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Litigating for the Future of Public Pensions in the United States

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INTRODUCTION

It is nearly impossible in the United States today to go too long without reading a headline about some aspect of the American public pension crisis and states undertaking public pension reform.[1] Public pensions are horribly unfunded,[2] millions of public employees are being forced to make greater contributions to their pensions,[3] retirees are being forced to take benefit

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[1] *See* Hazel Bradford, *Pace of Pension Reform Ebbs as 49 States Change Laws*, PENSIONS AND INVESTMENTS (Apr. 14, 2014), www.pionline.com/article/20140414/PRINT/304149975/pace-of-pension-reform-ebbs-after-49-states-change-laws ("The financial crisis and its aftermath sparked some kind of pension reform in every state except Idaho.").

[2] The Pew Center on the States estimate that the total cost of providing pension benefits to all public employees in the United States will run exceed over $2.73 trillion dollars and that the average total funding level is only at about 85% or $2 trillion dollars right now. *See The Trillion Dollar Gap*: *Unfunded State Retirement Systems and the Roads to Reform* 1, THE PEW CENTER FOR THE STATES, (Feb. 2010), http://downloads.pewcenteronthestates.org/The_Trillion_Dollar_Gap_final.pdf.

[3] *See State and Local Pensions: An Overview of Funding Issues and Challenges* 4, CENTER FOR STATE & LOCAL GOVERNMENT EXCELLENT, (January 2011) ("According to the U.S. Census Bureau, public pension funds distribute more than $175 billion in benefits annually to more than 7.7 million Americans, paying an average yearly benefit of some $22,700.").

cuts,[4] retirement ages and service requirements are being increased, and the list goes on and on.[5]

These headlines involve all level of American government, from the recent move to require federal employees to contribute more to their pensions,[6] to the significant underfunding of state and local public pension funds across the country,[7] to the sad spectacle of the Detroit municipal bankruptcy where the plight of public pensions plays a leading role in that

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[4] *See* Alicia H. Munnell, Jean-Pierre Aubry & Mark Cafarelli, *COLA Cuts in State/Local Pensions*, Center for Retirement Research (May 2014), http://crr.bc.edu/briefs/cola-cuts-in-statelocal-pensions/ (finding that seventeen states have reduced, suspended, or eliminated cost-of-living-adjustments (COLAs) for public employee pensions"). In another context, as part of the Stockton, California municipal bankruptcy, it is estimated that retirees lost anywhere from thirty to seventy percent of their pension and medical benefits through the restructuring process. *See* Laura Mahoney, *Stockton Poised to Approve Ch. 9 Plan, Ask Bankruptcy Court for Approval*, PENSION & BENEFITS DAILY (BNA) (Oct. 3, 2013), http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=36982339&vname=pbdnotallissues&jd=a0e2e0g8b0&split=0.

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

[6] The Bipartisan Budget Act of 2013, H.J. Res. 59; Pub. L. 113–67, increased the required employee pension contribution for new employees first hired after December of 2013 to 4.4% of pay. *See* Kellie Lunney, *What the Budget Deal Means for Federal Employees*, THE NATIONAL JOURNAL (Dec. 11, 2013), http://www.nationaljournal.com/budget/what-the-budget-deal-means-for-federal-employees-20131211.

[7] Only a third of American states have put aside sufficient money to fund their pensions and some 20 states have funding levels below 80%, which is considered an unhealthy rate. *See* Pew Center on States, *supra* note 2, at 4.

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drama.[8] The underfunding of public pension plans has led not only to a number of bankruptcy proceedings, but has also led states to reduce promised pension payouts to retired plan members or to increase pension contribution requirements for active employees.[9]

There are also issues surrounding public pensions that transcend the level of government involved. For instance, a country-wide push exists for public plans to adopt consumer-driven, defined contribution plans of the 401(k)-variety.[10] Additionally, legislation to offer public retirement system participation to private-sector workers in a number of states has started to take root.[11] Needless to say, there is much happening in the American public pension world.

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8 *See infra* Part IV.

9 *See infra* Part III.

10 *See* Hazel Bradford, *Baltimore approves moving new city employees to DC or hybrid plan*, PENSIONS AND INVESTMENTS (May 7, 2014), www.pionline.com/article/20140507/ONLINE/140509869/baltimore-approves-moving-new-city-employees-to-dc-or-hybrid-plan ("Baltimore will offer new employees the choice of a defined contribution plan or a hybrid plan under reforms approved Monday by the City Council."). Yet, there has not been as much activity as some expected. *See* Bradford, *supra* note 1 ("CRR [Center for Retirement Research] researchers found that just 15% of public plan sponsors introduced some form of defined contribution plan after 2008.").

11 *See* Hazel Bradford, *States Pushing to Offer Retirement Accounts to Private Sector*, PENSIONS AND INVESTMENTS (May 14, 2014), http://www.pionline.com/article/20140512/PRINT/305129971/states-pushing-to-offer-retirement-accounts-to-private-sector ("Expanding the public retirement system to the private sector moved to political reality from abstract concept this year, as 16 states either are considering legislation or taking the first steps toward implementing new approaches."); *see also id.* ("One approach being considered by various states is the Secure Choice Pension proposed by NCPERS [National Conference on Public Employee Retirement Systems]. Modeled after cash balance plans, with voluntary contributions to a public/private partnership, it calls for states to set up

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Regardless of whether the crisis of the day involves federal, state, or local pension plans, not lurking too far in the background is an on-going debate about how the current public pension system must be reformed to provide a more secure and cost-effective retirement for public employees in the future.[12] Implementation of reforms, especially ones that either increase the financial burden on employees and/or retirees, or that diminish the benefits that employees and/or retirees will receive, inevitably lead to protracted litigation.[13] Indeed, it can be said without embellishment that the various stakeholders involved in the American public pension funding crisis are presently litigating for the future of American public pensions.

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

More specifically, the state case study involves changes made to one of the healthiest public pension programs in the country, the Wisconsin

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boards and administrators for professionally managed plans with diversified portfolios. Participation would be voluntary and benefits would be portable.").

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

[13] *See infra* Parts II-IV.

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Retirement System (WRS).[14] These pension reforms were part of the infamous anti-union laws, Act 10 and Act 32, which were enacted in 2011 by Republican Governor Scott Walker.[15] The on-going Wisconsin litigation, *Madison Teachers Inc. v. Walker*,[16] involves a provision in Act 10 that does not permit the City of Milwaukee to pay its employees' pension contribution share.[17] This case nicely illustrates some of the major constitutional arguments being forwarded concerning whether such reform proposals are consistent with existing employee and retiree pension rights.

The city case study involves the on-going municipal bankruptcy litigation involving the city of Detroit. Many have placed the blame for the Detroit bankruptcy on out-of-control legacy costs, including costs to fund

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[14] *Study of the Wisconsin Retirement System*, *In Accordance With 2011 Wisconsin Act 32* 9, DEPARTMENT OF EMPLOYEE TRUST FUNDS (June 30, 2012), etf.wi.gov/publications/wrs-study.pdf (reporting that WRS is an "efficient and sustainable retirement system," which has been fully funded since 2004).

[15] *See* 2011 W.A. 11 ("Act 10"), *available at* http://legis.wisconsin.gov/11Act010.pdf. For additional information on the enactment of Act 10 and its aftermath, *see generally* Paul M. Secunda, *The Wisconsin Public Sector Labor Dispute of 2011*, 27 ABA J. LAB. & EMP. L. 293 (2012).

[16] No. 2012AP2067, 2013 WL 1760805 (Ct. App. Wis. Apr. 25, 2013) (certifying pension and other labor issues to Wisconsin Supreme Court for decision). The Court of Appeals opinion lays out the dispute between the parties, but does not answer any of the legal questions. The Wisconsin Supreme Court granted certification, heard oral argument in November 2013, and a decision is pending as of May 2014. The decision of the Dane County Circuit Court striking down the pension provision is available at: No. 11CV3774, 2012 WL 4041495 (Wis. Cir. Ct. Sept. 12, 2012).

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

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various local city pension plans.[18] Rather than involving litigation in state or federal court, the Detroit drama has played out in federal bankruptcy court under Chapter 9 of the United States Bankruptcy Court.[19] As will be discussed, this is a very underdeveloped area of the law and the bankruptcy judge has had to grapple with many challenging issues involving the interplay of the bankruptcy system and state constitutional provisions which protect against the diminishment of pension rights.[20] This is a particularly interesting area of American public pension law to explore because it differs greatly from how pensions would be treated if Canadian municipalities found themselves in financial distress.[21]

After surveying the current state of public pension litigation in the federal, state, and local context in the United States, the paper concludes by suggesting that all public pension plans could benefit from being uniformly regulated either through ERISA (for federal pension plans) or through adoption of uniform law (for state and local pension plans).[22] Following up

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[18] *See, e.g.*, Richard Summerfield, *Legacy Costs Push Communities to the Brink*, FINANCIER WORLDWIDE (Oct. 2013), http://www.financierworldwide.com/article.php?id=11125 ("While no two cases are ever the same, one of the most common themes running through the majority of insolvent cities and towns is the presence of crippling legacy costs.").

[19] 11 U.S.C. §§ 901-904 (2012) (general provisions).

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

[21] *See* John R. Sandrelli & Valerie Cross, *American Municipal Bankruptcies: The View from Canada* 387 *in* ANNUAL REVIEW OF INSOLVENCY LAW 2013 (Sarra ed. 2014) ("Canada's model paints a more stable picture of municipal finance, suggesting America may need to more rigorously and closely monitor municipal distress.").

[22] *See infra* Part V.

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analyses undertaken by other public pension commentators,[23] but providing an innovative twist to past proposals and analyses, this article argues for a hybrid approach to the public pension crisis in the United States.

First, Congress should remove the governmental plan exemption from ERISA for the federal government employee pension plans. On the other hand, because of significant federalism concerns in having the federal government regulate state and local pension plans,[24] the best option is for states to adopt a uniform public pension law for their state and local pensions. The combination of these two approaches will lead to public employees benefitting from better reporting and disclosure, fiduciary, funding, vesting, and benefit accrual requirements, which in turn will ensure the future security of their pensions. At the same time, the federal, state, and local governments will benefit by being able to spend more predictable amounts of money on pension obligations, thereby eventually substantially reducing their pension obligations over time.

This article proceeds in five parts. Because of the peculiar hodgepodge that constitutes the American employer-sponsored pension system, Part I seeks to provides a brief overview of the difference between public and private-sector occupational pensions in the United States, as well as difference between defined benefit and defined contribution pension plans. Having set out those distinctions, the next three parts examine the status of litigation at the various levels of American government. Part II lays out the pension system for federal employees and notes the current lack of litigation. Part III then considers current Wisconsin pension litigation and explores the constitutional causes of actions utilized in that case. Part IV next reviews the on-going Detroit municipal bankruptcy litigation's impact

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[23] *See* Richard E. Mendales, *Federalism and Fiduciaries: A New Framework for Protecting State Benefit Funds*, 62 DRAKE L. REV. 503 (2014) (arguing for uniform state code that states could adopt to govern state and local benefit plans); Amy B. Monahan & Renita K. Thukral, *Federal Regulation of State Pension Plans: The Governmental Plan Exemption Revisited*, 28 A.B.A. J. LAB. & EMP. L. 291, 292 (2013) (providing overview of reasons why ERISA has not been expanded to federal, state, and local governmental plans).

[24] *See* Monahan & Thukral, *supra* note 23, at 297-98.

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on city employee pensions and appraises the unique characteristics of that system. Part V concludes by suggesting that current public pension litigation is likely to lead to inconsistent results in different venues[25] and, therefore, advances a proposal to expand ERISA's coverage to cover federal employees and to encourage states to adopt a uniform law on public pensions. This type of two-prong legislative approach will provide the necessary uniform set of legal standards for public pension plans to avoid the problems that have been plaguing them over the years and hopefully lead to a more secure retirement for American public employees at all levels of government.

I. OVERVIEW OF AMERICAN EMPLOYER-SPONSORED PENSION SYSTEM

Although the federally-enacted Employee Retiree Income Security Act of 1974 (ERISA)[26] governs private-sector employee benefits law in the United States, the law does not apply to federal, state, or local pensions, which are exempted "governmental plans."[27] Consequently, public

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[25] Not only will public pension litigation results likely be inconsistent across federal, state, and local disputes, but as Professor Olivia Mitchell aptly observes, it is unclear "how much can be learned from one state to another" when it comes to public pension litigation. *See* Jonathan Miltimore, *Minnesota Judge Ok's Discovery in Pension Suit*, WATCHDOG (September 15, 2010), http://watchdog.org/6571/minnesota-judge-oks-discovery-in-pension-suit.

[26] 29 U.S.C. §§ 1001-1461 (2007). Congress enacted ERISA to protect employees' retirement and welfare benefits. Section 2 of ERISA contains the Findings and Declarations of Policy. Specifically, it states: "It is hereby declared to be the policy of the Act to protect . . . the interests of participants in employee benefit plans and their beneficiaries." ERISA § 2(b).

[27] 29 U.S.C. § 1003(b)(1) (2012) ("The provisions of this title shall not apply to any employer benefit plan if – such plan is a governmental plan (as defined in Section 3(32)."). In turn, ERISA Section 3(32) reads: "The term 'governmental plan' means a plan established or maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing." *Id.* § 1002(32). *See also id.* §

employee pension schemes are regulated by the federal government for federal employees,[28] and by state and local governments for their employees.[29] These public pension funds (numbering about four thousand plans in total) represent an extremely important segment of the overall American pension market, as "[s]tate and local defined benefit pension funds held $3.05 trillion in assets in fiscal year 2012 . . . . State plans held $2.53 trillion and locally administered plans held $521 billion in assets, including cash and investments."[30]

As far as state and local government pension plans in the United States, these plans initially had many similar attributes as private-sector employer-sponsored plans under ERISA.[31] Now, however, with there being more stringent regulations of private pension plans, and a dramatic shift to defined contribution plans in the private sector,[32] there has been significant

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1321(b)(2) (exemption of governmental plans from PBGC insurance scheme); I.R.C. §§ 401, 414(d) (2012) (exemption of governmental plans from applicable tax code provisions).

[28] *See infra* Part II.

[29] State pension plans are discussed *infra* Part III, and local pension plans are discussed *infra* Part IV.

[30] Hazel Bradford, *State and Local Pension Plans Pass $3 Trillion Mark in Fiscal Year 2012*, PENSIONS AND INVESTMENT (Apr. 29, 2014), http://www.pionline.com/article/20140429/ONLINE/140429829/state-and-local-pension-plans-pass-3-trillion-mark-in-fiscal-year-2012.

[31] For most of their history, public-sector pension plans were substantially identical to private-sector pension offered by larger employers. *See* Charles B. Stockdale, Douglas A. McIntyre, Michael B. Sauter, *The Sixteen States That Are Killing Their Pensions*, 24/7 WALL STREET (Mar. 4, 2011), at http://247wallst.com/2011/03/04/the-sixteen-states-that-are-killing-their-pensions.

[32] *See* William T. Payne & Stephen M. Pincus, *The Constitutional Limitations of Public Employee Pension Reform Legislation*, 19 THE PUBLIC LAWYER 12, 13 (2011) ("[D]efined benefit plans still make up the bulk of

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divergence in pension plan structure and design in the private and public sectors.[33] For instance, a pension plan subject to ERISA "must design, structure, and fund its plan in accordance with federal rules," whereas public pension plans "are largely free to structure their pension plans as they see fit and are not subject to any funding requirements other than what state law might impose."[34] The lack of strict funding requirements for many of these pension plans is often blamed for the significantly underfunded state of many public pension plans in the United States today.[35] As far as not subjecting public plans to the stricter requirements of ERISA, it might be that Congress thought it unnecessary to legislate fiduciary and disclosure standards for the public plans because it saw state and local taxpayers as the primary backstops if these public plans failed.[36] Presumably, federalism

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the retirement plans in the public sector."); COLLEEN E. MEDILL, INTRODUCTION TO EMPLOYEE BENEFITS LAW: POLICY AND PRACTICE 121-22 (3ed. 2011) (chart showing that in 2007 in the private-sector there were 48,982 DBPs and 658,805 DCPs and that there were more than three times as many DCP participants than DBP ones).

[33] *See* Monahan & Thukral, *supra* note 23, at 291.

[34] *Id.* at 292.

[35] *See* Roger Lowenstein, *Broke Town, U.S.A.*, N.Y. TIMES, Mar. 3, 2011, at MM26 (estimating unfunded part of public pension promises to be between $1 trillion and $3.5 trillion); *see also* Andrew Barry, *Munis on the Mend*, BARRON'S (Oct. 14, 2013), http://online.barrons.com/article/SB50001424053111903891504579121802222118332.html#articleTabs_article%3D1 ("What separates most states with strong pension funding from those with deep deficits is a willingness to fund their plans consistently at the actuarially required contribution level.").

[36] *See* Monahan & Thukral, *supra* note 23, at 297 ("Congress believed 'the ability of the governmental entities to fulfill their obligations to employees through their taxing power' eliminated much of the need to regulate how pension plans were funded.") (quoting S. Rep. No. 93-383 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4890, 4965).

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concerns (that is, the appropriate balance of power between federal and state government power) also motivated Congress not to try to assume power over public plans.[37]

As far as the structural issues, federal, state, and local workers have much broader access to defined benefit plans than defined contribution pension plans.[38] This difference in pension plan structure is crucial. In defined benefit (DB) plans, "the burden is placed on the employer to contribute funds to the pension plan on an actuarial sound basis so that sufficient funds exist to pay the worker when he or she retires."[39] The employer invests funds on a periodic basis on behalf of its employees so that the individual is entitled at retirement to a guaranteed payment (in a lump sum or annuity form) based on some set payment formula related to

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[37] *Id.* (citing H.R. 2, 93d Cong. §§ 101, 201, 301 (introduced Jan. 3, 1973)).

> Ultimately . . . [governmental] plans were exempted, and Congress instead included a provision in ERISA requiring that governmental plans be studied in order for Congress to be more fully informed before taking any action impacting such plans. [29 U.S.C. § 1231]. For many years afterwards, bills were introduced to bring governmental plans within ERISA's purview, but none have been successful.

Id.

[38] Whereas 87% of state government workers and 83% of local workers had access to participate in defined benefit pension plans, only 43% of state workers and 24% of local workers had access to defined contribution plans. *See* U.S. Bureau of Labor Statistics, *State and Local Government Employee Benefits,* March 2010, available at http://www.bls.gov/opub/ted/2011/ted_20110309.htm (last visited Mar. 11, 2011). Common examples of defined contribution plans in the public sector include Section 457 and Section 403(b) plans. *See* MEDILL, *supra* note 26, at 104.

[39] *See* Paul M. Secunda, *The Forgotten Employee Benefit Crisis: Multiemployer Benefits Plan on the Brink,* 21 CORNELL J. L. & PUB. POL'Y 77, 84 (2011).

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years of service and salary history.[40] Some of these DB plans are backed by government insurance schemes in case of company insolvency. In the United States, for example, the Pension Benefit Guaranty Corporation (PBGC) undertakes this role by providing government insurance for terminated private-sector DB plans.[41]

On the other hand, defined contribution (DC) plans place all of the respective risk (i.e., risk of longevity, risk of investment return, and risk on inflation) on the employee.[42] In a typical 401(k), 403(b), or 457 plan, the employer provides a suitable menu of investment options to the employee and then may or may not match whatever salary contribution the employee makes to their individual pension account.[43] After that contribution, the employer is completely off the hook; they have no additional pension funding responsibilities.[44] Whether an employee has sufficient funds for retirement under a DC plan depends greatly on the investment return the employee receives on the funds in her individual pension account.[45]

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[40] JEFFREY M. HIRSCH ET AL., UNDERSTANDING EMPLOYMENT LAW 198–99 (2d ed. 2013).

[41] The PBGC is established under Title IV of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. §§ 1301-1461 (2012); *see* Mark Daniels, *Pensions in Peril: Single Employer Pension Plan Terminations in the Context of Corporate Bankruptcies*, 9 HOFSTRA LAB. L. J. 25, 32 (1991) (providing analysis and critique of treatment of pension plan obligations during corporate bankruptcies).

[42] *See generally* Paul M. Secunda, *401K Follies: A Proposal to Reinvigorate the United States Annuity Market*, ABA SECTION ON TAXATION NEWSQUARTERLY 13, 14 (Fall 2010).

[43] *See id*.

[44] *See* Payne & Pincus, *supra* note 32, at 13 ("Underfunding is never an issue with 401(k) plans because the retiree receives only what has been contributed and any investment returns. The risk is squarely on the worker if his or her investment choices do not perform up to expectations.").

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Such consumer-driven investment devices have the advantages of portability, permitting employees to have more control over their pensions, and having the option to elect a lump sum distribution, as opposed to an annuity.[46] The disadvantage of placing the onus of retirement security on employees, however, is that they may be financially illiterate, apathetic, or just not have the money to put away in retirement given other life exigencies like first homes, student loans, and unpredictable medical expenses.[47] Additionally, these DC plans, are not backed up by government insurance schemes.[48] Although some movement exists in the public sector towards adopting defined contribution plans,[49] for now the DC plan dilemma primarily afflicts the private-sector pension world.

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[45] HIRSCH ET AL., supra note 40, at 199.

[46] Secunda, *supra* note 42, at 13.

[47] *See id.* ("[N]o guarantee exists that a participant will receive any specified amount of benefit at retirement and many baby boomers are waking up to this strange new world of being in charge of their future retirement.").

[48] *See* HIRSCH ET AL., *supra* note 40, at 199.

[49] *See* Bradford, *supra* note 10 (newly hired workers in Baltimore can choose to contribute 5% of their salary either to a hybrid defined benefit plan or to a defined contribution plan). This legislation has just been passed and an effective date has not yet been announced. *See id.* *See also* PAULA SANFORD & JOSHUA M. FRANZEL, THE EVOLVING ROLE OF DEFINED CONTRIBUTION PLANS IN THE PUBLIC SECTOR 6 (2012), *available at* http://www.slge.org/wp-content/uploads/2012/10/The-Evolving-Role-of-Defined-Contribution-Plans.pdf ("Many public officials are concerned with the long-term costs of their current defined benefit programs and will continue to redesign these plans and consider alternative retirement arrangements. However, most of the changes implemented to date, including switching to hybrid and core defined contribution plans, usually affect new employees.").

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Public pension plans also look significantly different in design and operation from private sector pension plans under ERISA. For instance, less federal oversight exists, and much discretion is left to state and local jurisdictions.[50] Important differences also exist in the budgeting process and the applicable accounting standards.[51] Design issues for public pension vary because the focus is on public-sector-specific issues such as: (1) the need to make up for the lack of Social Security participation and coverage for some public employees,[52] (2) the possibility of having tax deductible

[50] For instance, many states do not require their public sector plans to pre-fund at any given level, like ERISA does. This state of affairs has led to many state and local pension plans to be significantly underfunded. *See* Payne & Pincus, *supra* note 32, at 13 ("Unlike employers in the private sector, which must follow ERISA's minimum funding requirements, most states are not required to prefund their plans at any level. This complete discretion has permitted some states to "kick the can down the road" and put off making their required pension contributions year after year.").

[51] *See* Mendales, *supra* note 23, at 506-507. *See also* Bradford, *supra* note 1 ("One new wrinkle in 2014 that could dampen recent improvements is Governmental Accounting Standards Board rules that will, for the first time, add another number to the political equation: net pension liability . . . . Adding a system's total unfunded liability, instead of just the current amount due, to its financial reports will make an underfunded plan look worse, and even a relatively well-funded one look less so.").

[52] *See* State and Local Pensions, *supra* note 3, at 5 ("All private sector employees participate in Social Security, while 30 percent of state and local employees do not."). *See also* Gov't Accountability Office, No. GAO-08-248T, *Social Security: Issues Regarding the Coverage of Public Employees* 3 (2007), available at http://www.gao.gov/new.items/d08248t.pdf (statement of Barbara D. Bovbjerg, Director of Education, Workforce, and Income Security) (observing that about one out of every four employees covered by public pension plans receive no benefits under the Social Security system because their employers have opted out of it).

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employee contributions,[53] and (3) and the need to address earlier mandatory retirement ages for police and firefighters.[54] Finally, public plans require a higher degree of public transparency because of governmental decision making involved.[55]

Differences in structure, design, and operation between American public and private-sector pension plans means that unique issues must be considered in the public context that either do not apply in the private sector or apply less often.[56] Additionally, because the government is acting in an employment capacity when it deals with public pensions, every time that the state employer seeks to modify or amend the pension structure for employee pensions, there are a host of constitutional concerns that must be potentially considered.[57] Indeed, although many see ERISA as providing more stringent regulation of private-sector pensions than state public pension laws

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[53] *See* Public Plans Practices Task Force of the American Academy of Actuaries, *Risk Management and Public Plan Retirement Systems* 4 (Oct. 2010), *available at* http://actuary.org/pdf/pension/PPPTF_Final_Report_c pdf.

[54] *Id.*

[55] *See id.*

[56] *See* Mendales, *supra* note 23, at 508 ("Many of the key issues that need to be addressed, including adequate public funding, protecting state credit, and states' ability to offer attractive benefit packages to their employees, differ from those addressed by ERISA, which is designed primarily to protect individual beneficiaries of privately sponsored benefit plans.").

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

do with regard to public plans, it is actually easier to amend private plans than public plans. This is because although ERISA "protects accrued benefits . . . it allows employers to change the terms going forward. In contrast, most states have legal provisions that constrain sponsors' ability to make changes to *future* benefits for current workers."[58]

For instance, under a federal or state constitutional contracts clause claim,[59] plaintiff employees or retirees may obtain injunctive relief to enjoin the contemplated pension reform, with regard to cuts on both already earned pension benefits and future rates of benefit accrual.[60] Moreover, for a number of states that see pension rights as property rights, the Takings Clause of the Fifth and Fourteenth Amendments of the federal constitution may also provide "just compensation" for interference with public pension rights.[61] Additionally, under state constitutional home rule amendments,

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

[59] U.S. CONST. ART. I, § 10, cl. 1. State constitutional impairment of contract provisions are identical to the federal one and are subject to the same legal analysis. *See* Monahan, *supra* note 23, at 1040.

[60] *See* Monahan, *supra* note 23, at 1032.

[61] U.S. CONST. amend. V, XIV; Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 122 (1978) (holding that Takings Clause applicable to states through Fourteenth Amendment). *See also* Prof'l Firefighters Ass'n of Omaha v. City of Omaha, 2010 WL 2426446, at *5 (D. Neb. June 10, 2010) (finding that cutting pension benefits can constitute an abridgement of a property right). Indeed, most states have found that pensions are a form of deferred compensation and constitute a property right. *See* Amy B. Monahan, *Public Pension Plan Reform: The Legal Framework*, 5 EDUCATION, FINANCE & POLICY 617 (2010).

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state government may be limited in dictating how local government officials operate their local pension plans.[62] Finally, at least at the local level, bankruptcy proceedings may also come into play if a municipality is permitted to seek protection from its creditors under the Bankruptcy Code.[63]

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

The next three sections consider the federal, state, and local pension systems in the United States by considering the unique design of the federal system, an illustrative example of state pension litigation concerning a city pension system, and a local pension case study involving the use of the federal bankruptcy law in Detroit.

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

Civilian federal employees take part in a complex retirement system that features two distinct defined benefit (DB) plans, one defined contribution (DC) plan, and Social Security benefits.[64] In light of significant funding issues, Congress has recently enacted new legislation that has dramatically increased the level of contributions that some federal employees are required to make to the pension trust fund.[65]

[62] *See infra* Part III.

[63] *See infra* Part IV.

[64] *See* KATELIN P. ISAACS, FEDERAL EMPLOYEES' RETIREMENT SYSTEM: BENEFITS AND FINANCING 1, CONG. RESEARCH SERV. (98810) (2014).

[65] *See* Alan Fram, *Congress targets fed workers' pensions for savings,* PHILLY.COM (Dec. 16, 2013),

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A. Federally-Sponsored Pension Plans

Federal employees receive pension benefits through either the Civil Service Retirement Act of 1920 (CSRS)[66] or the Federal Employees' Retirement System Act of 1986 (FERS).[67] Federal employees who were hired after 1984 and employees who voluntarily switched from CSRS to FERS, participate in the FERS.[68] Employees covered by the FERS also receive Social Security Benefits and have the option to participate in the Thrift Savings Plan (TSP).[69] The TSP is a defined contribution plan similar to 401(k) plans that are provided to private sector employees.[70] Employees who participate in CSRS are generally not entitled to Social Security Benefits nor can they participate in TSP.[71] Those employees eligible to participate in TSP can deposit up to a maximum of $17,500 in 2014 to their accounts with their employing agency matching up to 5% of pay.[72]

B. Changes to Employee Contributions to Federal Pensions

Participants of both CSRS and FERS contribute a percentage of their

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http://www.philly.com/philly/news/politics/congressional/20131216_ap_ca7746fb4334497598848da30c856b8e.html.

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

[67] Federal Employees' Retirement Act of 1986, Pub. L. No. 99-335, 100 Stat. 514.

[68] *See* Nielsen v. Department of the Interior, 198 Fed. App'x. 953, 954 (Fed. Cir. 2006).

[69] ISAACS, *supra* note 64, at 1.

[70] KATELIN P. ISAACS, RETIREMENT BENEFITS FOR MEMBERS OF CONGRESS 3, CONG. RESEARCH SERV. (RL30631) (2014).

[71] Isaacs, *supra* note 64, at 1.

[72] Isaacs, *supra* note 70, at 3.

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income to the Civil Service Retirement and Disability Fund (CSRDF), the civil service trust fund.[73] The CSRDF is a communal trust fund from which the defined benefits of both the CSRS and the FERS systems are paid out.[74] In September of 2011, CSRDF had an unfunded actuarial liability of $761.5 billion, of which $741.4 billion was attributable to CSRS and $20.1 billion was attributable to FERS.[75]

In large part, this liability can be attributed to a major flaw in the design of the CSRS. In designing CSRS, Congress failed to take into account future employee pay raises and cost-of-living adjustments (COLA), which then required the federal government to contribute additional funds to cover this shortfall.[76] Moreover, while private employers are required to pre-fund their defined benefit plans under ERISA,[77] the federal government was not required to pre-fund its pension liability.[78] In light of this significant

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

[74] *See id.*

[75] Isaacs, *supra* note 64, at 13.

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

[77] *See* 29 U.S.C. §§ 1081-1085 (minimum funding rules).

[78] *See* Dennis Cauchon, *Federal Retirement Plans Almost as Costly as Social Security*, USA TODAY (September 29, 2011), http://usatoday30.usatoday.com/news/washington/story/2011-10-11/federal-retirement-pension-benefits/50592474/1 ("Private employers are legally

unfunded liability, Congress acted to increase the funding to the CSRDF.

In December of 2013, Congress passed the Bipartisan Budget Act of 2013.[79] This Act increased the required employee contribution for new employees first hired (or rehired with less than five years of service) after December of 2013 to 4.4% of pay.[80] This increase did not affect employees' first hired before 2013, who contribute 0.8% of pay to the CSRDF, or employees first hired in 2013, who contribute 3.1% of pay to the CSRDF.[81]

Recently, the House, based on Republican support only, passed a nonbinding FY2015 budget resolution that would call for even greater increases in employee contributions to federal pensions.[82] Under this resolution, new federal workers would be placed in a DC plan and current federal and congressional employees would be required to increase their

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required to put money into pension funds to match retirement promises. Private pensions have $2.3 trillion in stocks, bonds, real estate and other assets. State and local governments have $3 trillion in retirement funds. The federal government has nothing set aside.").

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

[80] *See* Kellie Lunney, *What the Budget Deal Means for Federal Employees*, THE NATIONAL JOURNAL (Dec. 11, 2013), http://www.nationaljournal.com/budget/what-the-budget-deal-means-for-federal-employees-20131211.

[81] Isaacs, *supra* note 64, at 10. *See also Federal Workers' Pensions Targeted in Budget Deal*, POLITICO (Dec. 16, 2013), http://www.politico.com/story/2013/12/budget-deal-federal-workers-pensions-101186.html.

[82] Louis C. LaBrecque, *House OKs Budget Plan That Would Increase Retirement Contributions by Federal Workers*, BLOOMBERG BNA PENSION AND BENEFITS DAILY (April 10, 2014), http://news.bna.com/pdln/display/batch.

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contributions to the CSRDF.[83] The Democratic-controlled Senate, however, is not expected to take up this resolution.[84]

C. Other Recently Proposed Public Pension Reforms

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

First, the Sequester Replacement and Spending Reduction Act of 2013,[85] proposes to increase employee contributions to CSRS and FERS over the course of three years for a cumulative increase of 2.3%.[86] Second, the Public-Private Employee Retirement Parity Act,[87] would end coverage under the FERS for prospective employees and convert these employees to Social Security and TSP benefits.[88]

Third, and finally, the Provide for the Common Defense Act of 2013,[89] proposed significant changes to federal retirement programs, including an

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83 *Id.*

84 *Id.*

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

86 Isaacs, *supra* note 64, at 10.

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

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

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

increase in employee contributions to the CSRS and FERS by 1.2% over three years and the implementation of a new method of calculating COLAS for beneficiaries of CSRS and FERS.[90]

D. The Lack of the Federal Pension Litigation

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

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

III. State and Local Pension Litigation Case Study: The Battle Over Increasing Pension Contributions in Wisconsin

The value of many public pension funds decreased dramatically during the global recession of 2008.[91] Although securities have rebounded to a large extent since that time,[92] the losses suffered then are still being felt

[90] Eric Katz, *GOP Lawmakers: Cut Fed Benefits Not Defense Spending*, GOVERNMENT EXECUTIVE (December 3, 2013) http://www.govexec.com/management/2013/12/gop-lawmakers-cut-fed-benefits-not-defense-spending/74807. *See also* Isaacs, *supra* note 65, at 17.

[91] *See* Stockdale et al., *supra* note 31 ("During a period like the market collapse of 2008, the value of many large pension funds plunged.")

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

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now. Indeed, many estimates suggest that public pension funds in the United States are still running at a deficit similar to the deficit that existed during the beginning of the global recession over five years ago.[93]

The current underfunded status of many state public pension plans have caused the predictable finger-pointing concerning the seemingly generous employee benefits public employees receive (though some studies show that public employees do not receive lavish pension and other employee retiree benefits).[94] In the meantime, state legislatures continue to explore different pension reform options to make up pension underfunding.[95] For instance, no fewer than seventeen states have passed legislation that has either reduced or eliminated the COLA (cost-of-living adjustment) for retirees currently receiving public pensions.[96] Because such legislation significantly diminishes the amount of retirement benefits these individuals will receive, much COLA litigation has ensued, with the retirees largely being unsuccessful in invalidating these reforms.[97]

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[93] *See* Carl A. Hess, Thomas J. Healey & Kevin Nicholson, *Public Pension Reform: Benefit Design as the Key to Sustainability*, PUBLIC SECTOR INC. (Jan. 7, 2014), http://www.publicsectorinc.org/2014/01/public-pension-reform-benefit-design-as-the-key-to-sustainability/ ("[E]stimates of the nationwide public pension deficit range from $730 billion to $4.4 trillion").

[94] *See* Jeffrey H. Keefe, *Are Wisconsin Public Employees Overcompensated?*, ECONOMIC POLICY INSTITUTE BRIEFING PAPER #290 (Feb. 10, 2011), *available at* http://epi.3cdn.net/9e237c56096a8e4904_rkm6b9hn1.pdf.

[95] *See* Mary Williams Walsh, *The Burden of Pensions on States*, NY TIMES, Mar. 10, 2011, available at http://www.nytimes.com/2011/03/11/business/11pension.html?_r=1&ref=pensionsandretirementplans (last visited Mar 15, 2011) ("More money, from employers and employees in some combination, will be needed, and perhaps much more in coming years.").

[96] *See* Munnell et al., *supra* note 4, at 1.

[97] *See id.* at 4 ("Of the 17 states that changed their COLA, 12 have been challenged in court."). Of those 12 challenges, courts have rule in nine

On the other hand, municipal employees have had at least initial success in pushing back against non-COLA pension reforms instituted in Wisconsin in 2011. Although Wisconsin maintains one of the healthiest state pension plans in the country,[98] the 2011 pension reforms required most public employees to contribute to their pensions for the first time.[99] The effect of this provision on the pension rights of Milwaukee city employees was dramatic. For instance, a contribution requirement of 5.5% of "an employee's pay would be equivalent to 114.4 hours of pay . . . [or] equivalent to loss of 14.3 days of pay, assuming an eight-hour day."[100]

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states and only one group of plaintiffs (Washington) have been successful. *Id.*

[98] For instance, a recent report on the financial health of the Wisconsin public pension system concluded that, "Wisconsin's pension system is on excellent financial footing and among the healthiest in the nation, according to multiple independent reports and an analysis by COWS [Center on Wisconsin Strategy] and CEPR [Center for Economic and Policy Research]."). *See* Center on Wisconsin Strategy, *The Wisconsin Retirement System is One of the Healthiest in the Country* (March 2011), *available at* http://www.cows.org/pdf/bp-WRS.pdf.

[99] It appears that requiring pension contributions was part of a larger political battle over the future of public sector collective bargaining rights and reducing the size of the budget deficit. *See* Secunda, *supra* note 15, at 297. The pension contribution increase measure was at the very least an easy way for the new Republican Governor Scott Walker to cut government operating expenses through a government-wide, disguised pay cut.

[100] *See, e.g., Letter from City Attorney Grant F. Langley to Alderman Joseph A. Dudzik re: Constitutionality of the Provision of the Pending State Budget Repair Bill Mandating that Certain Members of the Employes' Retirement System of the City of Milwaukee Pay Employee Required Contributions* 11, Feb. 28, 2011, *available at* http://lawprofessors.typepad.com/laborprof_blog/2011/03/milwaukee-city-atty-letter-explaining-why-walker-budget-bill-unlawfully-violate-public-employee-pens.html (last visited May 15, 2014).

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Public laborers in the City of Milwaukee responded to these reforms in *Madison Teachers Inc. v. Walker*,[101] by seeking to invalidate the pension reform measure under Section 62.623[102] on three grounds: (1) the City of Milwaukee's home rule authority,[103] (2) the contracts clause of the Wisconsin Constitution,[104] and (3) the due process clause of the Wisconsin Constitution.[105] The treatment of these legal claims by the Wisconsin trial court will be analyzed both to see how such claims have fared in Wisconsin, but also to understand the nature of these claims and their viability outside of Wisconsin.

A. Home Rule Amendment

The plaintiffs argued that the violation of the Wisconsin Constitution's Home Rule Amendment stems from the fact that the pension reform provision (Sec. 62.623) requires a 5.5% salary contribution from Milwaukee employees[106] to the Milwaukee Employee Retirement System (Milwaukee

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[101] No. 11-CV-3774, 2012 WL 4041495 (Wis. Cir. Sept. 14, 2012).

[102] WI. STAT. § 62.623 (2012) (enacted under 2011 Wisconsin Acts 10 and 32).

[103] WIS. CONST. ART. XI, sec. 3(1).

[104] WIS. CONST. ART. I, sec. 12.

[105] WIS. CONST. ART. I, sec. 1.

[106] That section states in pertinent part:

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

2011 W.A. 10, §149.62.623. Sec. 62.623 only applies to Wisconsin municipal employees in cities of the first class, which only includes

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Retirement System) and forbids the city from agreeing to make that pension contribution on the employee's behalf.[107] This provision is in direct conflict with Sec. 36-08-07-a-l of the City of Milwaukee's Charter Ordinances.[108] That Charter Ordinance provision requires the city to make the employee's share of pension contributions for those employees hired before January 1, 2010.[109] The legal question thus comes down to whether the state pension reform provision can supplant Milwaukee's Charter Ordinance.

Although it might seem obvious that a state legislative enactment should supersede a contrary local ordinance, such conflicts are analyzed under the Home Rule Amendment. That Amendment gives municipalities the right to "determine their local affairs and government subject only to this constitution and to such enactments of the legislature of statewide concern as with uniformity shall affect every city or village."[110] Courts have interpreted this language to mean that state legislation concerning local affairs is only permitted as long as the legislation affects every city and

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Milwaukee. However, similar provisions exist for other cities and villages in Wisconsin, as well as for state employees. *See* Madison Teachers, Inc. v. Walker, No. 2012-AP-2067, 2013 WL 1760805, at *1 (Wisc. Ct. App. Apr. 25, 2013) ("This appeal involves municipal employees, but the statutory provisions at issue here have direct counterparts in a separate statutory subchapter that applies to state employees. Thus, a decision on the provisions affecting municipal employees would appear to be dispositive with respect to state employees.").

[107] *Madison Teachers Inc.*, 2012 WL 4041495, at *9.

[108] *Id*.

[109] *Id.*

[110] Wis Const. Article XI, sec. 3(1). "The Home Rule Amendment is a constitutional limitation on the power of the Legislature. It both directly grants legislative power to municipalities and limits the legislature's exercise of its legislative power." *Id.* (citing State ex rel. Michalek v. LeGrand, 11 Wis. 2d 520, 526, 253 N.W.2d 505 (1977)).

village in Wisconsin uniformly.[111] The issue is where the legislation is about local affairs or state-wide concerns. If the former, the state cannot legislate in that area; if the latter, the legislation is valid.[112] In making this distinction, the term "local affairs" is subject to liberal interpretation, but the legislature's determination that a matter is of "state-wide concern" is afforded great weight.[113]

The plaintiffs argued that the Charter ordinance concerning pension contributions was a matter of local concern. In support of this argument, they cited to a 1947 provision in the Milwaukee ERS which states:

> For the purpose of giving to cities of the first class the largest measure of self-government with respect to pension annuity and retirement systems compatible with the constitution and general law, it is hereby declared to be the legislative policy that all future amendments and alterations to this act are matters of local affair and government and shall not be construed as an enactment of statewide concern.[114]

Because the state pension reform initiated in Section 62.623 did not contain the legislature's express intent that the legislation was a matter of state-wide concern and based on the express intent of the Charter Ordinance that pension provision should be considered a matter of local concern, the trial court concluded that Section 62.623 violated the Home Rule Amendment by interfering with Milwaukee "local affairs" and, thus, was declared null and void.[115]

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[111] *See* Van Gilder v. City of Madison, 222 Wis. 58, 267 N.W. 25 (1936).

[112] *Madison Teachers Inc.*, 2012 WL 4041495, at *9.

[113] *Id.* (citing *Van Gilder*, *261* N.W. at 30-31).

[114] Sec. 31, Ch. 441, Laws of 1947.

[115] *See Madison Teachers Inc.*, 2012 WL 4041495, at *11 ("The court finds that the allocation of responsibility for contributions to the Milwaukee ERS between the City and its employees is a 'local affair' for purposes of the Home Rule Amendment under *Michalek.* A statute that alters it is an unconstitutional intrusion into a matter reserved to the City of

All the trial court's holdings, including the one concerning the Home Rule Amendment, are currently under review by the Wisconsin Supreme Court and may still be overturned.[116] However, the use of the Home Rule Amendment illustrates how state constitutional provisions, not duplicated in the federal constitution, can play a pivotal role in deciding the fate of pension reform legislation.[117] That being said, the use of this device to find pension reform legislation invalid in the future appears to be somewhat limited. On the one hand, not every municipality is likely to have a Charter ordinance that definitively establishes the pension system as a matter of local control (although larger cities may be more sophisticated in this regard). On the other hand, one suspects that future pension reform efforts in Wisconsin will have express language stating that the legislation is of state-wide concern and such statements will be given great weight under current legal precedent in Wisconsin. Finally, Home Rule Amendment provisions only apply to local pension plans, not to state pension plans, for the straightforward reason that state plans do not involve the exercise of control over "local affairs."

B. Contract Clause Analysis

The Milwaukee public employee laborers were also successful at the trial court level in challenging the increased pension contribution under the

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Milwaukee.").

[116] After the Wisconsin Court of Appeals certified the question concerning the trial court's pension findings, the Wisconsin Supreme Court heard oral arguments on this case and a final decision should be issued in the summer of 2014. *See* Patrick Marley, *Judge Holds Employment Commissioners in Contempt in Act 10 Ruling*, JS ONLINE (Oct. 21, 2013), http://www.jsonline.com/news/statepolitics/contempt-claims-in-act-10-case-go-to-dane-county-judge-today-b99124619z1-228640081.html.

[117] And most states have home rule constitutional provisions. *See* Kenneth E. Vanlandingham, *Municipal Home Rule in the United States*, 10 WM. & MARY L. REV. 269, 277-78 (1968) (finding 33 states have constitutional home rule amendments).

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Wisconsin Constitution's contract clause.[118] Because of the complexity of contract clause analysis, this part is divided into a general overview of contract clause analysis and then a discussion of the trial court's finding in the *Madison Teachers* case.

1. General Overview of Contract Clause Legal Analysis

The federal version of the Contracts Clause, in pertinent part provides that, "No State shall . . . pass any . . . Law impairing the Obligation of Contracts."[119] Similarly, the Wisconsin state constitution states: "No . . . law impairing the obligation of contracts, shall ever be passed."[120] Even though the respective legislatures wrote these provisions in unambiguous language, they have been interpreted to mean that they do not "make unlawful every state law that conflicts with any contract."[121] Instead, a court is tasked with "reconcile[ing] the strictures of the Contract Clause with the essential attributes of sovereign power necessarily reserved by the States to safeguard the welfare of their citizens."[122]

Based on this guidance, Contract Clause claims are analyzed either under a two or three-pronged test.[123] The first question is "whether the state law has . . . operated as a substantial impairment of a contractual relationship."[124] This first question is sometimes divided into two questions

[118] *See Madison Teachers Inc.*, 2012 WL 4041495, at *1.

[119] U.S. CONST. art. I, § 10, cl. 1.

[120] WIS. CONST. art. I, § 12.

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

[122] U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 20 (1977). *See also* Energy Reserves Grp., Inc. v. Kan. Power & Light Co., 459 U.S. 400, 410 (1983).

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

[124] Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 244 (1978).

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(including in Wisconsin): (1) has the contract been impaired; and (2) if so, is the impairment substantial.[125] In any event, if the court concludes that contract was substantially impaired, the court next considers whether the impairment was "reasonable and necessary to serve an important government purpose."[126] Where the state is alleged to have impaired a public contract to which it is a party, "less deference to a legislative determination of reasonableness and necessity is required, because the State's self-interest is at stake."[127]

Wisconsin courts interpret the contracts clause in the Wisconsin Constitution in the same manner as its counterpart in the federal Constitution.[128] As in all constitutional challenges, when a law is challenged under the contracts clause, there is a strong presumption that the law is constitutional.[129] As far as burden of proof, Wisconsin courts hold that the challenging party has the burden to prove beyond a reasonable doubt that the law is unconstitutional.[130]

Although the language of the Wisconsin contract clause appears mandatory, it is not absolute[131] and must sometimes yield to the state's police power.[132] Nevertheless, the contract clause still imposes some limits

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[125] *See Reserve Life Insurance Company v. LaFollette*, 323 N.W. 2d 173 (Wis. Ct. App. 1982) (adopting a three-part inquiry to determine whether a state law was unconstitutional under the contract clause).

[126] *See U.S. Trust*, 431 U.S. at 25.

[127] *Parella*, 173 F.3d at 59.

[128] *See* Chappy v. Labor and Industry Review Commission, 401 N.W. 2d 568, 574 (Wis. 1987).

[129] *Id.* at 573.

[130] *Id.*

[131] *Chappy*, 401 N.W. 2d at 571.

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on the ability of a state to interfere with existing contractual relationships despite its police power.[133]

First, under this three-part contract clause test, Wisconsin courts have long held that contractual rights conferred pursuant to a municipal pension system are subject to the Wisconsin constitution's contract clause and that a state law that alters the contract is impairing an existing contractual relationship.[134] Second, courts consider whether the impairment is substantial.[135] A party must show that the law interferes with the parties' "expectations" to prove a substantial impairment.[136] In this regard, a court should consider whether the law was foreseeable or even plausible at the time the contract was made.[137] There is therefore a factual element to determining whether impairment is substantial.[138] Arguing that the new statutory obligation itself is a substantial impairment is not sufficient; rather, the party must provide evidence showing the effect of the impairment.[139]

Courts outside of Wisconsin have found that a law substantially impairs a contractual obligation when it unilaterally reduced "contractually established, future state employee salary obligations."[140] In this vein, courts

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[132] *See* State ex rel. Building Owners and Managers Ass'n of Milwaukee v. Adamany, 219 N.W. 2d 274, 280 (Wis. 1974).

[133] *See* Allied Structural Steel Company v. Spannaus, 438 U.S. 234, 242 (1978).

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

[135] *See Reserve Life*, 323 N.W. 2d at 176.

[136] *See Allstate*, 200 F. Supp. 2d at 1018.

[137] *See id*.

[138] *See Reserve Life*, 323 N.W. 2d at 178.

[139] *See id.*

[140] *See* University of Hawaii Professional Assembly v. Cayetano, 183 F.3d

have noted that interfering with employee pay creates a "financial hardship" and "is not an insubstantial impairment to one confronted with monthly debt payments and daily expenses for food and the other necessities of life."[141] Furthermore, when the state is faced with a budgetary deficit, the legislature has many alternatives available to it, such as reducing state services not governed by contract and raising taxes.[142]

If the court determines that a contractual impairment is substantial, the third and final step is to examine the purpose of the state legislation to determine whether the impairment is justified[143] and serves a significant and legitimate public interest.[144] To determine whether a law is justified, the court balances the extent of impairment against the public purpose the law purportedly serves.[145] In turn, the severity of impairment impacts the level of the court's scrutiny.[146] Under this sliding scale approach, the court applies a low level of scrutiny when the impairment is insubstantial and stricter scrutiny when the impairment is more severe.[147]

2. Contract Clause Analysis in *Madison Teachers*

In *Madison Teachers*, the plaintiff city laborers claimed that the required

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1096, 1104 (9th Cir. 1999).

141 *See id*. at 1105 (citing Association of Surrogates & Supreme Court Reporters v. New York, 940 F.2d 766 (2d Cir. 1991)).

142 *See id.* at 1106 (citing Opinion of the Justices (Furlough), 135 N.H. 625 (1992)).

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

144 *Chappy*, 401 N.W. 2d at 575.

145 *University of Hawaii*, 183 F.3d at 1107.

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

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

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pension contribution under Section 62.623 substantially impaired, without justification, a contractual right they had under the Milwaukee ERS. More specifically, they pointed to Milwaukee Charter Ordinance § 36-13-3-g, which provides that all pension plan participants have a "vested and contractual right to the benefits in the amount and on the terms and conditions as provided in law on the date the combined fund is created."[148] Such benefits, terms, and conditions under the Charter Ordinance, plaintiffs argued, included the city's obligation to pay the employee's share of retirement contributions.[149] Accordingly, "§ 63.623 alters that contractual right by prohibiting the City of Milwaukee from making those contributions."[150]

Applying the three-part contract clause analysis in the *Madison Teachers* case, the trial court first asked if the pension reform law impaired a contract. Although the state maintained that "the relevant section of the charter ordinance does not create a contractual right to employer contributions," the court agreed with plaintiffs that the pension reform measured impaired the city employees' contractual rights under the Milwaukee ERS to have the city pay their pension contributions because "increasing the amount the employee is required to contribute diminishes the value of the benefit for which the employee has contracted."[151]

Having found a contractual impairment, the court next considered whether the impairment was substantial. The state argued that it was not a substantial impairment both because municipal employee pension plans have been heavily regulated and because the impairment served a legitimate public purpose.[152] The court disagreed and based its finding of substantiality on the unforeseeability of the state's action.[153] According to

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[148] *Madison Teachers*, 2012 WL 4041495, at *11.

[149] *Id.*

[150] *Id.*

[151] *Id.*

[152] *Id.* at *12.

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the court, the impairment was not foreseeable, and therefore substantial for three reasons:

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

The third and final step of the contract clause analysis had the court examine whether the substantial impairment was justified. This part of the test amounts to balancing the substantiality of the contract impairment against the interest that the state is seeking to serve by passing the legislation.[154]

Here, the court found persuasive a California Supreme Court case, *Abbott v. City of Los Angeles*,[155] which held a similar increase in pension contributions to be an unjustified, substantial impairment of employee pension rights. In particular, the *Abbott* court found that neither the rising costs to the city nor speculation about future effects on taxpayers were enough to permit the contractual impairment.[156] The California Supreme Court also found a lack of evidence that the new legislation was necessary for "the preservation or protection of the pension program."[157]

The court in *Madison Teachers* came to the same conclusion,

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[153] *Id.*

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

[155] 50 C.2d 438, 326 P.2d 484 (Ca. 1958).

[156] *Id.* at 455.

[157] *Id.*

finding the substantial impairment of city employee pension rights unjustified based on budget concerns[158] or the current health of the Milwaukee ERS.[159] As already discussed, the Wisconsin Retirement System is one of the healthiest in the country and has not been significantly underfunded in the last twenty-five years.[160] Moreover, pension plans are not generally funded by general tax revenue, but by compensation commitments to employees in the form of deferred compensation.[161] Consequently, the court concluded that the plaintiffs

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

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

[160] *See supra* notes 14, 98.

[161] *See* Rick Ungar, *The Wisconsin Lie Exposed – Taxpayers Actually Contribute Nothing to Public Employee Pensions*, FORBES POLICY PAGE BLOG (Feb. 25, 2011), *at* http://blogs.forbes.com/rickungar/2011/02/25/the-wisconsin-lie-exposed-taxpayers-actually-contribute-nothing-to-public-employee-pensions (last visited Apr. 10, 2011) ("The pension plan is the direct result of deferred compensation – money that employees would have been paid as cash salary but choose, instead, to have placed in the state

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had established beyond a reasonable doubt that the pension reform legislation amounts to a substantial impairment of their contractual rights without justification.[162]

Again, it remains to be seen whether the Wisconsin Supreme Court will affirm the trial court's contract clause decision. What can be gleaned from the trial court's analysis is that such findings are highly fact specific and turn on such factors as charter amendments and even the financial health of the pension system, which might make state action more necessary and justified. In any event, this contract clause analysis provides a useful example for how other contract clause challenges have been mounted, fought, and decided across different state pension systems.[163]

C. Due Process Analysis

The last claim brought by the Milwaukee city employees in the *Madison Teachers* case alleged that the required contribution to the Milwaukee ERS

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operated pension fund where the money can be professionally invested (at a lower cost of management) for the future.").

[162] *Id.*

[163] Indeed, other cases from other courts stand for the proposition that state legislation that has the effect of reducing the pension rights of public employees to this magnitude would satisfy the requirement that the contractual impairment in question is substantial. *See, e.g.,* University of Hawaii Professional Assembly v. Cayetano, 183 F.3d 1096 (9th Cir. 1999) (finding that statute delaying payment of wages for six day period constituted a substantial impairment); Association of Surrogates and Supreme Court Reporters v. State of New York, 940 F.2d 766 (2d Cir. 1991) (holding that statute that provided for withholding of 10-days' pay prior to retirement constituted substantial impairment); Massachusetts Community College v. Massachusetts, 649 N.E. 2d 708 (Mass. 1995) (finding that between 2 and 15 day furloughs of public employees constituted a substantial impairment).

amounted to a deprivation of their property without due process.[164] Such claims require that a property interest be identified,[165] and then only if a property interest is found, does the court inquire whether the property interest was taken without due process.[166]

As to the first question, the court found the city employees had a property interest in their pension benefits because they a legitimate claim of entitlement to such benefits.[167] More specifically, "[t]he ordinance . . . created an entitlement to a certain benefit of employment with the City of Milwaukee: payment by the city of the employee's share of contributions to the pension plan."[168]

The court, however, did not find that this property interest had been deprived without due process of law. This is because generally speaking, "legislative determination[s] provide all the process that is due."[169] Although irrational and/or arbitrary legislation may still be found to violate due process, the court found that the plaintiffs had not provided evidence that the pension reform legislation at issue in the case met that criteria and, therefore, dismissed the due process claim.[170]

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

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164 *Madison Teachers*, 2012 WL 4041495, at *13.

165 *Id.*

166 *Id.*

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

168 *Id.*

169 *Id.* (citing Logan v. Zimmerman Brush Co., 455 U.S. 422, 432-33 (1982)).

170 *Id.*

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underfunded pensions, or related matters. On the other hand, it is interesting that the plaintiffs in *Madison Teachers* did not attempt to bring a takings clause claim.[171] The absence of this claim may be based on the belief that takings claims largely rise or fall on the same basis as contract clause claims, and so an independent taking claim was not necessary.[172] In any event, this due process claim does not appear to have been appealed to the Wisconsin Supreme Court,[173] and so of the three claims, it is the only one whose determination is final.

IV. LOCAL PENSION CASE STUDY: THE DETROIT BANKRUPTCY LITIGATION

Not all local public pension issues concern state pension reform efforts. Increasingly, municipalities in the United States are turning to the Bankruptcy Code to help alleviate the massive amounts of money owed to their retirement and other benefit plans.[174] Of course, the most well-known example of this phenomenon involves the City Detroit.[175] When Detroit

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171 *See* U.S. Const. amend. V ("nor shall private property be taken for public use, without just compensation.").

172 *See* Jack W. Beerman, *The Public Pension Crisis*, 70 WASH. & LEE L. REV. 3, 63-64 (2013) ("With regard to state and local reforms, the Takings Clause is unlikely to add much to claims under the Contract Clause because a participant's interest in pension promises is unlikely to be property unless it is found to be a contractual promise protected under the Contract Clause or state law pension doctrine.").

173 *See* Madison Teachers, Inc. v. Walker, No. 2012-AP-2067, 2013 WL 1760805, at *1 (Wisc. Ct. App. Apr. 25, 2013) (not mentioning due process claim as one that has been certified to the Wisconsin Supreme Court).

174 States are not currently eligible for bankruptcy under Chapter 9. *See* 11 U.S.C. § 109 (not listing states as entities permitted to seek bankruptcy protection).

175 Although Detroit is the most-well known municipal bankruptcy, there have been a number of others, especially in California in the past few years. In the Stockton, California bankruptcy, it is estimated that retirees lost

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filed for bankruptcy protection in the summer of 2013, it was the largest municipal bankruptcy filing in American history.[176]

One of the more complicated issues surrounding the Detroit bankruptcy was the degree to which the bankruptcy court could cut back on pension benefits owed to employees and retirees given specific provisions in the Michigan State Constitution providing protections against diminishment of pension rights.[177] Going in to the Detroit bankruptcy litigation it was unclear what protections, if any, Detroit public employees had under the U.S. Bankruptcy Code with regard to their pension rights because of the lack of precedent in this area.[178] Although the Detroit bankruptcy

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anywhere from thirty to seventy percent of their pension and medical benefits through the restructuring process (though contributions to the California Public Employees' Retirement System (CalPERS) were not touched). *See* Laura Mahoney, *Stockton Poised to Approve Ch. 9 Plan, Ask Bankruptcy Court for Approval*, PENSION & BENEFITS DAILY (BNA) (Oct. 3, 2013),http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=36982339&vname=pbdnotallissues&jd=a0e2e0g8b0&split=0. On the other hand, cities like Vallejo, California, that did not touch their pension obligations to CalPERS as part of past bankruptcy processes are again struggling to pay pension costs and are in danger of re-entering the bankruptcy process. *See* Tim Reid, *Two Years After Bankruptcy, California City Again Mired in Pension Debt*, REUTERS, Oct. 1, 2013, *available at* http://www.reuters.com/article/2013/10/01/usa-municipality-vallejo-idUSL2N0HM05C20131001.

[176] It is estimated that Detroit has 700,000 citizens, and that there are some 23,000 pension recipients and 9,000 current public employees. *See* Editorial, *For Detroit Retirees, Michigan's Pension Promise Must Be Kept*, DETROIT FREE PRESS (Aug. 1, 2013), http://www.freep.com/article/20130801/OPINION01/308010019.

[177] The Michigan Constitution states: "The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby." MICH. CONST. art. IX, § 24.

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proceedings have not yet concluded, the bankruptcy court has made a number of important rulings concerning the relationship between state constitutional provisions protecting pension rights and the Bankruptcy Code.

This Part discussed these development in two sections. The first section provides a very general overview of American municipal bankruptcy law. The second section then seeks to show how this law has been applied to the pension claims of city employees and retirees in Detroit. Needless to say, and unsurprisingly, the take home point is that municipal employees should never seek to have their pensions be subject to bankruptcy processes where their pension claims are likely to be reduced to some degree given their lack of sophistication and lack of voice in such a process.

1. Overview of American Municipal Bankruptcy Law

Insolvencies involving municipal bankruptcies fall under Chapter 9 of the U.S. Bankruptcy Code.[179] Municipalities cannot be forcibly liquidated, only required to restructure their debt.[180] Additionally, states have to pass legislation providing that they assent to their municipalities seeking

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[178] Municipal bankruptcies are still relatively rare in the United States. *See* Elizabeth K. Kellar, *Why Municipal Bankruptcy is Rare (and Should Be)*, ICMA.ORG (Aug. 29, 2013), http://icma.org/en/icma/newsroom/highlights/Article/103661/Why_Municipal_Bankruptcy_Is_Rare_and_Should_Be ("Over the last five years, only thirteen local governments—less than one percent of all eligible municipalities—have sought bankruptcy protection.").

[179] 11 U.S.C. § 901 et seq.

[180] *See See* KRISTEN DEJONG & BETH DOGHERTY, NUVEEN ASSET MGMT., MUNICIPAL BANKRUPTCY: A PRIMER ON CHAPTER 9, at 1, (2013), *available at* http://www.nuveen.com/Home/Documents/Viewer.aspx?fileId=48362; *see also* 11 U.S.C. §§ 301, 904 (2012) (prohibiting involuntary bankruptcies of municipalities).

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bankruptcy protection under Chapter 9.[181] Moreover, even if a state has given such assent,[182] there is a very time-consuming eligibility process where the federal bankruptcy court determines whether a municipality can actually go through the Chapter 9 process.[183]

Even if assent and eligibility are present, there are necessarily different considerations at play during a municipal bankruptcy than with a corporate one. For instance, there are issues concerning the need to continue to provide essential public services (like police, fire, sanitation, and utilities),[184] and there are issues concerning municipalities' ability to generate additional revenue through tax levies (as opposed to becoming more profitable through corporate reorganization).[185] Of course, municipalities do have bondholder creditors and other lenders just like

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[181] *See* 15 MCQUILLIN MUNICIPAL CORPORATIONS § 39:76 (3d ed. 2013); *see also* RANDYE SOREF ET AL., BUSINESS WORKOUTS MANUAL § 35:5 (2013–2014 ed. 2013) (discussing Chapter 9 bankruptcy provisions' recognition of state sovereignty in local affairs per the Tenth Amendment of the U.S. Constitution).

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

[183] *See generally* Eric W. Lam, *Municipal Bankruptcy: The Problem with Chapter 9 Eligibility—A Proposal to Amend 11 U.S.C. § 109(c)(2) (1988)*, 22 ARIZ. ST. L.J. 625 (1990).

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

[185] *See* Kevin A. Kordana, *Tax Increases in Municipal Bankruptcies*, 83 VA. L. REV. 1035, 1104–06 (1997) (evaluating the effectiveness of tax increases arising out of municipal bankruptcy).

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private companies.[186] The other similarity is that both private companies and municipalities have employees who have pension claims that are substantially impacted when their employers seek bankruptcy protection. While pension claims receive a priority under Chapter 11 corporate reorganizations,[187] such claims do not receive a priority under Chapter 9.[188]

The lack of creditor priority for employee creditors during the Chapter 9 bankruptcy process has significant implications. Generally, creditors of the insolvent public employer are notified of the insolvency filing and may file

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[186] *See id*. at 1046 (discussing the status of municipal bondholders in Chapter 9 bankruptcy proceedings); *see also* McConnell & Picker, *supra* note 184, at 429 (comparing creditor claims in private versus public bankruptcies).

[187] *See* 11 U.S.C. § 507(a)(4)–(5) (2012) (assigning "unsecured claims for contributions to an employer benefit plan" fifth priority). Combined with wages, these pension claims receive their preferred status up to a capped amount ($12,475 as of April 1, 2013). *See* Bob Eisenbach, Going Up: Bankruptcy Dollar Amounts Will Increase on April 1, 2013, In the (Red): The Bus. Bankr. Blog (Feb. 26, 2013), http://bankruptcy.cooley.com/2013/02/articles/business-bankruptcy-issues/going-up-bankruptcy-dollar-amounts-will-increase-on-april-1-2013. The employee is entitled to the priority for these amounts due within the 180 days prior to the bankruptcy petition. 11 U.S.C. § 507(a)(4)–(5) (2012). The pension priority (the fifth priority with other employee benefits under Section 507(a)(5) of the Bankruptcy Code) is only available if the $12,475 cap is not used up by the wage claim (the fourth priority under Section 507(a)(4) of the Bankruptcy Code).

[188] *See* JAMES E. SPIOTTO, CHAPMAN & CUTLER LLP, UNFUNDED PENSION OBLIGATIONS: IS CHAPTER 9 THE ULTIMATE REMEDY? IS THERE A BETTER RESOLUTION MECHANISM? 6 (2011), *available at* www.sec.gov/spotlight/municipalsecurities/statements072911/spiotto-slides2.pdf ("Pension obligations for municipal workers do not have priority in bankruptcy and no protection for deferred compensation.").

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claims for satisfaction of the debts owed to them by the public employer.[189] The court will liquidate some or all of the assets of the municipality in as expeditious a manner as practicable by paying off the claims of creditors according to a predetermined hierarchy of claims.[190]

Creditor claims that are given preference over other creditor claims are said to enjoy a "priority" and are satisfied first among the various claims.[191] The concept of priority is important because of the insolvent municipalities' limited assets.[192] Only those creditors who have the highest priorities are likely to have any of their claims against the municipality satisfied.[193] The lower the priority of one's claim, the more likely the creditor will receive little or nothing from the remaining assets.[194] Thus, if a pension claim is given a relatively low priority among a municipalities' creditors, there is every chance that the employee will not receive any pension payments for these claims.[195]

Regarding Chapter 9 municipal bankruptcy proceedings, not much experience exists for how employee claims should be treated (though in a number of recent municipal bankruptcies in California, pensions have not

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189 *See* RICHARD I. AARON, BANKRUPTCY LAW FUNDAMENTALS 28 (2013).

190 *See* AARON, *supra* note 189, at 29, 35.

191 *Id.* at 429.

192 *See* GORDON JOHNSON, OECD, INSOLVENCY AND SOCIAL PROTECTION: EMPLOYEE ENTITLEMENTS IN THE EVENT OF EMPLOYER INSOLVENCY 5 (2006), *available at* http://www.oecd.org/corporate/ca/corporategovernanceprinciples/38184691.pdf.

193 *See* AARON, *supra* note 189, at 429.

194 *Id.*

195 *See id.*

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been cut).[196] What does appear clear is that the wage and pension priorities of Section 507 of the Bankruptcy Code, which apply to Chapter 11 corporate reorganizations, do not apply in Chapter 9.[197] Thus, most people believe that unfunded municipal pension liabilities are unsecured and enjoy the lowest priority among creditors.[198]

The lack of employee priority for their pension claims is problematic, but even with a greater creditor right, the bankruptcy process does not favor public employee pension claims. This is because employees are less likely, given the amount of money involved, the complexity of the process, and their lack of knowledge, to take advantage of whatever priority they receive for their employment claims.[199] Not only that, but even if employees do manage to negotiate the process, file a timely claim, and receive a fairly large portion of what they are owed, they will likely not receive it for many years given how long it takes the bankruptcy process to be completed.[200] Thus, if the aim of the social protection system is to protect already-earned employee pensions when their public employer becomes insolvent in a more timely and efficient manner, the granting of a priority alone may not be the best method for doing so.[201]

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[196] *See supra* note 175 and accompanying text.

[197] *See supra* note 188 and accompanying text.

[198] *Id.*

[199] *See* JOHNSON, *supra* note 192, at 7.

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

[201] Indeed, because of this dynamic, many countries in the private sector provide for guarantee funds or insurance schemes. The United States has such an insurance scheme for defined benefit pension plans in the private

2. The Detroit Bankruptcy Litigation

Detroit Emergency Manager Kevyn Orr, with the acquiescence of the Governor Bill Snyder of Michigan, filed for bankruptcy in the summer of 2013, claiming that the city had a deficit of $18 billion, of which $5.7 billion represented retiree healthcare liabilities and $3.5 billion represented pension liabilities.[202] Even before the bankruptcy petition was filed, public employee unions and the pension funds went on the offensive to protect city employee pensions from the bankruptcy process.[203] Citing the Michigan State Constitution provisions which protect pension obligations from diminishment,[204] the plaintiffs argued that the Chapter 9 bankruptcy

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sector through the Pension Benefit Guaranty Corporation (PBGC). *See* 29 U.S.C. §§ 1301-1461 (2012). Although the payments available under such guarantee funds are limited to certain amounts for specified time periods prior to the insolvency filing, *See, e.g.*, 11 U.S.C. § 507(a)(4)–(5) (2012) (U.S. limitation upon claims to within 180 days of insolvency through PBGC), they do provide a timelier and surer method for protecting the already-earned pension claims of employees. *See* JOHNSON, *supra* note 192, at 7. Unfortunately, no such guarantee schemes exists for public pension claims in the United States.

[202] *See* Bernie Woodall & Joseph Lichterman, *Detroit manager scores first win over unions in bankruptcy bid*, REUTERS (July 24, 2013), http://www.reuters.com/article/2013/07/24/us-usa-detroit-idUSBRE96N05Z20130724.

[203] *See* Stephanie Francis Ward, *Detroit Bankruptcy Unconstitutional, judge rules in pension case*, ABA JOURNAL (July 19, 2013), http://www.abajournal.com/news/article/judge_grants_pension_lawyers_motion_detroit_bankruptcy/ ("During the hearing the judge said she planned to issue an order blocking the bankruptcy filing. However Rick Snyder, the governor of Michigan, and Kevyn Orr, Detroit's emergency manager, filed the bankruptcy petition five minutes before the Thursday hearing began.").

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

proceeding had to be stopped before it interfered with these state constitutional rights.[205] Although the unions and pension funds were initially able to get a state court judge to stay the bankruptcy proceedings until the scope of the constitutional provision could be determined,[206] that victory was short-lived. A couple days later a state court of appeals vacated that stay order and allowed the bankruptcy proceeding to go forward.[207]

From there, Bankruptcy Judge Steven Rhoads found that he had jurisdiction over all Detroit city assets, including its pension funds, stayed all related state court proceedings against state officials who filed the bankruptcy, and ruled that all objections concerning the bankruptcy processes' impact on pension claims had to be heard in bankruptcy court.[208] He then held the necessary eligibility hearings under Chapter 9, and over the vehement objections of the city unions and pension funds, found that Detroit was eligible for bankruptcy.[209] A number of public unions and pension

[205] Ward, *supra* note 203.

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

[207] *See* Martha Neil, *Appeals Court Puts Brakes on State Court Judge's Order Derailing Detroit Bankruptcy*, ABA Journal (July 23, 2013), http://www.abajournal.com/news/article/appeals_court_puts_brakes_on_state_judges_order_derailing_detroit_bankruptc/ ("Injunctive relief granted Friday by a Michigan judge who ordered the city of Detroit to withdraw its Chapter 9 bankruptcy filing was stayed Tuesday by the state court of appeals.").

[208] *See* Woodall & Lichterman, *supra* note 202 ("Judge Steven Rhodes ordered three lawsuits filed by city workers, retirees and pension funds be halted and extended that stay to suits against Michigan's governor, treasurer and Detroit's emergency manager. Rhodes' action ensures that the only path to fight the city's Chapter 9 bankruptcy petition runs through his courtroom in downtown Detroit.").

[209] *See* Nathan Bomey, Brent Snavely & Alisa Priddle, *Judge rules Detroit eligible for historic Chapter 9 bankruptcy, pensions can be cut*, DETROIT

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funds responded by filing appeals to stop the bankruptcy process from going forward.[210]

At the same time, Judge Rhoads concluded that the Michigan State Constitution did not prevent pension obligations from being subject to the bankruptcy process.[211] He concluded that pension obligations were essentially contractual in nature and subject to adjustment under the Bankruptcy Code like any under contractual obligation.[212] More worrisome for public employees and retirees, he also concluded that pension claims had no priority under Chapter 9 and thus, would be treated as unsecured claims.[213]

These legal conclusions appeared to have spurred various public employees and retirees to engage in informal mediation to come up with a an agreement that would permit the bankruptcy process to go forward, while sparing large parts of the pension obligations owed to employees and retirees.[214] For instance, under an agreement between the city and groups

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FREE PRESS (Dec. 3, 2013), http://www.freep.com/article/20131203/NEWS01/312030084/Detroit-bankruptcy-eligibility-Steven-Rhodes-Chapter-9-Kevyn-Orr ("Rhodes — in a surprise decision this morning — also said he'll allow pension cuts in Detroit's bankruptcy. Rhodes emphasized that he won't necessarily agree to pension cuts in the city's final reorganization plan unless the entire plan is fair and equitable.").

[210] *Id.*

[211] *Id.*

[212] *See* Nathan Bomey, *Judge Rules Pensions Can Be Cut in Detroit Bankruptcy*, DETROIT FREE PRESS (Dec. 3, 2013), http://www.freep.com/article/20131203/NEWS01/312030080/Judge-Steven-Rhodes-pensions.

[213] *Id.* ("'Pension benefits are a contractual obligation of a municipality and not entitled to any heightened protection in bankruptcy,' Rhodes said.").

[214] *See* Steven Church, *Detroit Reaches Accord on Health Benefits, Pensions with Police, Firefighter Retirees*, Bloomberg BNA Pension &

representing retired police and firefighters, "[p]olice and firefighter retirees would see no cuts in their monthly pensions, while cost-of-living increases would be reduced by more than half."[215] The deal was helped by pledges by private foundations and the state of Michigan to kick in almost a billion dollars to both continue to pay active retirees and to make sure current employees also will have pensions when they retire.[216] Almost simultaneously with the retired police and firefighters, the city reached deals with two major pension funds.[217] These compromises require the pension plans to drop pending appeals concerning the impact of the Michigan Constitution on the bankruptcy process.[218] The agreements must also be both voted on by impacted city employees and retirees and will be presented to Judge Rhoads during a hearing in July 2014 as part of the process of approving the plan of adjustment.[219] However, it is important to note that at

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Benefits Daily (Apr. 15, 2014), http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=44880369&vname=pbdnotallissues&jd=a0e9c4p3j1&split=0.

[215] *Id.*

[216] *Id.* ("The deal, reached April 15, can go through only if the city wins approval of a proposal from the state and private foundations, who offered $816 million to bolster the city's pension systems in exchange for a plan that would shield Detroit's art collection from a forced sale.").

[217] *See* Steven Church, *Detroit Pension Funds Reach Tentative Deal with City on Cuts*, Bloomberg BNA Pension & Benefits Daily (Apr. 16, 2014), http://news.bna.com/dlln/DLLNWB/split_display.adp?fedfid=44950897&vname=dlrnotallissues&jd=a0e9c8v4e6&split=0 ("General employees' pensions would shrink by 4.5 percent, instead of the 26 percent initially proposed by emergency manager Kevyn Orr, according to a person familiar with the settlement. They would lose an annual cost of living adjustment.").

[218] *Id.* ("As part of the 'grand bargain' with the state and foundations, pensioners and city employees will have to give up their rights to sue to block the bankruptcy proceedings.").

[219] *Id.* ("Any pension deal can go through only if enough retirees and

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time of the writing of this article, not all city retirees have a deal with the city in place yet.[220]

The lesson appears to be that even with specific Constitutional language seeking to protect against pension cut-backs, no pension rights are safe from diminishment once the bankruptcy process commences. Although the bankruptcy process appears to have led to relatively minimal cuts in pension benefits for both employees and retirees in Detroit, it should be remembered that without the state and private foundations providing money to the pension funds, the outcome of this process could have been very different. That being said, it should also be emphasized that municipal bankruptcies cannot even take place in many states which have not passed legislation authorizing municipal bankruptcies. Nevertheless, because of the uncertainty of the bankruptcy process, municipalities and their employees will do well to pass comprehensive pension reform which will allow them to address current pension underfunding and to avoid bankruptcy proceedings.

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

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

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current employees vote in favor of a final version of such an agreement as part of the city's plan of adjustment. That plan needs the approval of U.S. Bankruptcy Judge Steven Rhodes."). More recently, the bankruptcy court gave Detroit's plan of adjustment to emerge from bankruptcy approval and the impacted groups will vote on the plan from May to July of 2014. *See* Nora Macaluso. *Judge Approves Detroit Adjustment Plan; State Aid, Creditors' Vote Awaited*, BLOOMBERG BNA PENSION & BENEFITS DAILY (May 6, 2014), http://news.bna.com/pdln/PDLNWB/split_display.adp?fedfid=46049895&vname=pbdnotallissues&jd=a0e9z4a8u4&split=0 ("Rhodes ordered the city to send ballot materials to pension plan participants and other creditors by May 12, and voting will continue until July 11. A confirmation hearing is scheduled to begin July 24.").

[220] *Id.* ("A court-approved committee representing all retirees, including former general employees who have an average pension of about $19,000 a year, wasn't mentioned in either of the pension accords.").

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

A. Previous Attempts to Harmonize American Public Pension Law

Commentators in the past have remarked on two potential methods for providing more consistent and uniform standards for public pension plans across the board: expand ERISA's funding, fiduciary, and other provisions to all public pension plans[221] and/or provide a model uniform public pension law with many of the same ERISA provisions that states could adopt with additional emphasis on issues unique to public pension plans.[222]

Each of these approaches have already been attempted or contemplated to one degree or another. In fact, when ERISA was first enacted in 1974, Congress considered covering governmental plans along with private sector plans.[223] As discussed above, this proposal was rejected both because it was thought that taxpayers would back underfunded pension plans if states or municipalities became financially distressed[224] and because of federalism concerns that the federal government would trench upon traditional areas of state law concern.[225] Two other reasons were advanced for not applying

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[221] *See* Monahan & Thukral, *supra* note 23, at 292.

[222] *See* Mendales, *supra* note 23, at 510-511.

[223] *See* Monahan & Thukral, *supra* note 23, at 297 ("When ERISA was being debated by Congress, active consideration was given to including governmental plans within its reach."); Mendales, *supra* note x, at 508-09 ("Congress itself believed that it could not apply ERISA to the *509 states based on these issues when it originally enacted the legislation in 1974.").

[224] *See supra* note x and accompanying text.

[225] *See* Monahan & Thukral, *supra* note 23, at 297. *See also* Gualandi v. Adams, 385 F.3d 236, 243 (2d Cir. 2004) ("[O]ne Senator commented that 'State and local governments must be allowed to make their own

ERISA to governmental plans: "Congress thought private pension plans were more likely than public pension plans to incorporate unduly restrictive and unfriendly provisions that prevented employees from vesting,"[226] and "Congress was worried that imposing minimum funding and similar standards would have 'entail[ed] unacceptable cost implications to governmental entities.'"[227] Since that time, although a provision was placed in ERISA to study the possibility of expanding the law to governmental plans[228] and a number of pieces of legislation were introduced to do just that every year between 1978 and 1984,[229] no such law eliminating the governmental plan exemption has ever been enacted.

On the other hand, the National Conference of Commissioners on Uniform State Laws put forward in 1997 a uniform public pension law: the Uniform Management of Public Employee Retirement Systems Act (UMPERSA).[230] This uniform law seeks to: (1) ensure all pension assets

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determination of the best method to protect the pension rights of municipal and state employees."'); Roy v. Teachers Ins. & Annuity Ass'n v. Coll. Ret. Equities Fund, 878 F.2d 47, 50 (2d Cir. 1989) ("We think it clear that the congressional goal of preserving federalism requires that when a pension plan has been established by a governmental entity for its employees and the governmental entity's status as employer has not changed, the plan must be exempt from ERISA as a governmental plan.").

[226] *Id.* (citing Rose v. Long Island R.R. Pension Plan, 828 F.2d 910, 914 (2d Cir. 1987); H.R. Rep. No. 93-533 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4667).

[227] *Id.* (citing H.R. Rep. No. 93-807 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4830; *see also* H.R. Rep. No. 93-533, 1974 U.S.C.C.A.N. 4639, 4668).

[228] 29 U.S.C. § 1231 (2006).

[229] *See* Monahan & Thukral, *supra* note 23, at 297 (citing Ridgeley A. Scott, *Misuse of Public Pension Assets: White Collar Crimes and Other Offenses*, 26 IND. L. REV. 589, 590 (1993)).

[230] Uniform Management of Public Employee Retirement Systems Act

are held in trust; (2) impose prudent investment rules; (3) establish trustee liability for fiduciary breaches; (4) set up required disclosures to plan participants, and (5) establish an enforcement schemes for violation of the Act.[231] Although UMPERSA establishes some important new rules concerning investment strategies and protections for investing public pension assets, it does not go nearly far enough in providing other necessary regulations to ensure the financial stability of public plans.[232] Indeed, perhaps in recognition of UMPERSA's shortcomings, only two states, Wyoming and Maryland, have adopted this Uniform Law in the last seventeen years.[233]

B. Hybrid Approach for Standardizing American Public Pension Law

This article proposes a hybrid approach to standardize the best public pension law practices at all levels of American government, largely in accordance with pension principles established under ERISA. This section is further divided into an exploration of expanding ERISA to cover federal

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(1997), http://www.uniformlaws.org/Act.aspx?title=Management%20of%20Public%20Employee%20Retirement%20Systems%20Act.

[231] *See* Management of Public Employee Retirement Systems Act Summary, Uniform Law Commission (1997), http://www.uniformlaws.org/ActSummary.aspx?title=Management%20of%20Public%20Employee%20Retirement%20Systems%20Act.

[232] *Accord* Mendales, *supra* note 23, at 521-22 (criticizing UMPERSA for, among other reasons, providing "only for simplified administration, accounting, and disclosure concerning the financial records of retirement systems," and "not require auditing."). Mendales also points out rightly that UMPERSA "fails to include an emergency fund to provide backup coverage for plans whose ability to pay benefits has been threatened or blocked by an unforeseen emergency." *Id.* at 522.

[233] *See Overview of Management of Public Employee Retirement Systems Act*, http://www.uniformlaws.org/Act.aspx?title=Management%20of%20Public%20Employee%20Retirement%20Systems%20Act.

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pension plans and an examination of formulating a new and improved uniform public pension law for adoption by the states.

1. Expanding ERISA Coverage to Federal Pension Plans

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

This approach makes sense when one reconsiders each of the reasons Congress chose not to subject public pension plans to ERISA in the first place. First, and most obviously, arguments about federalism have no role to plays if the federal government moves to regulate federal benefit plans under ERISA. Second, Congress mistakenly believed in the 1970s that underfunded public pension plans would be bailed out by taxpayers if they encountered financial problems.[234] But with the recent spate of municipal bankruptcies and the significant underfunding of federal, state and local pension funds, history has shown that the federal government and states are either unwilling or incapable of raising tax revenue to bail out failing pension plans. Third, Congress was worried that imposing ERISA minimum funding requirements would cause the financial burden of those requirements to fall on taxpayers.[235] Yet again, history has proven that without minimum funding standards, public pension funds have become significantly underfunded (as federal pension plans are right now)[236] and the taxpayers will take an even a greater financial burden as a result.

In all, none of the justifications for excluding governmental plans *in toto* from ERISA coverage seem to apply with any force to excluding federal pension plans alone. It may be argued that generally speaking that federal plans are not in as bad of shape as state and local plans and that the laws regulating federal plans are more in keeping with the strict regulations of ERISA. Yet, as described above, the federal pension trust became

[234] *See* Monahan & Thukral, *supra* note 23, at 297.

[235] *Id*.

[236] *See supra* note 75 and accompanying text.

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underfunded in the first place both because the CSRS did not take into account employee pay raises and COLAs, but also because Congress failed to pre-fund these funds on an actuarial sound basis.[237] This dynamic has led the federal pension trust to have an actuarial liability of $761.5 billion dollars.[238] Surely, additional reporting, participation, eligibility, benefit accrual, funding, fiduciary, and enforcement mechanisms provided by ERISA would go a long way in reducing the pension underfunding that the federal system now faces and ensuring that such financial issues do not recur in the future.

Logistically, federal legislation should be passed to partially lift the governmental plan exemption so that federal employee pensions under the FERS, CSRS, and TSP, would be subject to the various ERISA pension plan requirements (and also subject to plan qualification under the Internal Revenue Code).[239] This would be a relatively modest expansion of ERISA, as there are about 2.7 million federal employees in the United States.[240] On the other hand, given recent Congressional bills to require federal employees to contribute to their pensions and/or to migrate to a defined contribution plan,[241] ERISA might provide the necessary protective

[237] *See supra* note 76 and accompanying text.

[238] *See supra* note 75 and accompanying text.

[239] *See* Monahan & Thukral, *supra* note 23, at 294 ("In addition to ERISA requirements, retirement plans also must comply with provisions in the Internal Revenue Code of 1986 (the Code) in order to receive certain tax benefits. While ERISA exempts governmental plans entirely from its reach, the Code still imposes some, though significantly reduced, requirements on governmental plans.").

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

[241] *See supra* notes 85-90 and accompanying text.

framework under which such pension plan design implementations could occur.

2. Construction of a New, More Comprehensive Uniform Public Pension Law for State and Local Pension Plans

Whereas federal employee pension plans would be subject to ERISA, state and local pension plans would continue to be exempt under this hybrid proposal. Instead, and in place of the current UMPERSA uniform law, this article proposes adopting a far more comprehensive model law that would require each state to have one public pension system for the entire state; contain ERISA-like provisions concerning reporting and disclosure requirements, fiduciary requirements, and meaningful remedial provisions; and also contain provisions specifically suited to address unique issues surrounding public pension plans. In thinking about what such a uniform law should look like, this article borrows liberally from recent writings by Professor Mendales on a new uniform public employee benefit law.[242]

First, Professor Mendales' uniform law proposal requires that, "all benefit funds maintained by a state, its subdivisions, and instrumentalities be subsumed under common administration by state agencies selected in a nonpolitical way and be subject to uniform rules on financing and accountability."[243] This state-wide uniform law would have a number of advantages. A state-wide plan that covers all state and local employees would provide uniform funding, fiduciary, and enforcement mechanisms applicable to all public employees in the state and would ensure that local plans would not have different or inconsistent provisions.[244] It would also

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[242] Whereas the focus of this article's proposal is on public pensions, Professor Mendales' proposal more broadly seek to cover all public employee benefit plans sponsored by states and municipalities. See Mendales, *supra* note 23, at 522.

[243] *Id.* at 510.

[244] Having state-wide plans operating under a uniform code, in turn, would "provide a template to assist legislatures in dealing with difficult issues such as funding, investing and administering trust funds, structuring benefits, and ensuring the integrity of benefit funds." *Id.* at 514. It would also help overcome local pension plans' vulnerability to political pressure, which

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likely make it easier to "pass the model act without separately drafting and wrangling over individual programs for different groups of employees."[245] Having all public pension plans in one state pension fund would also have the advantages that come with economies of scales, including access to more sophisticated financial advisors and actuaries, more competitively priced investment products, and the ability to diversify pension assets among a larger group of investments.[246] Finally, Mendales proposes compacts or more informal arrangements be entered into by states that adopt the uniform code to "address common problems faced by states in administering their respective codes and for coordinating state efforts to keep their codes uniform on important issues."[247] This article favors a more incremental approach based on informal arrangements between the states, as interstate compacts would require federal involvement which would complicate state pension plan regulation unnecessarily.[248]

Second, such model legislation would provide for adequate funding provisions and ensure that the promised benefits were paid on a timely basis.[249] Many of the funding requirements would be drawn directly from

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causes local plans "to underestimate the long-term costs of benefits and, in turn, required employer and employee contributions." *Id.* at 518.

[245] *Id.* at 511.

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

[247] *Id.* at 539. For further discussion of interstate compacts for pooling resources for benefit funds, *see generally id.* at 546-547.

[248] *Id.* at 545 n. 167 ("Article I, Section 10, Clause 3 of the federal Constitution allows states to enter compacts with each other if specifically permitted by Congress.").

[249] *Id.* at 511.

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the ERISA context, while other provisions would require plans to engage in internal de-risking strategies. One example of an internal approach is "hedging" against interest rate changes,[250] while another example is "liability driven investing," in which an effort is made to match the characteristics of the investment assets underlying the pension promise with payout obligations to pensioners.[251] Such hedging or liability-driven investing would reduce the risks associated with plan investment.[252] Similarly, strong fiduciary language, combined with minimum pre-funding requirements, would make it more difficult for politicians and bureaucrats to kick the public pension funding can down the block.[253] Of course, a number of the basic ERISA provisions involving eligibility, vesting, and benefit accruals could also be added.[254] Perhaps down the line, even a public-based PBGC insurance scheme could be put into place when a pension plan is terminated for lack of funding or because of the insolvency of a municipality.[255]

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[250] *See* Meghan Elwell & Alex Pekker, *Pension funds should derisk now,* PENSION AND INVESTMENTS (March 11, 2014), http://www.pionline.com/article/20140311/ONLINE/140319974/pension-funds-should-derisk-now.

[251] *See* Jayne Gest, *How to reduce your defined benefit risk, even after freezing the plan,* SMART BUSINESS (December 31, 2012), http://www.sbnonline.com/component/k2/1-akron-canton-editions/25783#.U015GPldWdw.

[252] *See* Mendales, *supra* note 23, at 511-12 (maintaining that uniform law should require using "qualified actuaries to match contributions and investment returns with predicted payouts to beneficiaries.").

[253] *See id.* at 512. Mendales also argues for the model law to have an Office of the Inspector General "to police the integrity of plan fiduciaries and their advisors. *Id.* at 538-39.

[254] *Accord id.* at 512-513 (laying out ERISA provisions that model law would borrow).

[255] *See* Paul M. Secunda, *An Analysis of the Treatment of Employee Pension and Wage Claims in Insolvency*

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

Finally, the model law should have provisions which ERISA does not have, which are specifically focused on the needs of public employees and employers. For instance, Professor Mendales identifies the following issues that need to be addressed by a uniform public pension law, which are not covered by ERISA: "adequate public funding, protecting state credit, and states' ability to offer attractive benefit packages to their employees."[256] For instance, the uniform law should have more extensive disclosure requirements, providing plan participants with information regarding the cost, risk, and expected returns on investments.[257] This more extensive disclosure could then also help "reduce the cost of borrowing funds by states and their instrumentalities by giving prospective purchasers of municipal securities improved information on the risks underlying such securities."[258] Other public employee-specific provisions could address: (1) the need for greater transparency given that governmental decisionmaking is involved; (2) state budgeting processes and state-specific accounting

and Under Guarantee Schemes in OECD Countries: Comparative Law Lessons for Detroit and the United States, 41 FORDHAM URB. L.J. 867, 936 (2014) (based on comparative study, arguing for establishment of federal pension and wage guarantee fund covering both public sector and private sector employees). Mendales contemplates a similar PBGC-like insurance scheme in cases of public pension plan emergencies. *See* Mendales, *supra* note 23, at 539-43.

[256] *See* Mendales, *supra* note 23, at 508.

[257] *Id.* at 514.

[258] *Id.*

standards; (3) the lack of Social Security coverage for some public employees; and (4) mandatory retirement ages for police and firefighters.

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

CONCLUSION

The purpose of this contribution to the Symposium has been to highlight the plight of American public pension plans. The public is demanding significant public pension reform thanks to lax legal regimes that have permitted significant pension underfunding. Pension underfunding exists at all levels of American government and inevitably leads to litigation concerning various pension reform measures that seek either to require additional employee contributions or to cut back on benefits for retirees. As a result, government officials, employees, and retirees are in the midst of litigating for the future of American public pensions. In the end, society as a whole loses regardless of the outcome of the litigation because either employees and retirees lose hard-earned pension benefits (and thus destitute must rely on government welfare programs) or states and municipalities spiral further out of financial control and perhaps, even into bankruptcy.

The start of a solution lies with harmonizing and standardizing the existing hodge-podge of American public pension law. Although ERISA is far from perfect in regulating private-sector pension plans in the United States, it nevertheless has provided uniform standards for management and administration of occupational retirement plans. In order to replicate that same consistency, this article proposes a hybrid approach which seeks to avoid some of the shortfalls of previous public pension reform proposals. By applying ERISA only to federal pension plans, and by permitting the states to adopt comprehensive uniform public pension legislation, public pension plans can take advantage of a reliable and stringent pension framework which will prevent future underfunding and fiduciary lapses. Perhaps with some luck, such a public pension regime might even one day provide an attractive model for our neighbors to the north to emulate.