



OFFICE OF THE ATTORNEY GENERAL
STATE OF ILLINOIS

Lisa Madigan
ATTORNEY GENERAL

June 30, 2005

FILE NO. 05-005

PENSIONS:

Constitutionality of General Assembly
Reducing Scheduled State Contributions
to the Retirement Systems

The Honorable Judy Baar Topinka
Treasurer, State of Illinois
Statehouse, Room 219
Springfield, Illinois 62706-1000

Dear Treasurer Topinka:

I have your letter and memorandum inquiring: (1) whether Public Act 94-004, effective June 1, 2005, incurred "State debt," as that phrase is defined in article IX, section 9, of the Illinois Constitution of 1970 (Ill. Const. 1970, art. IX, §9), by reducing the amount of the scheduled payments to the State retirement systems over the next two fiscal years, thereby requiring the legislation to have passed by a three-fifths vote of each house of the General Assembly; (2) whether the reduction in the amount of the scheduled payments to the State retirement systems violates article XIII, section 5, of the Constitution (Ill. Const. 1970, art. XIII, §5), which creates an enforceable contractual relationship that protects against the diminishment

or impairment of State pension benefits; and (3) whether Public Act 94-004 violates the provision of the American Federation of State, County and Municipal Employees (AFSCME) contract requiring the State to make contributions to the retirement systems, thereby constituting an impairment of contract in violation of article I, section 16, of the Constitution (Ill. Const. 1970, art. I, §16). For the following reasons, it is my opinion that Public Act 94-004 does not violate these provisions of the Constitution.

Background

The State of Illinois has created five State-funded retirement systems: the State Employees' Retirement System, the State Universities Retirement System, the Teachers' Retirement System of the State of Illinois, the General Assembly Retirement System, and the Judges Retirement System of Illinois. 1963 Ill. Laws 161. Each retirement system is governed by separate articles of the Illinois Pension Code (the Pension Code) (40 ILCS 5/1-101 *et seq.* (West 2004)) and is funded by a combination of employee contributions, employer (State) contributions, and interest and investment income. The respective sections of the Pension Code for the various retirement systems set forth the contribution requirements of the participants (40 ILCS 5/2-126, 14-133, 15-157, 18-133 (West 2004); 40 ILCS 5/16-152 (West 2004), as amended by Public Act 94-004, effective June 1, 2005) and the employer (State) (40 ILCS 5/2-124, 14-131, 15-155, 16-158, 18-131 (West 2004), as amended by Public Act 94-004, effective June 1, 2005). The overall amount of money needed to fund State pension benefits is based upon a combination of factors, including the formula for determining the pension benefits of

participants, the number of State employees participating in each system, their wages and length of State service, interest rates, and investment income.

On May 29, 2005, the General Assembly passed Senate Bill 27, which was signed into law by the Governor on June 1, 2005, as Public Act 94-004. This Act, among other things, makes changes to the required State contributions to the retirement systems. Specifically, Public Act 94-004 alters the funding plan that was created in 1994 (Public Act 88-593, effective August 22, 1994) by fixing the State contribution levels for FY2006 and FY2007, rather than requiring the State to make contributions based on actuarial calculations previously required by Public Act 88-593. Public Act 94-004 reduces the required State contributions to the retirement systems by \$1.1787 billion in FY2006 and \$1.1332 billion in FY2007. Public Act 94-004 also changes the current funding plan to specify that the State's contribution to the retirement systems for FY2008 through FY2010 would be increased in equal annual increments from the required State contribution for FY2007, so that by FY2011, the State will be contributing at a level percent of payroll. Although the General Assembly changed the annual State contributions to the retirement systems for FY2006 through FY2010, the General Assembly did not change the Pension Code requirement that, by the end of FY2045, the total assets of the retirement systems must be 90% of the total actuarial liabilities of those systems. 40 ILCS 5/2-124(c), 14-131(e), 15-155(a-1), 16-158(b-3), 18-131(c) (West 2004), as amended by Public Act 94-004, effective June 1, 2005.

"State Debt" Clause - Article IX, Section 9

Your first question is whether Public Act 94-004 has caused the State to "incur" "State debt" as those terms are used in article IX, section 9, of the Illinois Constitution of 1970 (Ill. Const. 1970, art. IX, §9). Specifically, your office has suggested that because the State is likely to be required to make larger payments in later years to fund the retirement systems, the decision to reduce State payments in the next two fiscal years is a decision to "incur" "State debt" under article IX, section 9.

Article IX, section 9 provides, in pertinent part:

(a) *No State debt shall be incurred except as provided in this Section. For the purpose of this Section, "State debt" means bonds or other evidences of indebtedness which are secured by the full faith and credit of the State or are required to be repaid, directly or indirectly, from tax revenue and which are incurred by the State, any department, authority, public corporation or quasi-public corporation of the State, any State college or university, or any other public agency created by the State, but not by units of local government, or school districts.*

(b) *State debt for specific purposes may be incurred or the payment of State or other debt guaranteed in such amounts as may be provided either in a law passed by the vote of three-fifths of the members elected to each house of the General Assembly or in a law approved by a majority of the electors voting on the question at the next general election following passage. Any law providing for the incurring or guaranteeing of debt shall set forth the specific purposes and the manner of repayment. (Emphasis added.)*

Although many Illinois cases have dealt with issues concerning "State debt" (see *People ex rel. Ogilvie v. Lewis*, 49 Ill. 2d 476 (1971); *People ex rel. Hanrahan v. Caliendo*, 50 Ill. 2d 72 (1971), *appeal dismissed*, 406 U.S. 965, 92 S. Ct. 2412 (1972); *Hoogasian v. Regional*

Transportation Authority, 58 Ill. 2d 117 (1974), *appeal dismissed*, 419 U.S. 988, 95 S. Ct. 298 (1974); *Day v. Regional Transportation Authority*, 66 Ill. 2d 533 (1977); *Geja's Cafe v. Metropolitan Pier & Exposition Authority*, 153 Ill. 2d 239 (1992)), no Illinois case has specifically addressed whether the State incurs "State debt" by reducing contributions to the retirement systems. In reviewing the constitutional debates concerning article IX, section 9, it is clear that the framers intended for that section to restrict a State's ability to *borrow* funds, via the issuance of bonds or other paper indebtedness. 3 Record of Proceedings, Sixth Illinois Constitutional Convention 1926-1934, 2095-2111; 5 Record of Proceedings, Sixth Illinois Constitutional Convention 3848-3872, 3896-3907. There is no evidence that the framers intended to extend the debt provisions beyond the commonly understood concept of borrowing.

This conclusion is consistent with opinion No. S-1265, issued July 15, 1977 (1977 Ill. Att'y Gen. Op. 99), which considered whether money deferred under the State Employees Deferred Compensation Plan became a debt of the State. In that opinion, Attorney General Scott stated, that "[t]his program does not involve the issuance of a debt certificate or going to the market place to borrow money and, thus, does not appear to be the type of debt contemplated by the Constitutional Convention when it drafted section 9." 1977 Ill. Att'y Gen. Op. at 101. This conclusion is also consistent with the opinion addressing the proposed James R. Thompson Center mortgage-loan agreement, concluding that a mortgage-loan transaction through which the State planned to borrow \$216.8 million would incur "State debt" under article IX, section 9. Ill. Att'y Gen. Op. No. 04-003, issued June 2, 2004. Other jurisdictions that have addressed the

incurrence of "debt" have reached similar conclusions under their respective state constitutions. *See, e.g., Village of Chefnak v. Hooper Bay Construction Co.*, 758 P.2d 1266 (Alaska 1988) (stipulated judgment against a city did not constitute "debt contracted" within meaning of Alaska's constitutional restrictions on debt contracted by a political subdivision); *Rochlin v. State*, 112 Ariz. 171, 540 P.2d 643 (1975) (unfunded liability in State pension fund was not "debt" within scope of analogous Arizona constitutional provisions).

Through Public Act 94-004, the State has reduced its contributions to the retirement systems for FY2006 and FY2007. However, Public Act 94-004 does not authorize the borrowing of money either through bonds, mortgage-loan agreements or other forms of indebtedness. Therefore, the reduction in contributions does not constitute "State debt" within the meaning of article IX, section 9.

Even assuming, *arguendo*, that the reduction in State pension contributions constitutes "State debt," such debt has not been "incurred" by the State as that term is used in article IX, section 9. The term "incurred," as used with reference to a debt, means to "become liable or subject to." *See Black's Law Dictionary* 768 (6th ed. 1990); *see also Hall v. County of Cook*, 359 Ill. 528, 546 (1935). The Pension Code requires that participants in a State-funded retirement system receive pension benefits, as provided by the Pension Code, due them at the time of their retirement. By reducing the amount of the State contributions to the retirement systems, the General Assembly has changed the overall level of expected funding of the retirement systems in the coming years. The General Assembly did not alter the ultimate

obligation—the pension benefits due the current participants if and when they vest. Although the reduction in State contributions is likely to necessitate funding increases in later years, the amount owed in the form of benefits to participants has not been increased by Public Act 94-004. Therefore, the State has not "incurred" any additional debt as that term is used in article IX, section 9. By contrast, when the State borrows and mortgages a property, it is liable for more debt than it was prior to signing the note and mortgage. Ill. Att'y Gen. Op. No. 04-003, issued June 2, 2004. Consequently, it is my opinion that no State debt has been "incurred" by the enactment of Public Act 94-004, and, therefore, that the enabling legislation did not require passage by a three-fifths vote of each house of the General Assembly.

My conclusion that Public Act 94-004 did not incur "State debt" within the meaning of article IX, section 9 in no way implies that Public Act 94-004 will prove to be fiscally prudent. Many, including yourself, have suggested that Public Act 94-004 reflects unwise public policy. Although this may prove to be so, it does not bear upon the narrower question — the only question I have been asked to address — of whether the statute abridges constitutional limitations. *Cf. People v. Purcell*, 201 Ill. 2d 542, 551 (2002) (in determining whether a statute is constitutional, "[o]ur role is not to determine how wise legislation may be"); *People v. Lindner*, 127 Ill. 2d 174, 188 (1989) ("the only question before us concerns the constitutionality, and not the wisdom, of the provision"); Ill. Att'y Gen. Op. No. 03-004, issued May 30, 2003 ("Just as the courts cannot dictate * * * funding policy, the judgment of the

Attorney General also cannot be substituted for that of the General Assembly in this critical area."). That a statute may be unwise does not render it unconstitutional.

Pension Protection Clause - Article XIII, Section 5

Although not specifically raised in your letter, a memorandum prepared for your office by outside counsel regarding the constitutionality of Public Act 94-004, a copy of which your office provided to us, references the pension protection clause of article XIII, section 5, of the Constitution. That clause creates an enforceable contractual relationship that protects against the diminishment or impairment of State pension benefits. The clause provides:

Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired. Ill. Const. 1970, art. XIII, §5.

The Illinois Supreme Court has interpreted this clause as making participation in a public pension plan an enforceable contractual relationship and mandating that the "benefits" of that relationship "not be diminished or impaired." *People ex rel. Sklodowski v. State*, 182 Ill. 2d 220, 228-29 (1998); *McNamee v. State*, 173 Ill. 2d 433, 439 (1996); *Kerner v. State Employees' Retirement System*, 72 Ill. 2d 507, 514-15 (1978), *cert. denied*, 441 U.S. 923, 99 S. Ct. 2032 (1979). Although the pension protection clause creates a contractual right for participants in a State-funded retirement system to receive pension benefits due them at the time of their retirement, the Court has made clear that the clause neither creates a contractual basis for participants to expect a particular level of funding nor "require[s] a specific level of pension

appropriations during a fiscal period." *People ex rel. Illinois Federation of Teachers v. Lindberg*, 60 Ill. 2d 266, 271-72 (1975), *cert. denied*, 423 U.S. 839, 96 S. Ct. 67 (1975). Thus, the pension protection clause "creates an enforceable contractual relationship that protects only the right to receive benefits." *McNamee*, 173 Ill. 2d at 446. In *Sklodowski*, the Court specifically held:

We therefore find neither a vested contractual nor constitutional right for beneficiaries to enforce the level of state contributions previously mandated by Public Act 86-273. The framers of the Illinois Constitution were careful to craft in the pension protection clause an amendment that would create a contractual right to benefits, while not freezing the politically sensitive area of pension financing. *Sklodowski*, 182 Ill. 2d at 233.

The Court's decisions make clear that the pension protection clause only protects pension benefits; it does not control funding. Public Act 94-004 does not purport to change the level of benefits that current or former employees are entitled to receive. Rather, the legislation only changes the annual amount the State is required to contribute to the individual retirement systems.

Further, you have not indicated that you believe that Public Act 94-004 will impair benefits by placing the various retirement systems in default or imminent bankruptcy such that benefits are in immediate danger of being diminished or that those entitled to receive the benefits will not receive the necessary monies. *See McNamee*, 173 Ill. 2d at 446-47, quoting 4 Record of Proceedings, Sixth Illinois Constitutional Convention 2926 ("The word "impaired" is meant to imply and to intend that if a pension fund would be on the verge of default or imminent

bankruptcy, a group action could be taken to show that these rights should be preserved.""); *see also Sklodowski*, 182 Ill. 2d at 232-33. Therefore, it is my opinion that Public Act 94-004 does not violate article XIII, section 5, of the Constitution.

Impairment of Contract Clause - Article I, Section 16

You have also questioned whether the AFSCME contract with the State, which requires the State to pay for the employees' contributions to the appropriate retirement systems, has been impaired by Public Act 94-004's reduction in State contributions to the retirement systems, thereby violating article I, section 16, of the Constitution.

Article XIII, section 3, of the current AFSCME contract provides, in pertinent part:

During the term of this Agreement, the Employer shall continue in effect, and the employees shall enjoy the benefits, rights and obligations of the retirement program provided in the Illinois Pension Code, Illinois Compiled Statutes, Chapter 40 and as amended or superseded.

* * *

Effective January 1, 2005, employees shall make half the employee contribution to the appropriate Retirement System in an amount equal to the coordinated rate (2% for covered employees; 2.75% for covered employees in the alternative formula).

Effective January 1, 2006, employees shall make the employee contribution to the appropriate Retirement System in an amount equal to the coordinated rate (4% for covered employees; 5.5% for covered employees in the alternative formula).
(Emphasis added.)

The Constitution prohibits the State from enacting laws that impair the obligation of contracts. Ill. Const. 1970, art. I, §16. A law that substantially impairs a contractual right is unconstitutional, unless justified as a reasonable exercise of the police power to secure an important public interest. *Stelzer v. Matthews Roofing Company, Inc.*, 117 Ill. 2d 186, 190 (1987). In contract impairment cases, the primary inquiry is "whether the state law has, in fact, operated as a substantial impairment of a contractual relationship." *Panzella v. River Trails School District 26*, 313 Ill. App. 3d 527, 535 (2000), quoting *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244, 98 S. Ct. 2716, 2722 (1978).

Public Act 94-004 reduces the State's contribution to the State-funded retirement systems for FY2006 and FY2007. The legislation does not change the terms of the contract requiring the State to pay the employees' portion of the contribution, nor does it change the pension benefits that the State employees will receive. Thus, Public Act 94-004 does not impair the AFSCME contract or violate article I, section 16, of the Constitution.

Moreover, the State is continuing to make the employer's contribution to the retirement systems, albeit in a reduced amount for FY2006 and FY2007. Additionally, the FY2006 Budget, as signed by the Governor, Public Act 94-015, effective June 10, 2005, reduces the State's contribution to the "State Contributions to State Employees' Retirement System" line-item for each of the State offices/agencies involved, not the "Employee Retirement Contributions Paid by the State" line-item provided for in the AFSCME contract. Thus, the State's payment of

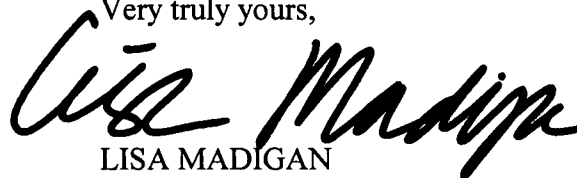
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the employee contribution to the various retirement systems under the AFSCME contract is unaffected by Public Act 94-004.

Conclusion

Based on the foregoing, it is my opinion that Public Act 94-004 does not constitute the incurrence of "State debt" as that phrase is defined in the Constitution, nor does it diminish or impair the pension rights of employees. Finally, the legislation does not impair the AFSCME contract.

Very truly yours,

A handwritten signature in black ink, appearing to read "Lisa Madigan". The signature is written in a cursive, flowing style.

LISA MADIGAN
ATTORNEY GENERAL