cut benefits, but must instead raise taxes or cut other spending, or both. However, raising taxes, while always theoretically possible, is not always constitutionally required. See *Buffalo Teachers*

Fed'n, 464 F.3d at 372; *Baltimore Teachers Union*, 6 F.3d at 1019-20.

Nor can the legislature be faulted for having chosen not to impose even more severe austerity measures after already taking action in recent years to greatly reduce the resources for critical public services — including for human services, public health and safety — despite the increased needs triggered by the Great Recession. The consequences of making even deeper cuts to these programs would be draconian. Thus, especially given the deference the legislature is owed, the Court should conclude that the General Assembly's determination in this regard is constitutionally acceptable.

4. The Act Is Reasonable In Light of the Relevant Circumstances.

The facts also validate the legislative determination that the Act's pension modifications are reasonable. The impairment is by no means excessive, particularly considering the severity of the difficulties facing the systems and the State. The scale of the impairment is also reasonable considering the size of the systems' underfunding attributable to unforeseen circumstances, and the fact that the pre-Act COLAs generated unintended economic benefits to members substantially greater than were reasonably expected. The Act's benefit changes are also manifestly reasonable in light of the other circumstances, including the huge, unexpected increase in the share of general revenues the State would have to devote to making pension contributions instead of funding critical programs and services. The benefit changes are carefully targeted to address the specific problems that generated the unanticipated increase in unfunded liabilities, including, in particular, the COLAs that give retirees far more purchasing power compared to actual inflation than was originally expected. And the reductions in future benefit increases are fairly and equitably allocated to minimize the impact on members with the smallest pensions, and who had already retired or were closest to retirement.

a. Any impairment is moderate

As described above, despite the extraordinary financial pressures on the systems and the State following the Great Recession, the Act makes limited reductions in future benefit increases. That the reductions are limited supports the General Assembly's determination that the Act is reasonable. For many members, there will be no reductions. For a substantial majority of the others, the value of those reductions (which are quite small in earlier years) represents only a single-digit lessening, below 10%, of the projected value of their total lifetime benefits.

And even that decrease is, for almost all of these members, effectively still less because of the significant decline in inflation since the 3% compounded COLA was adopted in 1989. Because of the historic inflation rate leading up to 1989 (averaging 5.5% between 1980 and 1989) and the projected rate after 1989 (between 4% and 5%) (Facts, ¶¶ 20, 55), the clear expectation at the time the legislature acted in 1989 was that the 3% compounded COLA would fall short of keeping up with inflation by 1% to 1.5%. As a result, the expectation was that the real (i.e., inflation-adjusted) value of pension benefits would decrease by between 1% and 1.5% per year. The legislature did not intend, and the members could not reasonably have expected, that a 3% compounded COLA would even match, much less exceed, actual inflation. Yet, because inflation has averaged 2.7% since 1989, that is what has happened for many retirees. These circumstances not only support the legislature's finding that the Act is reasonable, but also lower the "'height of the hurdle'" the Act must clear generally. See *Felt*, 107 Ill. 2d at 166 (quoting *Spannaus*, 438 U.S. at 245).

b. The Act was passed in response to unforeseen and unintended events.

The reasonableness of the Act is further supported by the unforeseen and unintended nature of the events triggering the crisis for the systems and the State. When considering an impairment of contractual obligations, some courts do not consider the unforeseen and unintended nature of events prompting the impairment to be an essential criterion to sustain that impairment as a valid

exercise of police powers. See *Baltimore Teachers Union*, 6 F.3d at 1019-21 (upholding government action impairing its own contractual obligations without specifically finding that events prompting that action were unforeseen). Even if that is a necessary factor, however, it is clearly established here.

Defendants do not dispute that a large portion of the systems' unfunded liabilities are a result of the State's historical practice — predating even 1970, when the systems' funded ratio was below 50% (Facts, ¶ 15) — of not making contributions at a level that would have fully funded them. But that is not the *sole* cause of these unfunded liabilities. And even Plaintiffs do not contend that the historical practice is the sole cause of the unfunded liabilities. To the contrary, other unforeseen and unintended events, many connected to the consequences of the Great Recession, added tens of billions of dollars to the systems' unfunded liabilities. Those events, such as investment losses, depleted the systems' assets by more than 31% over a two-year period. They also simultaneously increased the systems' actuarial liabilities because the systems needed to lower their assumptions as to future returns on their investment. And, those events lowered future inflation assumptions to the point that the COLAs would not only exceed the originally expected level of purchasing-power protection, but also materially exceed actual inflation. The enormity of these unforeseen events cannot be overemphasized.

After the General Assembly made a responsible long-term commitment in the 1994 Funding Law to bring the systems to a 90% funding level by 2045, the Great Recession shifted the ground on which that commitment was made, and on which its fulfillment was realistically possible. The share of state revenues that would need to be devoted to making pension contributions jumped dramatically, while the same economic crisis also dried up state revenues and greatly increased other needs, including for public education, human services, health, and safety. In light of those events, no one can reasonably dispute the legitimacy of the General Assembly's determination that the Act

was a reasonable response.

Plaintiffs apparently contend that because *much* of the systems' underfunding resulted from the State's failure for years to make larger contributions, *none* of the total underfunding can be considered the result of unforeseen events, thereby supporting an exercise of the State's police powers. Their joint answer to Defendants' affirmative matter alleges:

> [T]he State has long chosen not to adequately fund the State retirement systems. In fact, at the time of the 1970 Constitutional Convention, the [TRS, SERS and SURS] were reportedly funded at levels of 40%, 43% and 47%, respectively. . . . The *majority* of the unfunded liability upon which defendants seek to justify their unlawful conduct is attributable to the State's *knowing and by design* underfunding of its pension systems, which started well before 2000.

(Joint Answer to Aff. Matter, par. 2, emphasis added.) As an initial matter, these allegations concede that *not all* of the systems' unfunded liabilities result from historic contribution shortfalls. Beyond that, the allegations are factually incomplete and inaccurate. They fail to recognize the separate, and significant, cause of the underfunding resulting from unintended and unforeseen events, including those related to the Great Recession. They also fail to recognize the State's historic commitment in the 1994 Funding Law to achieve 90% funding for the systems, which was essentially on track until it was derailed by the Great Recession. In fact, the systems's funded ratios were above 70% in the late 1990s, and above 60% in the mid-2000s. (Facts, ¶¶ 27, 47.) In any event, the fact that some of the systems' underfunding can be attributed to decisions by the General Assembly does not make every dollar of underfunding foreseen, regardless of the cause.

c. The Act was reasonable in light of the relevant circumstances.

Taken as a whole, the circumstances surrounding enactment of Public Act 98–599 confirm that it was reasonable. The crisis in the aftermath of the Great Recession was real, not a pretext for granting a politically expedient benefit to special interests. Even the labor unions representing

members of the systems agreed that the situation called for "truly shared sacrifice." The Act's benefit changes are intended to address only a portion of the underfunding caused by the Great Recession, not the larger underfunding caused by the historic decisions of the General Assembly. As a result, the benefit changes are reasonably limited to the level necessary to make a meaningful contribution, along with the State's share, to the solution. They also are prospective in effect, reducing only future benefit increases. And they are equitably designed to minimize the impact on public servants with the lowest salaries, the longest service, and the greatest age when the Act took effect.

d. The Act targets the specific problems prompting its passage.

The factors supporting a finding that the Act is reasonable include the manner in which its provisions are specifically tailored to address the problems that had to be addressed and that motivated the Act's passage. A major problem was that benefit levels were unexpectedly growing faster compared to actual inflation than was expected when the COLAs were last increased in 1989. The Act focuses directly on this key driver of the systems' unfunded liabilities. Indeed, the many studies of various reform options prepared for the General Assembly showed that without this type of reform, any savings would be inadequate to address the magnitude of the underfunding. For similar reasons, the court in *Maryland State Teachers Association* upheld the law challenged in that case, emphasizing that it was constitutionally justified in light of the unanticipated effects of the earlier-enacted COLA provision.

> [T]he legislature responded to the problem it perceived as threatening to the systems and it moved to enhance the actuarial soundness of the pension systems when it passed the 1984 amendment offering the four option menu plan. That piece of legislation directly addressed the problems perceived to be caused by the unlimited COLA.

594 F. Supp. at 1369. Similar observations apply here.

The Illinois Supreme Court's decision in *Felt* offers a useful comparison. There, the State sought to justify a change in the formula for calculating judicial pensions (basing them on a member's salary during the last year of service instead of the last day of service) by arguing that the change was necessary to prevent judges from retiring immediately after receiving a statutory salary increase. 107 Ill. 2d at 166. The Court found this argument unconvincing, stating:

> It appears that the legislature enacted the amendment from concerns that the Judicial Retirement System was not adequately funded. The result contemplated by the legislature was that judges would be discouraged from retiring upon obtaining salary increases without having contributed to the pension fund on the basis of the increased salary. . . . There is no indication in the record before us, however, that a significant number of judges, or the plaintiffs themselves, retired shortly after salary increases *or that such retirements are a cause of the retirement system's underfunding*.

Id. (emphasis added). Here, by contrast, the COLA formula, which has unexpectedly increased in real terms as inflation substantially declined, is a major cause of the systems' underfunding. And there is a close nexus between the *cause* of the system underfunding — the unintended economic benefit generated by the COLAs — and the *statutory response*, which provides a closely targeted fix for that specific problem.

The General Assembly also faced the need to reestablish a viable schedule to put the systems on a financially sound footing. The Act directly addresses this concern, too, increasing the systems' funding level from 90% to 100% by 2044. Indeed, that funding commitment is strengthened by the Act's provisions, which include the State's contributions in a continuing appropriation and establish a mechanism for judicial enforcement. Thus, both the benefit and funding aspects of the Act are reasonable because they specifically target their provisions to the problems requiring legislative action.

e. The Act equitably distributed its burdens among affected persons.

Finally, the Act's reasonableness is confirmed by the manner in which it allocates the reductions in future benefit increases among affected individuals. As explained above, members with the smallest pensions experience no reductions compared to prior law. For other members, the reductions are minimized for current retirees and persons close to retirement, members with the lowest salaries, and members with the longest public service. Given the need to include meaningful benefit reductions, that allocation fairly and equitably responds to legitimate concerns about the effects of such reductions on those least able to absorb them. At the same time, members furthest from retirement obtain the greatest benefit from the ongoing reduction in their payroll contributions.

4. Any Impairment Is Not Necessarily Substantial.

While the Court need not decide the issue in order to grant Defendants' motion for summary judgment, the record also supports the conclusion that the Act's reductions in future benefit increases, taken as a whole, are not constitutionally "substantial." The present value of those reductions is about $23 billion (and only $20 billion after accounting for the reduction in active member contributions). (Facts, ¶ 177.) That amount is substantially *less* than the portion of the systems' liabilities that are attributable to the fact that the COLAs enacted in 1989 generated benefits beyond what was reasonably expected when they were adopted. As explained above, when the COLAs were last increased in 1989 to a 3% compounded rate, actual and anticipated inflation were well above that level. Thus, a 3% compounded COLA was intended to protect against, not match or exceed, inflation that was higher than 3%. But inflation has been much lower than 3% and is expected to stay lower — at about 2.3% — in coming years. (Facts, ¶ 55.)

In *U.S. Trust Co.*, the Court held that contractual benefits that are not reasonably expected — sometimes referred to as "windfall" benefits — are not within the constitutional protection for contractual obligations. 431 U.S. at 31 & n.30 (discussing *City of El Paso*, 379 U.S. at 515); see also

Energy Reserves Group, Inc., 459 U.S. at 411 (stating that a law that "restricts a party to gains it reasonably expected from the contract does not necessarily constitute a substantial impairment."). That characterization applies here, where retirees have received the unexpected benefit of having a 3% compounded COLA during an extended period of sub-3% inflation. For this reason as well, the Act constitutes a valid exercise of the State's police powers.

* * *

In sum, the facts relevant to an evaluation of the constitutionality of Public Act 98–599, viewed in light of the deference owed to the General Assembly's determinations that the Act was a necessary and reasonable response to the fiscal crisis it addressed, establish as a matter of law that the Act constitutes a legitimate exercise of the State's reserved sovereign power. Therefore, the Act does not violate the Pension Clause or the Contracts Clause of the Illinois Constitution. Accordingly, Defendants are entitled to summary judgment on Plaintiffs' claims that Public Act 98–599 violates the Pension Clause and Contracts Clause of the Illinois Constitution.

IV. Public Act 98-599 Does Not Violate the Equal Protection Clause.

Plaintiffs in the Retired State Employees Association action, Sangamon County Case No. 2014 MR 1 ("*RSEA*"), and the Illinois State Employees Association Retirees action, Sangamon County Case No. 2014 CH 3 ("*ISEAR*") also allege that Public Act 98–599 violates the Equal Protection Clause in Article I, Section 2 of the Illinois Constitution because the Act amends four of the state pension systems without making corresponding changes to the fifth state pension system, the Judges' Retirement System of Illinois ("JRS"). This claim fails as a matter of law. "Equal protection guarantees that similarly situated individuals will be treated in a similar fashion, unless the government can demonstrate an appropriate reason to treat them differently." *People v. Whitfield*, 228 Ill. 2d 502, 517 (2007). As Plaintiffs concede (see Pls. Mem. Supporting Mot. Summ. J. at 5 (Sangamon County Case Nos. 2014-MR-1 and 2014-CH-3 June 25, 2014) (hereinafter "Mem.

Supporting Mot. Summ. J."), when equal protection challenges are made to economic-oriented legislation such as Public Act 98–599, the rational basis test applies to any classification drawn by the legislation. *McLean v. Dep't of Revenue*, 184 Ill. 2d 341, 354 (1998). Under that test, Plaintiffs bear the burden of proving that Public Act 98–599 is an arbitrary and irrational enactment. *Weipert v. Ill. Dep't of Prof. Reg.*, 337 Ill. App. 3d 282, 289 (4th Dist. 2003). No less daunting for Plaintiffs, however, is "the threshold requirement for [their] equal protection claim," which requires them to prove that they are "similarly situated" to members of JRS. *Whitfield*, 228 Ill. 2d at 512. Plaintiffs cannot sustain either burden.

For numerous reasons — including unique separation of powers concerns applicable only to members of the State Judiciary — judges are unlike other public employees. Moreover, even if there were no material difference between judges and all other public servants, Plaintiffs still cannot show that the limited reach of Public Act 98–599 is an arbitrary means of achieving the legislature's otherwise legitimate objectives.

A. The ISEAR and RSEA Plaintiffs Are Not Similarly Situated to Members of JRS.

At the outset, Plaintiffs cannot show that they are "similarly situated" to the sitting and former judges who are members of JRS. The Illinois Supreme Court has repeatedly made clear that "[t]he equal protection clauses of our constitution and the United States Constitution do not prohibit the establishment of legislative classifications; nor do they require that all persons be treated uniformly." *Friedman & Rochester, Ltd. v. Walsh*, 67 Ill. 2d 413, 418 (1977); see also *Committee for Educ. Rights v. Edgar*, 174 Ill. 2d 1, 32 (1996) (government may distinguish between classes so long as doing so is not "wholly unrelated to the purpose of the legislation"). The presence of some similarities is not enough. Plaintiffs must establish that they are similarly situated to members of JRS "in all relevant aspects." *In re Derrico G.*, 2014 IL 114463, ¶ 94. Plaintiffs fall short of meeting that standard.

Given their varying duties, public employees are not all similarly situated to one another, including with respect to their pension rights. Indeed, the Pension Code is filled with an array of provisions applicable to some public servants but not others, including provisions establishing varying retirement ages, vesting requirements, interest rates, and annuity calculations — even within the same retirement system. For that very reason, the Appellate Court, in *DiSabato v. Board of Trustees of State Employees Retirement System*, 285 Ill. App. 3d 827 (1st Dist. 1996), rejected a claim brought by a group of Secretary of State investigators asserting that the method of calculating their pension benefits as members of SERS violated the Equal Protection Clause because it differed from the method used to calculate benefits for state police officers, who also were members of SERS and had similar work responsibilities. The court held that the two sets of employees were not similarly situated, stating: "[T]he Pension Code classifies numerous types of State employees, granting varying pension benefits rights to them, despite the fact that many of their employment responsibilities may overlap. It is not for this court to 'second-guess' the legislature's wisdom in this regard." *Id.* at 834 (citing *Heller v. Doe*, 509 U.S. 312, 321 (1993)); see also *Friedman*, 67 Ill. 2d at 421-22 (rejecting equal protection claim based on "the fact that one of 18 funds created by the Pension Code is not exempt from garnishment and similar proceedings," when the others were exempt); *Wright v. Chicago Mun. Employees Credit Union*, 265 Ill. App. 3d 1110, 1118 (1st Dist. 1994) (holding that law allowing certain public employees but not others to assign refunds from pension fund did not violate equal protection). If Plaintiffs' equal protection theory is correct, *DiSabato* is wrongly decided and every distinction drawn between the retirement benefits provided to different types of employees is constitutionally suspect. That position is untenable.

Plaintiffs' claim is faulty for an additional reason. As members of a coordinate branch of government, judges are uniquely situated, not least due to distinctive legal constraints placed on the General Assembly with respect to judicial compensation. Thus, fundamental separation of powers

principles distinguish the legal issues surrounding alterations to the pensions provided to JRS members from the ones surrounding the modifications provided for by Public Act 98–599. In *Jorgensen v. Blagojevich*, 211 Ill. 2d 286 (2004), the Supreme Court invoked these same principles to hold that reductions in judicial cost of living increases are impermissible. *Id.* at 299 (quoting *O'Donoghue v. United States*, 289 U.S. 516, 530 (1933)). Striking down changes to the formula used to calculate judicial annuities in *Bardens v. Board of Trustees of Judges Retirement System*, 22 Ill. 2d 56, 62 (1961), the Court similarly observed that these amendments by the legislature came "perilously close" to intruding upon the constitutional qualifications for judicial service. By contrast, applying pension reform to teachers, university employees, other state employees, and legislators themselves, raises no similar separation of powers issue.

Plaintiffs cannot show that they are "similarly situated" to member of JRS "in all relevant respects," *Derrico G.*, ¶ 94, and without that showing their "equal protection claim must fail," *People v. Guyton*, 2014 IL App. (1st) 110450, ¶ 68. Plaintiffs do not perform the same duties and functions as judges, their compensation is not subject to the same legal restrictions, and changes in their retirement benefits are not subject to the same legal standards. Accordingly, the Court should enter summary judgment against Plaintiffs on their equal protection claim.

B. There Are Rational Reasons To Exclude JRS From Public Act 98–599.

Plaintiffs also cannot show that the distinction drawn by Public Act 98–599 is an irrational one. Under rational-basis scrutiny, "a statutory classification will not be declared unconstitutional 'if any state of facts reasonably may be conceived to justify it.'" *Friedman*, 67 Ill. 2d at 419 (quoting *Dandridge v. Williams*, 397 U.S. 471, 485 (1970)). That means that Plaintiffs have "the burden of demonstrating that [Public Act 98–599] is unreasonable and arbitrary." *Id.*

The scope of Public Act 98–599 is neither unreasonable nor arbitrary. While the Act seeks "to save state funds and solidify the pension systems," the legislature made clear in the Act's

preamble that it enacted pension reform in order to address the larger fiscal crisis facing the State as manifested by a $100 billion unfunded pension liability, "rapidly growing debts and deficits," and "the lowest credit rating of any State" in the country. Pub. Act 98–599, § 1. Plaintiffs cannot plausibly claim that including or excluding judges from Public Act 98–599 has any meaningful impact on the State's $100 billion unfunded pension liability, the State's debts and deficits, or the State's credit rating. As Plaintiffs acknowledge, JRS has just 725 retirees — less than 0.4% of all retirees. See Mem. Supporting Mot. Summ. J. at 7. Moreover, it is common knowledge that virtually all of the five state-funded systems' unfunded liability comes from the three largest pension systems: TRS, SERS, and SURS. (Def. Appendix, Ex. 1, Terry Report at 73, Table E-5). The legislature thus had no need or duty to include JRS in the Act to meaningfully address the acute financial problems facing the State. This critical distinction between the impact of reforming JRS and its far larger counterparts is sufficient to justify Public Act 98–599's scope.

In response, Plaintiffs appear to argue that it was irrational for the General Assembly to apply to the Act to their own members, and their own small retirement system, while exempting JRS. Mem. Supporting Mot. Summ. J. at 7-8. But the General Assembly's decision to impose on themselves, as elected legislators, the same sacrifice they imposed on other current and former public employees did not compel them to take the same steps with respect to members of the judiciary, as a coordinate branch of government. Plaintiffs thus fall short of proving that the legislature acted irrationally.

The authorities Plaintiffs rely upon in their cross-motion for summary judgment do nothing to undermine this analysis. For example, in *Jahn v. Troy Fire Protection District*, 255 Ill. App. 3d 933, 940 (3d Dist. 1994), aff'd, 163 Ill. 2d 275 (1994), the court ruled that there was no rational basis to set a willful and wanton standard of liability for *municipal* firefighters and a lower standard of liability for firefighters employed by *fire protection districts*. Nothing in the court's analysis could

be read to suggest that the General Assembly acts arbitrarily in a case like this one, where there are meaningful, substantive distinctions between the groups treated differently by the Act. Similarly, while the Supreme Court in *Maddux v. Blagojevich*, 233 Ill. 2d 508, 525-26 (2009), held that statutory age limits on judicial service violated equal protection, it did so because it was irrational for the General Assembly to apply those limits based on a distinction between persons who were constitutionally eligible to be judges and *were serving* as judges, and those who met the same qualifications but were *not serving* as a judge or had *never served* as a judge. Finally, *Bailey v. People*, 190 Ill. 28, 33-34 (1901), is entirely inapposite, for it addressed due process, not equal protection. In short, none of these cases has any bearing on the equal protection claim asserted here.[4]

* * *

In sum, Plaintiffs cannot meet their burden of proving that the legislature's decision not to address judicial pensions in Public Act 98–599 was either unreasonable or arbitrary. Members of the judiciary are not similarly situated to every other state employee, if for no other reason than the unique separation of powers implications of altering their compensation. *Jorgensen*, 211 Ill. 2d at 299. The *de minimis* impact of retired judges on the State's fiscal crisis further justifies the exclusion of judges from Public Act 98–599 and none of the authorities Plaintiffs invoke are to the contrary. Plaintiffs' equal protection claim therefore fails, and Defendants are entitled to summary judgment on that claim.

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[4] Plaintiffs are wrong, in any event, to assume that if their equal protection claim has merit, the remedy must be to invalidate the Act, as they demand. "[W]hen the right invoked is that of equal treatment, the appropriate remedy is a mandate of equal treatment, a result that can be accomplished by withdrawal of benefits from the favored class as well as by extension of benefits to the excluded class." *Heckler v. Matthews*, 465 U.S. 728, 740 (1984) (citation and internal quotation marks omitted). Thus, even if the Court were to find an equal protection violation in this case, the appropriate remedy could just as well be to apply the Act's provisions to JRS participants, rather than to strike down the entire Act. But the meaningful differences between judges and other public workers make that remedial question unnecessary to decide in this case.

V. Plaintiffs' Promissory Estoppel Claims Fail Both as a Matter of Law and on the Merits.

The *RSEA* and *ISEAR* plaintiffs assert claims on behalf of three individual plaintiffs (Hajek, Richter, and Mundstock) based on a common law theory of promissory estoppel. Specifically, these plaintiffs allege that certain "promises" were made that encouraged them to accept early retirement, but that those promises no longer hold true under Public Act 98–599, including a promise that the 3% automatic increase would continue through their retirements indefinitely. Plaintiffs' promissory estoppel claim should be rejected for multiple reasons.

First, the doctrine of promissory estoppel is an affirmative cause of action available to plaintiffs only in the absence of a contract. *Newton Tractor Sales, Inc. v. Kubota Tractor Corp.*, 233 Ill. 2d 46, 52 (2009). Although "a party may plead claims for breach of contract and promissory estoppel in the alternative," *Prentice v. UDC Advisory Servs., Inc.*, 271 Ill. App. 3d 505, 512 (1st Dist. 1995), "promissory estoppel is unavailable when an enforceable contract between the parties exists," *Olson v. Hunters Point Homes, LLC*, 2012 IL App (5th) 100506, ¶ 13. Thus, because the Pension Clause establishes a contractual status for Plaintiffs' retirement benefits (a proposition Defendants acknowledge), Plaintiffs cannot proceed under a promissory estoppel theory. See *Wagner Excello Foods, Inc. v. Fearn Int'l, Inc.*, 235 Ill. App. 3d 224, 237 (1st Dist. 1992) (stating that promissory estoppel is not intended "to give a party to a negotiated commercial bargain a second bite at the apple in the event it fails to prove breach of contract"); see also *All-Tech Telecom, Inc. v. Amway Corp.*, 174 F.3d 862, 869-70 (7th Cir. 1999); *Song v. PIL, LLC*, 640 F. Supp. 2d 1011, 1016 (N.D. Ill. 2009) (applying Illinois law).

Second, if Plaintiffs' claims to early retirement benefits were not part of their contractual relationship with the State protected by the Pension Clause, those claims are still subject to the State's police powers. "A promise enforced by estoppel, like a contract, contains an implied condition that the terms are subject to modification under the state's police power." *Christensen v.*

Minneapolis Mun. Employees Ret. Bd., 331 N.W.2d 740, 749-50 (Minn. 1983). It cannot be the case that promises recognized in a traditional contract are subject to modification pursuant to the State's police powers, while promises recognized only through promissory estoppel — a "quasi-contractual doctrine" — are not. If, therefore, Defendants prevail on their police powers defense, that defense also defeats any viable promissory estoppel claims.[5]

Third, apart from the State's police powers defense, the doctrine of sovereign immunity defeats Plaintiffs' promissory estoppel claim. The 1970 Constitution eliminated sovereign immunity as a constitutional principle but authorized the General Assembly to reestablish it by statute, which the General Assembly did by passing the State Lawsuit Immunity Act. See Ill. Const. art. XIII, § 4; 745 ILCS 5/1 (2012); *Senn Park Nursing Center v. Miller*, 104 Ill. 2d 169, 186-87 (1984). Under the Immunity Act, Illinois courts lack jurisdiction over actions seeking to require the payment of money by the State or to control the exercise of the State's power. *Currie v. Lao*, 148 Ill. 2d 151, 158 (1992). Accordingly, to the extent Plaintiffs have alleged a common law promissory estoppel claim regarding benefits beyond the scope of their contractual relationship with the State (which by definition is not a constitutional claim under the Pension Clause or the Contracts Clause), their action seeks to control the actions of the State itself by requiring it to honor alleged promises. In this circumstance, sovereign immunity bars Plaintiffs from any relief based on promissory estoppel.[6]

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[5] A right established only through promissory estoppel, rather than a traditional contract, is not protected by the Contracts Clause. *Anders v. Nicholson*, 150 So. 639, 642 (Fla. 1933); *Medina v. Board of Ret., L.A. Cty. Emps. Ret. Ass'n.*, 5 Cal. Rptr. 3d 634, 640 (Cal. App. 2003); see also *Crane v. Hahlo*, 258 U.S. 142, 146 (1922).

[6] Even though the nominal defendants in these suits include individual public officials, they are all sued in their official capacities, and these claims are therefore ones against the State for purposes of the Immunity Act. See *Hudgens*, 75 Ill. 2d at 355-56; see also *State Bldg. Venture v. O'Donnell*, 239 Ill. 2d 151, 161-65 (2010).

Finally, Plaintiffs' promissory estoppel theory fails as a matter to law to satisfy any of the traditional elements of such a claim. To prevail, Plaintiffs must identify and prove both an "unambiguous promise" and reliance on that promise that was "reasonable and justifiable." *Quake Const., Inc. v. American Airlines, Inc.*, 141 Ill. 2d 281, 309-10 (1990). In addition, they must overcome the rule that "ordinary . . . principles of . . . estoppel do not apply to public bodies under usual circumstances, . . . particularly . . . when the governmental unit is the State." *Hickey v. Illinois Cent. Ry. Co.*, 35 Ill. 2d 427, 447 (1966). For the equitable doctrine of promissory estoppel to be applied against the government, the person making the representation must possess *actual authority* to bind the government to the relevant commitment. *Patrick Eng'g, Inc. v. City of Naperville*, 2012 IL 113148, ¶¶ 35-36. Plaintiffs fail at each step.

Plaintiffs cannot show that they justifiably relied on any promise made by a person with authority to bind the State. Plaintiffs point to legislation passed in 2002 that amended the eligibility requirement for early retirement incentives, but that legislation did not say anything about the 3% COLA, and hence did not unambiguously promise the continuation of any particular COLA. See 40 ILCS 5/14-108.3 (2012). Plaintiffs identify a website as the source of the alleged promises (*ISEAR* Complaint, Exhibit A; *RSEA* Complaint, Exhibit D), but that website contained only generalized descriptions of the Early Retirement Program as opposed to anything that could be read to make a specific, binding promise. And reliance on representations made on a website lacking authority to bind the government is *per se* unreasonable. *Burnidge Bros. Almora Heights, Inc. v. Wiese*, 142 Ill. App. 3d 486, 495-96 (2d Dist. 1986). In short, Plaintiffs' promissory estoppel claims fail as a matter of law and on the merits, and Defendants are entitled to summary judgment on those claims.

VI. Public Act 98–599 Does Not Violate The Takings Clause Because It Does Not Affect A Protectable Property Interest or Result In A Taking.

The Illinois Constitution stipulates that "[p]rivate property shall not be taken or damaged for public use without just compensation as provided by law." Ill. Const. art. I, § 15. Citing that provision, Plaintiffs in the Harrison action, Sangamon County Case No. 2014 CH 48 ("*Harrison*") and the State University Annuitants Association action, Champaign County Case No. 2014 MR 207 ("*SUAA*"), assert that Public Act 98–599 constitutes an unlawful "taking" of their private property — their pension benefits — without just compensation in violation of the Takings Clause. Settled precedent establishes, however, that Defendants are entitled to summary judgment on that theory.

Initially, Plaintiffs lack a colorable claim under the Takings Clause because the record establishes that Public Act 98–599 represents a valid exercise of the State's police powers. As explained above, the legitimate exercise of the State's police powers justifies the Act's impairment of the State's contractual obligations. There is simply no authority to support the paradoxical conclusion that a contractual modification authorized by the State's police powers may nonetheless constitute an unlawful taking, for that would effectively negate the State's police powers. See *Northern Illinois Home Builders Ass'n v. County of DuPage*, 165 Ill. 2d 25, 32 (1995) (holding that ordinance imposing fees for public improvements in development was "not a confiscation of private property in violation of the takings clause of our State and Federal Constitutions, but instead a reasonable regulation under the police power") (citation and internal quotation marks omitted); cf. *Scott v. Williams*, 107 So. 3d 379 389 (Fla. 2013) (rejecting Takings Clause claim based on conclusion that reduction in pension benefits did not violate contract rights). Perhaps for that reason, Takings Clause challenges to modifications of public employee pension benefits "have been uniformly unsuccessful." Amy B. Monahan, *Public Pension Plan Reform: The Legal Framework*, 5 Educ. Fin. & Policy 617, 637 (2010).

Even if the State's right to use its police powers was not fully dispositive of Plaintiffs' claims under the Takings Clause, those claims still would fail for two additional reasons. First, Plaintiffs lack a private property interest protected by the Takings Clause. Second, even if a private property interest were at stake, Public Act 98–599 does not amount to a "taking" of that property interest.

A. The Act Does Not Affect a Property Interest Subject to the Takings Clause.

A plaintiff's threshold burden in any "takings" case is to establish that the government has affected a "private property" interest protected by the Takings Clause. *Forest Pres. Dist. of Du Page Cty v. West Sub. Bank*, 161 Ill. 2d 448, 457 (1994). Plaintiffs' Takings Clause claim fails at the outset because they cannot carry that burden. Typically, a taking occurs only where the government takes possession of an interest in real property. *Id.*; accord *Stahelin v. Forest Preserve Dist. of Du Page County*, 376 Ill. App. 3d 765, 772 (2d Dist. 2007). Invoking that principle, the Supreme Court in *Empress Casino Joliet Corp. v. Giannoulias*, 231 Ill. 2d 62, 83 (2008), held that a regulation imposing a surcharge on riverboat casinos did not constitute a "taking" because the government action was not "inextricably tied" to real property. And here, Plaintiffs do not allege that Public Act 98–599 has any effect on real property.

Federal courts have long expressed skepticism towards claims that contractual rights are protected by the Takings Clause in the U.S. Constitution. For example, in *Omnia Commercial Co. v. United States,* 261 U.S. 502, 509, 513 (1923), the Court held that contractual rights are not protected by the Takings Clause if the government frustrated the purpose of the contract without formally appropriating the contractual rights for its own use. And in *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 222-24 (1986), the Court, while not definitively declaring that "contractual rights are never property rights," held that a federal law nullifying a contractual provision was not a taking if the law did not permit the government to affirmatively possess the property for its own use. See also *Scott*, 107 So. 3d at 389 n.4. Following *Connolly*, the Seventh

Circuit has held that contractual rights are never protected by the Takings Clause. *Pro-Eco, Inc. v. Bd. of Comm'rs*, 57 F.3d 505, 510 (7th Cir. 1995) (ordinance affecting contractual option to buy real estate not a taking); *Pittman v. Chi. Bd. of Educ.*, 64 F.3d 1098, 1104 (7th Cir. 1995); see also *Ohio Student Loan Comm'n v. Cavazos*, 900 F.2d 894, 900-02 (6th Cir. 1990) (contract right to excess reserves not property subject to Takings Clause); *Buffalo Teachers Fed'n*, 464 F.3d at 374-75 (expressing "misgivings" as to whether contracts constitute property under Takings Clause).[7] Against that backdrop of state and federal precedent, this Court should hold that intangible pension rights are not "private property" protected by the Takings Clause.

B. Public Act 98–599 Does Not Result In a Regulatory Taking.

Even if Plaintiffs' contractual rights to pension benefits qualify as property for purposes of the Takings Clause, Public Act 98–599 does not amount to an unconstitutional "taking" of that property. It is axiomatic that there is no taking if the challenged regulation "substantially advances legitimate state interests" and does not deny an owner any economically viable use of his or her property. *Northern Illinois*, 165 Ill. 2d at 32-33; *Forest Preserve District*, 161 Ill. 2d at 457; *Stahelin*, 376 Ill. App. 3d at 772. Plaintiffs cannot prevail on either element.

As to the first element, there can be no reasonable dispute that the Act substantially advances a legitimate State interest. That is the case, the Illinois Supreme Court has held, if the law is a proportional response to a specific need. *Northern Illinois*, 165 Ill. 2d at 33. That test is met here, where Public Act 98–599 is specifically and uniquely geared to remedying the particular problems resulting from the massive unfunded liabilities facing the pension systems.

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[7] Some federal courts have construed *Connolly* more narrowly and applied the Takings Clause to contractual rights in specific, limited circumstances. See *Cienega Gardens v. United States*, 331 F.3d 1319, 1329 (Fed. Cir. 2003); *USF&G v. McKeithen*, 226 F.3d 412, 416-20 (5th Cir. 2000).

On the second element, Plaintiffs cannot show that the Act deprives them of any economically viable use of their claimed property interest. In *Connolly*, the Supreme Court instructed that "[g]iven the propriety of the governmental powers to regulate, it cannot be said that the Takings Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another." 475 U.S. at 222. The Court identified three factors that "have particular significance" in determining whether a regulation results in a taking: "(1) the economic impact of the regulation on the claimant; (2) the extent to which the regulation has interfered with distinct investment-backed expectations; and (3) the character of the governmental action." *Id.* at 224-25. Applying those factors, the Second Circuit in *Buffalo Teachers Federation* held that a wage freeze on teacher salaries was not a taking. 464 F.3d at 375. The court explained that: (1) the wage freeze did not have a substantial impact on individual teachers because the law did not abrogate their entire contracts, but only affected a small increase in wages; (2) the freeze did not unreasonably interfere with investment-backed expectations because it applied prospectively; and (3) the wage freeze was "uncharacteristic of a regulatory taking" because it was a "negative restriction," rather than an "affirmative exploitation by the state," that was enacted to promote the public good. *Id.* This Court's analysis of the *Connolly* factors should lead to the same conclusion.

The State's action in passing Public Act 98–599 is inconsistent with a "taking" because nothing in the Act allows the government to "physically invade or permanently appropriate [the plaintiffs'] assets for its own use." *Connolly*, 475 U.S. at 225. Instead, like the wage freeze in *Buffalo Teachers Federation*, Public Act 98–599 at most imposes limited "negative restrictions" on certain benefits (future increases in annual annuities) for the legitimate public purpose of remedying the State's fiscal crisis and improving the fiscal stability of the pension funds.

The record shows that Plaintiffs also cannot make a valid showing under either of the other factors. First, the economic impact of the pension law on individual participants is relatively small

or even non-existent, depending on the participant's age and final salary. Except for the highest paid workers, participants' core retirement annuities remain unchanged. See 40 ILCS 5/2-108, 2-108.1, 14-107, 14-108, 14-110, 15-135, 16-132, 16-132.2 (eff. June 1, 2014). The change in retirement age (delaying retirement in four-month increments up to a maximum of five years) does not apply to participants age 46 or above as of June 1, 2014. 40 ILCS 5/2-119, 14-107, 14-110, 15-135, 16-132 (eff. June 1, 2014). And, with respect to the primary change under the Act reducing future benefit increases, retirees will continue to receive an annual increase tied to the consumer price index. 40 ILCS 5/2-119.1, 14-114, 15-136, 16-133.1 (eff. June 1, 2014). Moreover, the Act alleviates that impact on current employees with a 1% reduction in the amount of their pension contributions.

Second, the Act has little or no impact on reasonable investment-backed expectations. As in *Buffalo Teachers Federation*, any effect on investment-backed expectations is lessened by the fact that the Act's changes apply only prospectively. Moreover, the Act is structured to have less effect (and sometimes none) on those who are already retired or close to retirement, or who are at the lower end of the salary spectrum. And while participants will face a slower growth in future *increases* in their annuities, that change does not negate any reasonably held investment-backed expectations. Indeed, because for many years inflation has averaged less than 3%, many current retirees have received annual increases that outpaced the reasonably expected level of inflation protection. (Terry ¶ 167, Table 18.) Even under the Act, 97% of retirees will have more purchasing power from their annuities that they would have under the prior law if inflation had continued at the 4% to 4.5% rate prevailing when this protection was granted. (Terry Report, ¶ 202.)

In sum, the pension reforms at issue were adopted to advance legitimate state interests and are, at most, restrictions on future benefits increases. Thus, even assuming *arguendo* that Plaintiffs have a protectable property interest in their pension benefits, Defendants still are entitled to summary judgment on Plaintiffs' claims under the Takings Clause.

C. Plaintiffs' Claim that the State's Failure to Fully Fund the Various Retirement Systems Violates the Illinois Constitution Is Contrary to Settled Precedent.

Plaintiffs in *Harrison* separately allege that the State's failure to fully fund the various retirement systems violates the Takings Clause. Compl. at 52-43. This argument strains credulity. The Illinois Supreme Court has repeatedly held that members of a public retirement system do not have "vested contractual rights to statutory funding levels." *People ex rel. Sklodowski v. State*, 182 Ill. 2d 220, 232 (1998); *McNamee v. State*, 173 Ill. 2d 433, 446 (1996) ("[T]he framers of our constitution simply did not intend that section 5 of article XIII control the manner in which state and local governments fund their pension obligations."); *People ex rel Ill. Fed. of Teachers v. Lindberg*, 60 Ill. 2d 266, 275 (1975) (a member in a state retirement system does not have "a present contractual relationship" to appropriations by the General Assembly for the retirement system); see also *Kanerva v. Weems*, 2014 IL 115811, ¶ 48 (discussing this precedent and stating, "we have concluded that the [Pension Clause] was aimed at protecting the right to receive the promised retirement benefits, not the adequacy of the funding to pay for them"). Thus, this aspect of Plaintiffs' Takings Clause claim effectively asks this Court to overturn multiple decisions by the Illinois Supreme Court, which it cannot do. Moreover, precedent in the few jurisdictions that do equate vested contractual rights with property rights under the Takings Clause makes clear that, because Illinois law holds that Plaintiffs do not have a *contractual* right to a particular funding level, they cannot have a property right to that funding level for purposes of the Takings Clause. See, e.g., *Yankee Atomic Elec. Co. v. United States*, 112 F.3d 1569, 1580 n.8 (Fed. Cir. 1997).

VII. The Change to the Effective Rate of Interest Used to Calculate Money-Purchase Annuities for Some SURS Members Does Not Impair the State's Contractual Obligation.

Individual plaintiffs in *Harrison* and *SUAA* claim that a change in the statutory provisions used to calculate the "effective rate of interest" applicable to SURS money-purchase annuities

impairs their contractual pension benefits in violation of the Pension and Contracts Clauses of the Illinois Constitution. Even if these Plaintiffs could show that Public Act 98–599 is not a valid exercise of the State's police powers, however, this claim still would be without merit because they cannot demonstrate any impairment of their contractual rights.

Under the prior version of the Pension Code, SURS members had a contractual right to an effective rate of interest, but not to a particular rate of interest. That is because before Public Act 98–599, the Illinois Comptroller had the sole discretion to determine the effective rate of interest for SURS participants. 40 ILCS 5/15–125(2) (2012) ("[T]he effective rate of interest shall be determined by the State Comptroller."). That discretion depended on the application of several factors, "including the system's past and expected investment experience; historical and expected fluctuations in the market value of investments; the desirability of minimizing volatility in the effective rate of interest from year to year; and the provision of reserves for anticipated losses upon sales, redemptions, or other disposition of investments and for variations in interest experience." *Id.* The Act now prescribes a specific number for the effective rate of interest: "the interest rate of 30-year United States Treasury bonds as of the beginning of that given fiscal year, plus 75 basis points." 40 ILCS 5/15-125(2) (eff. June 1, 2014).

The flaw in Plaintiffs' claim based on this statutory change lies in their assumption that because the effective rate of interest selected as a matter of discretion in recent years was higher than would result from applying the new formula at this time, the change must violate their contractual rights. But nothing in the old statute promised, much less guaranteed, a higher rate than under the new law.[8] Plaintiffs effectively claim the benefit of such a promise or guarantee, however. That is

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[8] In fact, the rate on 30-year treasury bonds was as high as 8% in the mid-90s and 6.6% in early 2000. (See www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield.)

inconsistent with the very statute on which they base their claim. Application of the listed factors inherently requires the exercise of discretion. Indeed, by prefacing the list with the word "including," the General Assembly made even clearer that the Comptroller had broad discretion to consider any relevant factors she deemed appropriate. And a grant of discretion is the opposite of requiring a specific outcome.

The situation might be different if Plaintiffs had any basis to assert that the exercise of discretion under the prior statute could *not* result in the rate provided by the new statute. But Plaintiffs rightly do not attempt to make that assertion, which would be tantamount to a claim that such discretion would amount to bad faith. "Where a contract specifically vests one of the parties with broad discretion in performing a term of the contract, the covenant of good faith and fair dealing requires that the discretion be exercised 'reasonably and with proper motive, not arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.'" *Mid-West Energy Consultants, Inc. v. Covenant Home*, Inc., 352 Ill. App. 3d 160, 165 (1st Dist. 2004) (quoting *Resolution Trust Corp. v. Holtzman*, 248 Ill. App. 3d 105, 112 (1st Dist. 1993)). Consequently, to sustain this claim, Plaintiffs would have to establish that a good-faith, discretionary application of the former factors — "including . . . historical and expected fluctuations in the market value of investments; the desirability of minimizing volatility in the effective rate of interest from year to year; and the provision of reserves for anticipated losses" — could not yield a rate equal to the one now provided by the Act. Understandably, Plaintiffs do not allege that is the case, nor could they do so. Again, the mere fact that the *past* exercise of discretion sometimes provided a higher rate does not mean that a lower rate *now* under the new statute would constitute bad faith. Because, therefore, these SURS Plaintiffs cannot demonstrate that the Act impairs their contractual rights in connection with the effective rate of interest used to calculate money-purchase annuities, Defendants are entitled to summary judgment on this claim.

VIII. There Is No Legal Basis for Plaintiffs' Request To Declare Public Act 98–0599 Void In Its Entirety.

Even though Plaintiffs specifically challenge only certain portions of Public Act 98–599, they ask the Court to declare the Act "void in its entirety." (Heaton Amended Compl., ¶ 19.) That request is unsupported by law because it is contrary to Public Act 98–599's explicit severability provision. When a court decides that a portion of a statute is invalid, it must decide whether that provision may be severed from the rest of the statute, which will then remain in force. *People v. Henderson*, 2013 IL App (1st) 113294, ¶ 18. Authority to do so exists in Section 1.31 of the Statute on Statutes, 5 ILCS 70/1.31 (2012), and may likewise be specifically provided in a severability provision in the challenged statute. See *People v. Warren*, 173 Ill. 2d 348, 371 (1996). Both apply here.

In particular, Public Act 98–599 contains an explicit severability provision stating that the provisions of the Act are generally severable from one another. 30 ILCS 805/97. It also includes a separate "inseverability clause" declaring the General Assembly's intent that a specific group of related provisions in the Act (including the COLA changes and the decrease in employee contributions) is intended to be collectively valid or invalid as a whole — i.e., are "mutually dependent and inseverable from one another but are severable from any other provision of the Act." *Id.* This means that, even if the Court agrees with Plaintiffs and declares unconstitutional some parts of Public Act 98–599 that are within the scope of the inseverability clause, the remaining parts of the Act will stand unless they are separately held unconstitutional on a basis specifically applicable to them. Plaintiffs' pleadings do not assert any specific challenge to many of these provisions outside the Act's inseverability clause, much less identify a theory under which they would violate the Illinois Constitution. Their conclusory request for a declaration that Public Act 98–599 is void in its entirety should be rejected.

Conclusion

For the foregoing reasons, Defendants' motion for summary judgment on all claims asserted by Plaintiffs in these consolidated actions should be granted.

Date: October 3, 2014

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I, Joshua D. Ratz, an attorney, hereby certify that on October 3, 2014, true and correct copies of the foregoing Memorandum in Support of Defendants' Motion for Summary Judgment was served by United States Mail, first class postage prepaid, upon all counsel of record as follows:

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