PENSIONS IN A PINCH: WHY TEXAS SHOULD RECONSIDER ITS POLICIES ON PUBLIC RETIREMENT BENEFIT PROTECTION

Comment*

Anna K. Selby†

---

* Selected as the Volume 43 Outstanding Student Article by the Volume 43 Board of Editors. This award was made possible by the *Texas Tech Law Review*, Volume 11 Board of Editors.

† B.A. History, Baylor University, 2009; J.D. Candidate, Texas Tech University School of Law, 2012.

I. DISPARITY IN RETIREMENT BENEFIT PROTECTION: STATEWIDE VS. NON-STATEWIDE

In January of 2011, Texas's 82nd Legislature convened with one gigantic task on its "to-do" list: budget cuts.[1] Reports indicated that Texas faced a budget shortfall of anywhere from $12 to $27 billion, and as the first drafts of budget proposals emerged from the house and senate, nearby states likely heard the collective groan of Texas citizens hit with the realization that "it's going to get ugly."[2] From education to healthcare to criminal justice, no area of Texas appears immune from deep spending cuts as Texas legislators try to spend taxpayer dollars more wisely in order to compensate for the decreased tax revenues resulting from high unemployment and a sluggish economy.[3] One area particularly hard hit by the economic downturn that began in 2008 is the public retirement system, which relies heavily on investment returns for its funding.[4]

Some reports show that, as of June 2010, public defined benefit plans in Texas face unfunded liabilities totaling $42 billion, which means that overall, many public retirement systems in Texas do not have enough money to pay future benefits promised to retirement members.[5] So, what remedies are available to the state and local governments responsible for these plans? The answer to that question depends largely on whether the retirement plans are statewide or non-statewide systems, for under current Texas law, members of statewide and non-statewide retirement systems receive drastically different levels of protection for the benefits they have earned under their respective systems.[6]

Texas law provides members of statewide retirement systems with virtually no protection for their earned benefits.[7] The Texas Legislature

---

1. *See* Kate Alexander, *Spartan Budget Plan Calls for Broad Cuts*, AUSTIN AMERICAN-STATESMAN, Jan. 18, 2011, at A01.

2. *See Tribopedia: 2011 Budget Shortfall*, THE TEX. TRIB., http://www.texastribune.org/texas-taxes/2011-budget-shortfall (last visited May, 17, 2011).

3. Alexander, *supra* note 1, at A01.

4. *2009-2010 Biennial Report*, TEX. PENSION REV. BD., 1, 29 (Nov. 30, 2010), http://www.prb.state.tx.us/files/reports/biennial2010.pdf [hereinafter *2009-2010 Biennial Report*].

5. *See id.* at 30. This figure represents a projected Unfunded Actuarial Accrued Liabilities (UAAL) based on estimations of an actuarial value of assets of $200 billion. *Id.*; *see infra* Part II.A.

6. *See infra* Part IV.

7. *See infra* Part IV.

retains the authority to unilaterally reduce the benefits that members expect to receive regardless of whether the member has reached eligibility for retirement or has *already* retired.[8] Conversely, members of non-statewide retirement systems receive extensive protection for the benefits they have earned.[9] Recent interpretations of Texas law strictly limit the ways local governments can alter their plans to reduce future benefit obligations.[10] This disparity of treatment arises from a simple conflict of interests: the member's interest in acquiring security for the benefits they have earned and the state or local government's interest in retaining the authority to manage retirement systems.[11] Both of the current benefit protection approaches Texas follows contain an imbalance of these two interests that consequently results in significant disadvantages for either the retirement member or the governing entity of the plan.[12]

Too much protection of retirement benefits leaves the governing authority devoid of the ability to safely navigate the fund through the perils of rough economic waters.[13] Without sufficient freedom to alter the terms of a plan's administration, the state or local government must rely on other measures, one of which is the increase of the government's contributions to the fund, which, of course, comes straight out of the taxpayer's pocket.[14] At times such as these, when taxpayer dollars are stretched thin, the government needs other options to ensure the financial stability of its retirement systems.[15] On the other hand, too little protection of retirement benefits leaves retirement members virtually at sea, devoid of any kind of an anchor to secure themselves against rough economic tides and a government that, according to Texas law, is free to take what has rightfully been earned.[16]

This Comment explores the disparity in Texas's retirement benefit protection and the need for a fresh approach that appropriately balances the interests of the retirement member with the governing body's authority to manage retirement systems. Part II provides the basic structure of how typical public retirement systems function. Part III specifically outlines the legislative authority and forms of oversight for retirement systems in Texas. Part IV follows the development of retirement benefit protection in Texas and the origins for the disparity between benefit protection in statewide and non-statewide systems. In Part V, this Comment examines the evolution of benefit protection for non-statewide systems, which reveals the increasing

8. *See infra* Part IV.
9. *See infra* Part IV.B.
10. *See infra* Part V.
11. *See infra* Part VII.
12. *See infra* Parts IV, VII.
13. *See infra* Part VII.
14. *See 2009-2010 Biennial Report*, *supra* note 4, at 28-29.
15. *See infra* Part VII.A.
16. *See infra* Part VII.A.

inconsistencies of Texas's benefit protection policies. Part VI then analyzes the varying ways in which other states approach the issue of retirement benefit protection. Part VII evaluates the different approaches to benefit protection and advocates for a streamlined approach that protects the property rights of retirement members without infringing on the ability of state and local governments to manage retirement systems. Finally, Part VIII urges the Texas Legislature to take the necessary steps to achieve a balanced and economically wise policy of retirement benefit protection in Texas.

II. OVERVIEW OF PUBLIC RETIREMENT SYSTEMS

A. Basic Structure

A retirement system is a plan that allows employees to retire from their jobs with the assurance of a continued source of income.[17] Retirement systems are available for both private and public sector employees, but in terms of regulation, there are significant differences between private and public systems.[18] Federal law regulates retirement plans within the private sector while the regulation of public systems remains, for the most part, within the authority of the states.[19] The public sector plans do not completely escape federal regulation; some federal law, such as parts of the Internal Revenue Code and the Age Discrimination in Employment Act, affect public plans.[20]

---

17. *See generally Retirement Handbook: Summary Plan Description*, FORT WORTH EMPLOYEES' RET. FUND, 1, 3 (Jan. 2009), http://www.fwretirement.org/images/RetirementHandbook2009.pdf [hereinafter *Retirement Handbook*] (providing a detailed explanation of the Fort Worth employees' retirement system).

18. *See Guide to Public Retirement Systems of Texas: A Comparison of Statutory Public Retirement Systems in Texas*, TEX. PENSION REV. BD., at *Executive Summary* (Jan. 2009), http://www.prb.state.tx.us/files/reports/January2009Primer.pdf [hereinafter *Guide to Public Retirement Systems of Texas 2009*].

19. *See Biennial Report 2007-2008*, TEX. PENSION REV. BD., i, 11, http://www.prb.state.tx.us/files/reports/Biennial2008.pdf (last visited May 17, 2011) [hereinafter *Biennial Report 2007-2008*]. The 1974 Employee Retirement Income Security Act (ERISA) regulates defined benefit and defined contribution plans within the private sector. *See* ERISA, 29 U.S.C. § 1001 (2006); *Biennial Report 2007-2008*, *supra* at 11.

20. *See Guide to Public Retirement Systems of Texas 2009*, *supra* note 18, at *Executive Summary*. Though ERISA applies only to private sector plans, many public sector plans adopt ERISA's imposition of the "prudent man" rule, which requires that plan fiduciaries carry out their duties "with the care, skill prudence and diligence which a prudent man, acting in a like capacity and familiar with such circumstances, would use" under conditions prevailing at the time. ERISA, 29 U.S.C. § 1104(a) (2006); *Pension Terminology*, TEX. PENSION REV. BD., 6, http://www.prb.state.tx.us/files/education/terminologyfinal.pdf (last visited May 17, 2011) [hereinafter *Pension Terminology*]; *see also* Roderick B. Crane, *Regulation and Taxation of Public Plans: A History of Increasing Federal Influence*, *in* PENSIONS IN THE PUBLIC SECTOR 119, 124 (Olivia S. Mitchell & Edwin C. Hustead eds., 2001). The Age Discrimination in Employment Act contains a provision that states that "an employee hired at an age more than 5 years prior to normal retirement age may not be excluded from such a plan unless the

State law controls all retirement systems within the public sector, but statutory provisions often allow municipalities to create and oversee their own retirement plans—resulting in both statewide and local plans.[21] States often offer more than one statewide retirement system, and some statewide plans cover local government employees as well as employees of the state.[22] For instance, some states create separate plans for teachers, college or university professors, judges, emergency workers, and other employees of state and local governments.[23] The characteristics of these plans depend largely on several variables: the kind of employees covered, the amount of employees covered, the controlling administrative body, the types of benefits provided, and the overall size of the plan.[24] Thus, from state to state, the kind and amount of retirement plans differ widely due to the varying needs and sizes of each state.[25]

B. Defined Benefit Plans

Retirement plans fall into two main categories: a defined benefit plan or a defined contribution plan.[26] A defined benefit plan guarantees that when members of the plan retire, they will receive a specific monthly benefit for their lifetime that is calculated from a defined formula.[27] These formulas differ from plan to plan, but one common formula uses a benefit multiplier along with length of service and average salary to calculate the monthly benefit a member should receive.[28] Funding for defined benefit plans comes from three main sources: employee contributions, employer contributions, and investment returns.[29] Plan managers must set the contribution rates of a plan at a level they expect will provide adequate funding to cover the amount of benefits the plan is obligated to pay out, but because determining the correct rates is a very involved and complicated

---

exclusion is justifiable on the basis of cost considerations . . . ." Age Discrimination in Employment Act, 29 C.F.R. § 1625.10(f)(1)(iii)(A) (2006); *see* Crane, *supra* at 128.

21. *See Guide to Public Retirement Systems of Texas 2009*, *supra* note 18, at *Executive Summary*; *see also* WILLIAM C. GREENOUGH & FRANCIS P. KING, PENSION PLANS AND PUBLIC POLICY 123 (1976) (stating that the "distinction between state and local designation pertains to responsibility for plan administration").

22. *See* GREENOUGH & KING, *supra* note 21, at 123.

23. *Id.*

24. *See* Olivia S. Mitchell et al., *Developments in State and Local Pensions Plans*, *in* PENSIONS IN THE PUBLIC SECTOR, *supra* note 20, at 11, 15 (noting that other factors—a more physically demanding job or eligibility for Social Security payments—also affect the type of retirement plan).

25. *See id.*

26. ROBERT L. CLARK ET AL., A HISTORY OF PUBLIC SECTOR PENSIONS IN THE UNITED STATES 11, 11 (2003).

27. *Id.*

28. *See id.*; *Pension Terminology*, *supra* note 20, at 3.

29. *See* Edwin C. Hustead & Olivia S. Mitchell, *Public Sector Pensions Plans: Lessons and Challenges for the Twenty-First Century*, *in* PENSIONS IN THE PUBLIC SECTOR, *supra* note 20, at 3, 6; *Retirement Handbook*, *supra* note 17, at 3.

process, plan managers use actuaries to evaluate the plan and to calculate its long-term liabilities——the future obligations of the plan——and the amount of contributions necessary to fund those obligations.[30]

Actuaries' primary task is, essentially, to calculate the financial consequences of risk, which they accomplish through the use of financial theory, statistics, and assumptions.[31] To calculate the financial risk of a plan, an actuary may choose between several different methods, but the end goal is the same: the determination of the plan's Normal Cost and the determination of the plan's Unfunded Actuarial Accrued Liability (UAAL), which, at its most basic level, is the "present value of benefits earned to date that are not covered by current plan assets."[32] The UAAL then serves as the basis for calculating the plan's amortization period——the amount of time necessary to pay off, through installments, the interest-accruing liability of the plan.[33] The longer the amortization period, the more unstable the plan; a typical amortization period, for a plan with an adequate contribution arrangement, is twenty to thirty years.[34] Furthermore, regulation of the amortization period is often how states monitor the strength of retirement plans.[35]

Another major factor in the strength of a retirement system is how closely the plan's actual investment returns match the expected investment returns.[36] Because the actuary assumes a certain level of returns will occur when determining what levels of contributions are necessary to cover the fund's obligations, any shortfall of returns results in the creation of more

30. *See* Hustead & Mitchell, *supra* note 29, at 6.

31. *See id.*; Mitchell et al., *supra* note 24, at 25. The assumptions an actuary makes in the course of evaluating a plan can be demographic or economic in nature and play a significant role in the actuary's evaluation of the stability of a plan. *See* Hustead & Mitchell, *supra* note 29, at 6. Demographic assumptions include factors such as expected rates of retirement, expected rates of termination before retirement, and expected rates of mortality, while economic assumptions include expectations related to inflation, salary growth, and investment returns. *See id.*

32. *Pension Terminology*, *supra* note 21, at 7. The Texas Pension Review Board describes Normal Cost as "generally represent[ing] the portion of the cost of projected benefits allocated to the current plan year." *Id.*; *see* Hustead & Mitchell, *supra* note 29, at 6; *Biennial Report 2007-2008*, *supra* note 19, at 37. The formula for determining the Unfunded Actuarial Accrued Liability is the Actuarial Accrued Liability (AAL) minus the Actuarial Valuation of Assets (AVA). *Biennial Report 2007-2008*, *supra* note 19, at 37. Some retirement plans use an AVA that is equal to the market value of the plan's assets while other plans utilize a "smoothing method," which decreases the effects of short-term volatility in the market value of the plan's assets. *Pension Terminology*, *supra* note 20, at 1; *Biennial Report 2007-2008*, *supra* note 19, at 37.

33. *Pension Terminology*, *supra* note 20, at 2; Mitchell et al., *supra* note 24, at 25.

34. *See* Mitchell et al., *supra* note 24, at 25.

35. *See, e.g.*, *Biennial Report 2007-2008*, *supra* note 19, at 15. Another way states measure the soundness of their plans is through the "funding ratio." Mitchell et al., *supra* note 24, at 25; *see Pension Terminology*, *supra* note 20, at 4. This is simply the ratio of the current assets of a plan to the present value of the accrued liabilities——the amount of benefits already earned by employees within the plan. *See* Mitchell et al., *supra* note 24, at 25; *Pension Terminology*, *supra* note 20, at 4.

36. *See* Mitchell et al., *supra* note 24, at 30.

liability for the plan.[37] High investment returns help reduce the amount of contributions the employer must pay into the system, so although many advantages lie in a plan's investment in the stock market, the well-known volatility and uncertainty tied to investments can also become a major liability for state and local governments in times of economic distress.[38]

C. Defined Contribution Plans

The alternative to a defined benefit plan is a defined contribution plan.[39] In a defined contribution plan, there are no amortization periods, formulas, or assumptions because the plan does not predetermine a specific benefit that will become due to the employee.[40] Instead, the plan establishes only the specific amount of contributions that will go into an individual account for the employee.[41] The employee's benefits upon retirement depend solely on the amount of money paid into their account, the net of investment returns, and the interest accrued on the account balance.[42] At retirement, employees may withdraw the account balance in one lump sum or convert the balance into an annuity, which allows them to receive periodic payments at a fixed amount.[43] Several factors, however, affect the determination of when an employee may retire.[44]

D. Vesting

For an employee to retire and begin receiving benefits, the member must first become eligible to receive those benefits——membership in a plan does not automatically confer rights to a postretirement income.[45] In most plans, the requirements for eligibility to retire relate to the age of the employee and the length of the employee's service, and upon meeting these requirements, employees obtain a legal right to their earned benefits.[46] It is possible, however, for an employee to acquire legal rights to the receipt of future benefits before meeting the eligibility requirements for retirement.[47]

---

37. *See id.* at 31. Most Texas plans use an expected investment return rate of 8%. *See 2009-2010 Biennial Report*, *supra* note 4, at 30.

38. *See* GREENOUGH & KING, *supra* note 22, at 121; Mitchell et al., *supra* note 24, at 36 (acknowledging that the significance of investment returns depends largely on the economic climate).

39. CLARK ET AL., *supra* note 26, at 11.

40. *See id.* at 20.

41. *See id.* at 11; *Pension Terminology*, *supra* note 20, at 3.

42. *See* CLARK ET AL., *supra* note 26, at 20; GREENOUGH & KING, *supra* note 22, at 121; Mitchell et al., *supra* note 24, at 12; *Pension Terminology*, *supra* note 20, at 3.

43. *See* CLARK ET AL., *supra* note 26, at 20; *Pension Terminology*, *supra* note 20, at 2.

44. *See infra* Part II.D.

45. *See* Mitchell et al., *supra* note 24, at 17.

46. *See, e.g.*, *Retirement Handbook*, *supra* note 17, at 3.

47. *See* Mitchell et al., *supra* note 24, at 17; DAN M. MCGILL, PRESERVATION OF PENSION BENEFIT RIGHTS 7 (1972); *infra* text accompanying notes 138-41.

The attainment of legal rights is referred to as "vesting," which confers upon an employee a "complete and consummated right not contingent upon any future event."[48] Though employees always have a fully vested right to their own contributions to a retirement plan, the vesting requirements specifically affect the benefits employees accrue through membership and service in the system.[49] Thus, if employees withdraw from the system before becoming vested, they have a legal right only to the contributions paid into the plan by the employee.[50] Because different plans set different lengths of service required before vesting occurs, the time at which an employee's benefits vest depends on the retirement plan.[51] In Texas, the issue of vesting and an employee's legal right to receive accrued benefits has become the subject of an increasing amount of confusion and debate related to exactly what rights an employee attains upon vesting and the types of changes the governing authorities can make to a plan without violating the rights of a vested employee.[52]

III. RETIREMENT SYSTEMS IN TEXAS

A. Structure of Texas's Systems

Article XVI, § 67 of the Texas Constitution empowers the legislature with the authority to "enact general laws establishing [retirement] systems" and lays out the general principles the legislature must follow in establishing and overseeing these systems.[53] Section 67 also provides that each retirement system, both statewide and non-statewide, shall have a board of trustees responsible for administering and overseeing the fund.[54] Although this constitutional provision establishes the basic foundation for public retirement systems, Texas statutes govern the more detailed aspects of public systems; even the locally controlled retirement plans remain subject to statutory regulation.[55] There are approximately 363 statewide and local retirement systems in Texas, and two of those systems are pooled,

48. MCGILL, *supra* note 47, at 5.

49. *See id.* at 7-8; *Pension Terminology*, *supra* note 20, at 8.

50. *See* MCGILL, *supra* note 47, at 7-8.

51. *See* Mitchell et al., *supra* note 24, at 17.

52. *See* Karen Steffen, *State Employee Pension Plans*, *in* PENSIONS IN THE PUBLIC SECTOR, *supra* note 20, at 41, 53-54.

53. TEX. CONST. art. XVI, § 67.

54. *See id.*

55. *See id.*; *see generally* TEX. GOV'T CODE ANN. §§ 801-865 (West 2004 & Supp. 2010) (regulating Public Retirement Systems in subtitle A, Employee Retirement System of Texas in subtitle B, Teacher Retirement System of Texas in subtitle C, Judicial Retirement Systems of Texas in subtitles D and E, Texas County and District Retirement System in subtitle F, Texas Municipal Retirement System in subtitle G, and Texas Emergency Services Retirement System in subtitle H); TEX. REV. CIV. STAT. ANN. arts. 6243a-1 to 6243o (West 2010) (governing the retirement systems of certain cities and towns).

each containing several hundred smaller systems.[56] To effectively govern such a vast amount of retirement plans, Texas utilizes the help of an oversight agency.[57]

B. Texas Pension Review Board

In 1979, Texas created the Texas Pension Review Board (TPRB) to effectively oversee the increasing amount of retirement systems under its control.[58] Under § 801 of the Texas Government Code, Texas charges the TPRB with "oversee[ing] all Texas public retirement systems, both state and local, in regard to their actuarial soundness and compliance with state law."[59] The code lays out the general duties of the TPRB, and in the course of carrying out those duties, the TPRB created "Guidelines for Actuarial Soundness," one of which is the determination that the TPRB will consider any plan with an amortization period over forty years as actuarially unsound.[60] The other four guidelines provide plan administrators and actuaries with specific instructions for managing and evaluating retirement plans.[61]

---

56. *See 2009-2010 Biennial Report, supra* note 4, at 74. Texas operates statewide systems for "teachers, higher education personnel at state colleges and universities, legislators, state employees, state judges, district attorneys, volunteer fire fighters, and state-elected officials." *Guide to Public Retirement Systems of Texas: A Comparison of Statutory Public Retirement Systems in Texas*, TEX. PENSION REV. BD., at *Executive Summary* (Jan. 2011), http://www.prb.state.tx.us/files/reports/2011primer.pdf [hereinafter *Guide to Public Retirement Systems of Texas 2011*]. The pooled systems in Texas are the Texas County & District Retirement System (TCDRS) and the Texas Municipal Retirement System (TMRS). *Id.* Together, these systems represent approximately 1,434 retirement systems. *Id.* With the combined systems of TCDRS and TMRS, Texas operates around 1,797 retirement systems, 1,530 of which are actuarially-funded, defined benefit plans. *Id.* The combined net assets of these systems amounts to nearly $175 billion. *Id.*

57. *See infra* Part III.B.

58. *Biennial Report 2007-2008, supra* note 19, at 3.

59. *Id.*; *see* TEX. GOV'T CODE ANN. § 801 (West 2004 & Supp. 2010); *Biennial Report 2007-2008, supra* note 19, at 15.

60. *See* TEX. GOV'T CODE ANN. § 801.202 (West 2004); *2009-2010 Biennial Report, supra* note 4, at 14. Texas statutes, however, specifically state that, for the Employees Retirement System of Texas and the Teacher Retirement System of Texas, no plan changes can occur "if, as a result of the particular action, the time, as determined by an actuarial valuation, required to amortize . . . would be increased to a period that exceeds 30 years by one or more years." TEX. GOV'T CODE ANN. §§ 811.006, 821.006. Projections by the TPRB show that the number of Texas plans with amortization periods over forty years could increase by 90% because many plans are currently managing to maintain a lower amortization period through significantly increased state or city contributions to the fund. *2009-2010 Biennial Report, supra* note 4, at 30. High city and state contributions, however, are becoming increasingly more challenging "as many sponsoring governmental entities are witnessing a decline in tax revenues and facing pressure to fund other public programs such as health care, education, and infrastructure." *Id.*

61. *2009-2010 Biennial Report, supra* note 4, at 14. The other four guidelines provide additional actuarial instructions:

> (1) The funding of a pension plan should reflect all plan liabilities and assets.
>
> (2) The allocation of the normal cost portion of contributions should be level as a percent of payroll over all generations of taxpayers.

IV. TEXAS DEVELOPMENT OF PENSION PROTECTION

For over six decades, Texas afforded all members of public retirement systems the same level of protection for their retirement benefits.[62] This uniformity, however, no longer exists.[63] Under current Texas law, statewide retirement system members and non-statewide retirement system members receive different levels of retirement benefit protection, and as the governing laws continue to evolve, the chasm separating the levels of protection for each type of system continues to widen.[64]

A. Judicial Precedent

The last time the Texas Supreme Court addressed the extent of employees' rights to their pension benefits, the country was in the midst of the Great Depression.[65] The court decided *Dallas v. Trammell* in 1937, and although this decision remains good law for statewide retirement systems, in 2003, Texas voters adopted an amendment to the state constitution that granted members of non-statewide public retirement systems protection of their retirement benefits.[66] In *Trammel*, the plaintiff, Trammell, was a retired police officer who had served the City of Dallas for twenty years.[67] Under the method of calculating retirement benefits in place at the time Trammell retired, his monthly pension payment amounted to $183.33.[68] The City of Dallas, however, subsequently adopted a change in the method for calculating benefits and applied the change to all members of the system, including those who had already retired and who were currently receiving pension payments under the old method.[69] Under the new method, Trammell received $72.36.[70] He sued the City of Dallas, claiming that the change in the calculation of benefits violated his constitutional rights.[71]

> (3) Funding of the unfunded actuarial accrued liability should be level or declining as a percent of payroll over the amortization period.
>
> . . . .
>
> (5) The choice of assumptions should be realistic and reasonable in the aggregate.

Id.

62. *See infra* Part IV.A.

63. *See infra* Part IV.A-B.

64. *See* TEX. CONST. art. XVI, § 66(d); Dallas v. Trammell, 129 Tex. 150, 156, 101 S.W.2d 1009, 1016-17 (1937); *infra* Parts IV.A-B.

65. *See Trammell*, 101 S.W.2d at 1009.

66. *See* TEX. CONST. art. XVI, § 66(d); *Trammell*, 101 S.W.2d at 1009.

67. *Trammell*, 101 S.W.2d at 1009.

68. *Id.* at 1009-10.

69. *Id.*

70. *Id.* at 1010.

71. *Id.*

Emphasizing the power of the legislature to amend or abolish laws as it deems necessary, the court held:

> [T]he right of a pensioner to receive monthly payments from the pension fund after retirement from service, or after his right to participate in the fund has accrued, is predicated upon the anticipated continuance of existing laws, and *is subordinate to the right of the Legislature to abolish the pension system, or diminish the accrued benefits of pensioners thereunder* . . . .[72]

Additionally, the court recognized the ways in which other states had addressed the same issue.[73] Noting that many states did not view retirement systems as implying any kind of contractual relationship between the legislature and the retirement system members, the court stated that even if such a contract existed, that contract would be "subject to the reserved power of the Legislature to amend, modify, or repeal the law upon which the pension system is erected . . . necessarily constitut[ing] . . . a reserved right to terminate or diminish [the anticipated pension]."[74]

There is an argument that if a similar case came before the Texas Supreme Court today, current perceptions of the laws regarding property rights would possibly result in a departure from the *Trammell* decision; however, a similar case has not arisen, and *Trammell* remains good law.[75] Thus, for sixty-six years Texas provided retirement members of both statewide and non-statewide systems no right of protection to their retirement benefits.[76]

B. Adoption of Texas Constitutional Amendment

In an effort to change the result of *Dallas v. Trammell* pertaining to non-statewide retirement systems, in 2003, the 78th legislature proposed a resolution that would allow Texas voters to decide whether or not to amend the constitution to allow for protection of retirement benefits for those members of non-statewide retirement systems.[77] The resolution, as

---

72. *Id.* at 1013 (emphasis added).

73. *See id.* at 1013-15.

74. *See id.* at 1014.

75. *See infra* Part VI.B (providing an outline of the current nationwide trends for protecting retirement benefits).

76. *See infra* Part IV.B.

77. House Comm. on Pensions & Invs., Bill Analysis, Tex. H.R.J. Res. 54, 78th Leg., R.S. (2003). The adopted amendment applies to all non-statewide retirement systems with the exception of the City of San Antonio's systems for firefighters and police officers. *Focus Report: Constitutional Amendments Proposed for September 2003 Ballot: Proposition 15*, HOUSE RESEARCH ORGANIZATION 44, 46 (July 28, 2003) [hereinafter *Proposition 15*]. The City of San Antonio has a local provision, which provides that the city itself assumes all responsibility for paying any future shortfalls its plan may have and therefore, opted out of the new amendment pursuant to a local-option election offered as part of the amendment proposal. *Id.*

originally introduced, amended § 67 of article XVI and provided that "[m]embership in a retirement system is a contractual relationship," which essentially means that all the provisions and formulas of the system in place at the time the employee enters the system are part of a contract between the plan administrators and that member.[78] The contractual relationship theory places great value in the employee's expectation for future benefits, rather than the legislative authority to change the laws controlling retirement plans.[79] When the bill reached the Texas House Committee on Pensions and Investments, however, the committee removed the language establishing a contractual relationship and explained the change as an effort to protect only the benefits earned under the formulas in place at the time the employee worked and to provide the local government with sufficient authority to alter benefits for the fund's protection.[80]

Once the resolution reached the Texas Senate Committee on State Affairs, the committee revised the language of the resolution to create a new § 66, instead of an amendment to § 67.[81] In the course of redrafting the language into a new section, the phrase "benefits accrued" appeared for the first time.[82] This phrase replaced the original language from the house committee's version, which prohibited the reduction or impairment of benefits "for service *performed before the effective date of any change* in the benefit structure."[83] The senate committee's use of the phrase "benefits accrued" to replace the language of the house committee's version caused concern due to the bill's lack of definition as to what exactly constitutes an accrued benefit.[84] Some suggested that, without a definition, others could construe the phrase broadly to an expanded scope that might "result in negative unintended consequences."[85] These concerns became realized less than five years after the amendment's adoption when controversy emerged over what kinds of benefits fall within the scope of "benefits accrued."[86]

V. DEFINING THE "BENEFIT" IN "BENEFITS ACCRUED"

In April of 2008, Texas Attorney General Greg Abbott (attorney general) issued an opinion that specifically addressed the meaning of the

78. Tex. H.R.J. Res. 54, 78th Leg., R.S. (2003) (as introduced); *see also* TEX. CONST. art. XVI, § 67 (providing general provisions for state and local retirement systems).

79. *See infra* Part VI.B.

80. *See* House Comm. on Pensions & Invs., Bill Analysis, Tex. H.R.J. Res. 54, 78th Leg., R.S. (2003).

81. *See* Senate Comm. on State Affairs, Bill Analysis, Tex. H.R.J. Res. 54, 78th Leg., R.S. (2003). The former § 66 was repealed on November 2, 1999. *See* TEX. CONST. art. XVI, § 66 (repealed Nov. 2, 1999).

82. *See* Tex. H.R.J. Res. 54, 78th Leg., R.S. (2003) (Senate Committee Substitution).

83. Tex. H.R.J. Res. 54, 78th Leg., R.S. (2003) (House Committee Substitution) (emphasis added).

84. *See Proposition 15*, *supra* note 77, at 47.

85. *See id.*

86. *See infra* Part V.

phrase "benefits accrued."[87] The need for a clear definition of the phrase arose when the City of Fort Worth (City) adopted a change in the Fort Worth Employees' Retirement Fund (FWERF).[88] With more than 10,000 members and an actuarial valuation of assets of more than $1.8 billion, the FWERF is one of the larger local retirement systems in Texas and operates as a defined benefit plan that covers both general city and public safety workers.[89] Because the FWERF is a non-statewide system, it is subject to art. XVI, § 66 of the Texas Constitution, which prohibits the City from "reduc[ing] or otherwise impair[ing] benefits accrued" by vested members in the plan.[90] To better understand the change proposed by the City, it is helpful to examine FWERF more closely.[91]

A. Fort Worth Employees' Retirement Fund: Structure and Funding Status

Article 6243i of the Texas Civil Statutes authorizes the City's establishment of the FWERF and empowers a board of trustees to administer the fund.[92] Upon retirement, members of the FWERF receive a monthly benefit for life based on their salaries, length of participation in the fund, and the "applicable multiplier."[93] To compute the correct salary used to determine a member's benefits, the FWERF uses a "compensation base" formula, which averages the earnings paid to the employee by the City for the three calendar years during which the employee's salary was the highest.[94] Because defined benefit plans depend largely on investment

87. *See* Tex. Att'y Gen. Op. No. GA-0615, at 4 (2008). The Honorable Phil King of the Texas House of Representatives requested the opinion from the attorney general. *Id.* at n.1. The Texas Supreme Court has stated that although attorney general opinions are not binding on courts, they are persuasive authority. Holmes v. Morales, 924 S.W.2d 920, 924 (Tex. 1996). The Office of the Attorney General defines opinions as "written interpretation[s] of existing law." *About Attorney General Opinions*, OFFICE OF THE ATT'Y GEN. OF TEX., https://www.oag.state.tx.us/opin/ (last updated Sept. 13, 2010). Additionally, the Office of the Attorney General states that "[u]nless or until an opinion is modified or overruled by statute, judicial decision, or subsequent Attorney General Opinion, an Attorney General Opinion is presumed to correctly state the law." *Id.*

88. *See* Tex. Att'y Gen. Op. No. GA-0615, at 2 (2008).

89. Gabriel Roeder Smith & Co., *Employees' Retirement Fund of the City of Fort Worth: Actuarial Valuation for the Year Beginning January 1, 2010*, 13 tbl.1, http://www.fwretirement.org/uploads/publications/2010%20Actuarial%20Valuation.pdf; *Biennial Report 2007-2008*, *supra* note 19, at 9; *Retirement Handbook*, *supra* note 17, at 3.

90. TEX. CONST. art. XVI, § 66.

91. *See infra* Part V.A.

92. *See* TEX. REV. CIV. STAT. ANN. art. 6243i, §§ 1.01-5.11 (West 2010).

93. *Retirement Handbook*, *supra* note 17, at 3. The administrative rules governing the fund establish the applicable multiplier. *Administrative Rules and Procedures*, FORT WORTH EMPLOYEES' RET. FUND, 1, 34, http://www.fwretirement.org/uploads/benefits/Administrative%20Rules_09.22.10.pdf (last updated Aug. 25, 2010) [hereinafter FORT WORTH EMPLOYEES' RET. FUND]. A FWERF member's accrued benefits vest after five years of service. *Retirement Handbook*, *supra* note 17, at 3.

94. *Retirement Handbook*, *supra* note 17, at 6. For example, suppose an employee earned their three highest annual salaries in the years 2001 ($41,000 earned), 2002 ($43,000 earned), and 2003 ($45,000 earned), the average of these three salaries ($43,000) would represent the compensation base used in calculating the employee's annual benefit. *Id.* at 7. Thus, if the employee worked for ten years

returns for funding, the economic downturn from 2001 to 2002 resulted in extensive investment losses for the FWERF and ultimately led to an October 1, 2002, actuarial valuation report calculating the FWERF amortization period as being infinite—meaning that, at the plan's current funding rates, the system would never be able to pay off the UAAL.[95] In an effort to make the fund more financially sound, the City increased its amount of contributions to the fund and also adopted a change in the calculation of members' retirement benefits.[96]

B. The Catalyst: FWERF's Attempt to Strengthen the Plan's Stability

The change in the FWERF plan altered the method of calculating an employee's compensation base by imposing a 12% cap on any increases in the annual earnings of an employee's highest three salary years—the years that make up the compensation base.[97] The City's brief to the attorney general provides an explanation of how the cap would operate:

> [T]he earnings cap takes the [member's] 4th highest year of annual earnings and uses it as a "base amount." The member's third highest year of earnings (i.e. the least of the [highest three]) for purposes of the compensation base calculation would be capped at 112% of the member's base amount. The member's second highest year of earnings would be capped at 112% of the amount calculated as the member's third highest year of earnings, and the member's highest year of earnings would be capped at 112% of the amount calculated as the member's second highest year of earnings.[98]

Because the cap was to be prospective only, salaries earned prior to the effective date of the change would not be subject to the cap.[99] If an employee's three highest years of earnings occurred prior to the effective

---

and the applicable multiplier was 3%, the employee would receive an annual benefit of $12,900 ($43,000 x 10 x 3% = $12,900). *Id.* Employees hired after October 23, 2007, or employees whose benefits had not vested as of October 23, 2007, however, are also subject to a salary cap, which limits the amount of allowed increases between each of the salary years used to calculate the compensation base. *See infra* text accompanying note 97.

95. *Biennial Report 2007-2008*, *supra* note 19, at 9. The January 1, 2010, actuarial report estimated a UAAL of $431 million and an amortization period of 40.5 years, which exceeds the recommended limit for amortization periods in the TPRB's Guidelines for Actuarial Soundness. Gabriel Roeder Smith & Co., *supra* note 89, at 21 tbl.8; *2009-2010 Biennial Report*, *supra* note 4, at 14.

96. *See Biennial Report 2007-2008*, *supra* note 19, at 9; *infra* Part V.B.

97. *See* Tex. Att'y Gen. Op. No. GA-0615, at 2 (2008); *supra* text accompanying notes 93-94.

98. Tex. Att'y Gen. Op. No. GA-0615, at 2 (2008).

99. *Id.*

date, the cap would not apply and, thus, would have no impact on the calculation of the benefits owed to that employee.[100]

Despite the FWERF's attempt to ensure the protection of vested members' rights to their benefits, a question arose on whether this change impaired the benefits of vested employees in a manner inconsistent with the 2003 constitutional amendment to article XVI, § 66, which applies only to non-statewide systems and specifically provides as follows:

> (d) On or after the effective date of this section, a change in service or disability retirement benefits or death benefits of a retirement system *may not reduce or otherwise impair benefits accrued* by a person if the person:
>
> (1) could have terminated employment or has terminated employment before the effective date of the change; and
>
> (2) would have been eligible for those benefits, without accumulating additional service under the retirement system, on any date on or after the effective date of the change had the change not occurred.[101]

The question of whether this change contravenes the Texas Constitution turns on the exact issue that emerged during the amendment's development in the legislature: whether the phrase "benefits accrued" should be interpreted broadly so as to include the method of calculation used to determine benefits.[102] Put simply, when an employee's benefits vest, does the method of calculation used to determine those benefits vest as well?

C. Texas Attorney General Opinion

After analyzing the language of the constitutional provision, the legislative intent behind the provision, and the related decisions of other states, the attorney general interpreted the phrase "benefits accrued" broadly to include the method of calculating benefits.[103] A review of the opinion reveals that the attorney general found both the literal text of the constitution and also the legislative intent behind the passage of the amendment to be inconclusive on whether a method of calculation is a benefit that should vest in an employee.[104] Because Texas has no relevant

---

100. *Id.* Similarly, if an employee earned one or two of their highest salaries before the effective date, the cap would only apply to those of the three highest salaries earned subsequent to the effective date. *See id.*

101. TEX. CONST. art. XVI, § 66(d) (emphasis added).

102. *See* Tex. Att'y Gen. Op. No. GA-0615, at 6-8 (2008).

103. *See* TEX. CONST. art., XVI, § 66(d); Tex. Att'y Gen. Op. No. GA-0615, at 11 (2008). Specifically, the attorney general stated, "[T]he constitutional provision prohibits a change in the method of determining the compensation base of vested employees if such action reduces or impairs retirement benefits that the employee would have been eligible to receive on or before the effective date of the change." Tex. Att'y Gen. Op. No. GA-0615, at 11 (2008).

104. *See* Tex. Att'y Gen. Op. No. GA-0615, at 6, 8 (2008).

case law on point, the decisions of other jurisdictions had a significant influence over the attorney general's interpretation of the constitution.[105]

1. Literal Text Analysis

The attorney general's literal text analysis resulted in a conclusion that the constitutional provision "protects rights to retirement benefits that existed and could be claimed on or before the effective date of the change."[106] Despite the City of Fort Worth's assertion that "a member's benefit will never be less than the level of such benefit using the . . . pre-cap retirement formula," the attorney general pointed out that while the amount of a benefit can never be less than what employees had at the time of the plan change, their future amount could be less than what they *would have* potentially received had the plan not changed.[107] The attorney general accorded great weight to a retirement member's expectation of a benefit, which is a significant departure from the legislative authority view pronounced in *Dallas v. Trammell*.[108] According to the attorney general, however, the actual language of the provision, on its face, leaves open the question of whether a method falls within the scope of "benefits accrued."[109]

2. Purpose and Intent of Amendment

Addressing the purpose and intent of the constitutional provision, the attorney general discussed both the legislature's intent in proposing the amendment and also the voters' intent in adopting the amendment.[110] The attorney general evaluated various analyses of the amendment from sources such as the Texas Legislative Council, the House Research Organization Focus Reports, and bill analyses from both the House Committee on Pensions and Investments (House Committee) and the Senate Committee on State Affairs (Senate Committee).[111] The Texas Legislative Council, for example, explained the amendment as allowing "those retirement systems

105. *See id.* at 8-10.

106. *Id.* at 5-6.

107. *Id.* at 4.

108. *See id.*; *supra* note 72 and accompanying text.

109. *See* Tex. Att'y Gen. Op. No. GA-0615, at 4-6 (2008).

110. *See id.* at 6-8.

111. *See supra* note 77; Tex. Att'y Gen. Op. No. GA-0615, at 6-8 (2008); *Analyses of Proposed Constitutional Amendments: September 13, 2003, Election*, TEX. LEGIS. COUNCIL, 100 (July 2003), http://www.tlc.state.tx.us/pubsconamend/analyses03/analyses03.pdf [hereinafter TEX. LEGIS. COUNCIL] (noting the effect the *Dallas v. Trammell* decision had upon members of retirement systems in Texas and the modern movement among states to protect members' rights through state constitutional amendments); *Proposition 15*, *supra* note 77, at 45; House Comm. on Pensions & Invs., Bill Analysis, Tex. H.R.J. Res. 54, 78th Leg., R.S. (2003); Senate Comm. on State Affairs, Bill Analysis, Tex. H.J.R. 54, 78th Leg., R.S. (2003).

the flexibility the systems need to adjust retirement benefits if necessary to respond to changing economic times, while still protecting the benefits that local government employees have already earned."[112]

The attorney general also pointed to analysis from the House Research Organization's focus report on proposed constitutional amendments and explained the analysis as follows:

> [The House Research Organization] noted that supporters of the amendment said that the amendment would "leave pension plans with cost-control options, such as reducing the benefits multiplier or increasing active member contribution." On the other hand, it noted that opponents said that the amendment would have a negative impact on the actuarial soundness of municipal pension funds "[b]ecause the amendment would protect all vested employees from having their benefits reduced or impaired, municipal pension plans and local governments [could] no longer make even minor adjustments to plan design or retirement eligibility."[113]

The opponents, however, stated the negative impact would occur from a broad interpretation of the amendment, not from the literal text of the amendment; they realized the possibility that others might give the phrase "benefits accrued" a wide scope and stated that such a construction "could result in negative *unintended* consequences."[114]

In its brief to the attorney general, the City relied on bill analyses from the House Committee to support the proposition that the resolution protected only those benefits earned from service already performed.[115] In the bill analysis for the House Committee's substituted version of the resolution, the committee stated that "[a]nnuitants are guaranteed their formula/multiplier *for the years they worked under that formula/multiplier.*"[116] The attorney general stated that the value of that portion of the bill analysis is "questionable" because it relates to express language in the House Committee's substituted version that was "deleted from the enrolled version . . . adopted by the legislature."[117] The language, however, was not simply discarded; the deletion was a result of the Senate

---

112. TEX. LEGIS. COUNCIL, *supra* note 111, at 101. The Texas Legislative Council is a "nonpartisan legislative agency that provides bill drafting, computing, research, publishing, and document distribution services to the Texas Legislature and the other legislative agencies. The council also serves as an information resource for state agencies, the citizens of Texas, and others as time and resources allow." TEX. LEGIS. COUNCIL, http://www.tlc.state.tx.us/tlc.htm (last visited May 17, 2011).

113. Tex. Att'y Gen. Op. No. GA-0615, at 7 (2008) (quoting *Proposition 15*, *supra* note 77, at 46).

114. *Proposition 15*, *supra* note 77, at 46 (emphasis added); *see supra* text accompanying notes 84-85.

115. *See* Tex. Att'y Gen. Op. No. GA-0615, at 7 (2008).

116. House Comm. on Pensions & Invs., Bill Analysis, Tex. H.J.R. 54, 78th Leg., R.S. (2003) (emphasis added).

117. Tex. Att'y Gen. Op. No. GA-0615, at 8 (2008).

Committee's decision to redraft the language in order to create a new § 66 instead of an amendment to § 67.[118] The Senate Committee replaced the phrase supporting the House Committee's bill analysis with the phrase "benefits accrued," which raises the question of whether the Senate Committee intended the substitution to change the meaning of the provision or whether the phrase was simply used as a more succinct way of describing what the provision protected.[119]

The Senate Committee does not explain the reasons for this substitution in the bill analysis and provides no definition of "benefits accrued."[120] Notably, however, the Texas Local Fire Fighters Retirement Act defines the phrase "vested accrued benefit":

> [T]he amount of the monthly benefit that a person is entitled to receive based on the person's service credit and compensation history as of the [day before the effective date of an addition or change adopted by the board of trustee of a retirement system] under the benefit formula and other terms established by a retirement system.[121]

This definition refers to the vested accrued benefit as "the *amount* of the monthly benefit," which suggests the benefit includes only the calculable amount and not the method of calculation as well.[122] The 78th legislature added this definition to the Texas Local Fire Fighters Retirement Act in 2003—the exact year in which the legislature adopted the constitutional amendment resolution, and although this definition is part of a different statute, it arguably reveals the intended scope of the phrase "benefits accrued" and thus deserves some deference.[123]

Ultimately, however, the attorney general concluded that even though the intent of the amendment was to allow prospective changes to retirement system benefits, "there is no persuasive support for the view that the constitutional amendment was intended to protect only benefits attributable to services performed before the effective date of a change."[124] Essentially, the attorney general found no answer to the question of whether a method should be included as a benefit within the constitutional provision.[125]

---

118. *See supra* text accompanying notes 81-83.
119. *See supra* text accompanying notes 81-83.
120. Senate Comm. on State Affairs, Bill Analysis, Tex. H.J.R. 54, 78th Leg., R.S. (2003).
121. TEX. REV. CIV. STAT. ANN. art. 6243e, § 2(10)-(11) (West 2010).
122. *Id.* (emphasis added).
123. *Id.*
124. Tex. Att'y Gen. Op. No. GA-0615, at 8 (2008).
125. *See id.*

3. *Use of Other Jurisdictions*

Looking to other jurisdictions, the attorney general then considered case law from three states whose supreme courts had applied state constitutional provisions to changes in the calculation of retirement benefits.[126] Specifically, the attorney general looked to decisions from New York, Illinois, and Alaska courts, each of which "have held that a change in the method for determining the base compensation for calculation of retirement benefits that reduces or impairs the benefits that 'vested' employees would have received before the change is unconstitutional."[127] The attorney general acknowledged that there is a difference in language between the Texas constitutional provision and the constitutional provisions of the other three states but found the other jurisdictions' decisions to be persuasive and therefore concluded that "benefits accrued" is a broad term that includes methods of calculating benefits.[128]

Yet the differences between the states' constitutions are worth considering. The constitutions of New York, Illinois, and Alaska each have provisions establishing that membership in a retirement system constitutes a contractual relationship.[129] Texas's constitutional provision does not contain any kind of contractual language, and the contractual provision contained in the original version of the constitutional amendment resolution was intentionally removed to "give[] the local government the ability to alter benefits in the future for protection of the pension fund."[130] Moreover, the New York and Illinois provisions protect "benefits," not just *accrued* benefits, which expressly provides a much wider scope than the language of

126. *See id.* at 8-10.

127. *Id.* at 8; *see also* Flisock v. State, Div. of Ret. & Benefits, 818 P.2d 640, 643 (Alaska 1991) (holding that a retirement system member was entitled to include unused leave within the base salary because the terms in place at the time of enrollment in the system allowed for unused leave to be included); Felt v. Bd. of Trs. of the Judges Ret. Sys., 481 N.E.2d 698, 702 (Ill. 1985) (holding that a change in the method for determining a judge's retirement benefits was unconstitutional); Kleinfeldt v. N.Y. City Emps.' Ret. Sys., 324 N.E.2d 865, 868 (N.Y. 1975) (holding that eliminating the "inclusion in final average salary of cash payments for accumulated vacation credits" was unconstitutional as applied to employees who became members of the system before the effective date of the change).

128. *See* Tex. Att'y Gen. Op. No. GA-0615, at 10-11 (2008).

129. *See* N.Y. CONST. art. V, § 7 ("After July first, nineteen hundred forty, membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired."); ILL. CONST. art. XIII, § 5 ("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."); ALASKA CONST. art. 12, § 7 ("Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired.").

130. House Comm. on Pensions & Invs., Bill Analysis, Tex. H.R.J. Res. 54, 78th Leg., R.S. (2003); TEX. CONST. art. XVI, § 66.

the Texas provision.[131] Nevertheless, the attorney general decided a contractual relationship theory is a sound policy that Texas should follow.[132] But, because constitutional protection is only one of the several ways in which states confront the issue of retirement benefit protection, in order to fully understand the contract relationship theory, it is necessary to explore all of the approaches used to address the issue.[133]

VI. HOW OTHER JURISDICTIONS PROTECT RETIREMENT BENEFITS

A. Gratuity Approach

In 1889, the Supreme Court decided *Pennie v. Reis*, which established public retirement benefits as "mere expectanc[ies], created by the law, and liable to be revoked or destroyed by the same authority."[134] Known widely as the "gratuity" approach, this theory represents the notion that the government grants benefits to retirees as a kind of voluntary gratuity, which forecloses any possibility of retirees claiming a protected right to receive benefits upon retirement.[135] After the *Pennie* decision, a majority of states adopted the gratuity approach and allowed their legislatures to alter or repeal, without restriction, laws affecting retirement benefits.[136] Today, however, only Texas and Indiana continue to exercise some form of the

131. N.Y. CONST. art. V, § 7; ILL. CONST. art. XIII, § 5. The Alaska provision uses the phrase "accrued benefits," but Alaska courts have interpreted the phrase to include both past and future benefits. ALASKA CONST. art. 12, § 7; *see infra* note 149 and accompanying text.

132. *See* Tex. Att'y Gen. Op. No. GA-0615, at 10 (2008).

133. *See infra* Part VI.

134. Pennie v. Reis, 132 U.S. 464, 471 (1889). In *Pennie*, the petitioner was an administrator for the estate of a deceased police officer. *Id.* at 465. Nine days prior to the police officer's death, the state of California repealed the act that had established payable-on-death pension benefits for members of the fund, and accordingly, the treasurer of the retirement fund refused to pay any benefits to the police officer's estate. *Id.* at 468-69. The Court held that, although the state withheld $2 from the police officer's monthly compensation to pay into the fund, the police officer never actually received or controlled the $2 and thus "had no such power of disposition over it as always accompanies ownership of property." *Id.* at 470. Because the police officer had no property rights to the benefits until the happening of an event that would cause the payments to be due the officer, the retirement benefits were "entirely at the disposal of the government." *Id.* at 471. Although the Supreme Court has not overruled *Pennie v. Reis*, disapproval of the *Pennie* rule is evident in some federal court decisions. *See, e.g.*, Zucker v. United States, 578 F. Supp. 1239, 1243 (S.D. N.Y. 1984) (stating that the court is "constrained" to adhere to the *Pennie* rule); Muzquiz v. City of San Antonio, 378 F. Supp. 949, 958 (W.D. Tex. 1974) (describing the *Pennie* decision as a "harsh" rule).

135. *See* Andrew C. Mackenzie, Case Note, Spiller v. State*: Determining the Nature of Public Employees' Rights to Their Pensions*, 46 ME. L. REV. 355, 356-57 (1994) (discussing pensioners' rights from a federal standpoint).

136. *See id.*; TERRY A.M. MUMFORD, ET AL., AMERICAN LAW INSTITUTE—AMERICAN BAR ASSOCIATION CONTINUING LEGAL EDUCATION: EMPLOYEE RETIREMENT AND WELFARE PLANS OF TAX-EXEMPT AND GOVERNMENT EMPLOYERS: THE EMPLOYER'S (IN)ABILITY TO REDUCE RETIREMENT BENEFITS IN THE PUBLIC SECTOR 27, 34 (Sept. 11, 1997).

gratuity approach while most states elect to treat retirement plans as establishing some type of a contractual relationship.[137]

B. Contractual Relationship Approach

While the United States Constitution contains no provision specifically establishing a contractual relationship between the state and retirement members, it does prohibit states from "impairing the Obligation of Contracts," and a majority of states include within their own constitutions a similar contract clause.[138] Additionally, though the establishment of a contract regarding retirement benefits does not arise from the United States Constitution, other sources, such as state constitutions or state court decisions, serve as a source for contractual protection, which then implicates federal—and possibly state—contract clause protection.[139] A limited number of states have specific constitutional provisions that characterize membership in a public retirement system as a contractual relationship between the members; thus, upon membership, employees become parties to a contract protected by their state constitution.[140] Most states, however, rely on courts to decide whether or not a contract exits, and

---

137. *See* Kunin v. Feofanov, 69 F.3d 59, 60 (5th Cir. 1995) (applying Texas law and describing public pensions as "wholly statutory creations" that are "subordinate to the state's power to alter or abolish pension benefits"); Haverstock v. State Pub. Emps. Ret. Fund, 490 N.E.2d 357, 360-61 (Ind. Ct. App. 1986) (applying the gratuity approach only to public retirement systems in which membership is mandatory); *infra* Part VI-B.

138. U.S. CONST. art. I, § 10, cl. 1 ("No state shall . . . pass any . . . Law impairing the Obligation of Contracts."); ALA. CONST. art. I, § 22; ALASKA CONST. art. I, § 15; ARIZ. CONST. art. II, § 25; ARK. CONST. art. II, § 17; COLO. CONST. art. II, § 11; FLA. CONST. art. I, § 10; GA. CONST. art. I, § 1, para. X; IDAHO CONST. art. I, § 16; ILL. CONST. art. I, § 16; IND. CONST. art. I, § 24; IOWA CONST. art. I, § 21; KY. CONST. § 19(1); LA. CONST. art. I, § 23; ME. CONST. art. I, § 11; MICH. CONST. art. I, § 10; MINN. CONST. art. I, § 11; MISS. CONST. art. III, § 16; MO. CONST. art. I, § 13; MONT. CONST. art. II, § 31; NEB. CONST. art. I, § 16; NEV. CONST. art. I, § 15; N.J. CONST. art. IV, § 7, para. 3; N.M. CONST. art. II, § 19; N.D. CONST. art. I, § 18; OHIO CONST. art. II, § 28; OKLA. CONST. art. II, § 15; OR. CONST. art. I, § 21; PA. CONST. art. I, § 17; R.I. CONST. art. I, § 12; S.C. CONST. art. I, § 4; S.D. CONST. art. VI, § 12; TENN. CONST. art. I, § 20; TEX. CONST. art. I, § 16; UTAH CONST. art. I, § 18; VA. CONST. art. I, § 11; WASH. CONST. art. I, § 23; W. VA. CONST. art. III, § 4; WIS. CONST. art. I, § 12; WYO. CONST. art. I, § 35.

139. *See* MUMFORD, ET AL., *supra* note 136, at 38-39. Although "[t]he Contract Clause is not an absolute bar to subsequent modification of a State's own financial obligations," it does strictly limit the kinds of changes a state may make to retirement systems deemed to be part of a contractual relationship. U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 25 (1977); *see also* Amy B. Monahan, *Public Pension Plan Reform: The Legal Framework*, 5 EDU. FIN. & POL'Y 617, 620-22 (2010), *available at* http://www.mitpress journals.org/doi/pdf/10.1162/EDFP_a_00014 (discussing further the application of the Contract Clause to contracts related to retirement systems). The threshold issue in a Contract Clause analysis is "whether a change in state law has resulted in 'the substantial impairment of a contractual relationship.'" Parker v. Wakelin, 123 F.3d 1, 4-5 (1st Cir. 1997) (quoting Gen. Motors Corp. v. Romein, 503 U.S. 181, 186 (1992)). If a court finds that a substantial impairment occurred, the impairment must be "reasonable and necessary to serve an important public purpose" in order to be constitutional. *U.S. Trust Co. of N.Y*, 431 U.S. at 25. The Supreme Court has stated, however, that "complete deference to legislative assessment of reasonableness" is inappropriate because of the State's interest in having the ability to alter the contract provisions for its own benefit. *Id.*

140. *See* MUMFORD, ET AL., *supra* note 136, at 38-39; *infra* Part VI.B.1.

although a majority of states find that retirement benefits are contractual in nature, there is a disparity among the states regarding the exact time at which retirement members' rights vest in the contract.[141] Some states follow the more strict approach and hold that the members' rights vest as soon as they begin their employment.[142] Other states hold that members' rights vest when they fulfill all the requirements necessary to become eligible to receive their benefits under the plan.[143] Regardless of whether state constitutions or state courts establish the contractual relationship, however, different states accord varying levels of protection to the contracts they deem to exist.[144]

1. Constitutional Theory

Only seven states have provisions in their constitutions establishing contractual protection: New York, Illinois, Alaska, Arizona, Hawaii, Michigan, and Louisiana.[145] New York led the way for this constitutional

---

141. *See* MUMFORD, ET AL., *supra* note 136, at 39-41; Mackenzie, *supra* note 135, at 360-61; *infra* Part VI.B.2.

142. *See, e.g.*, Betts v. Bd. of Admin., 21 Cal.3d 859, 863, 582 P.2d 614, 616-17 (1978) (holding that "a vested contractual right to pension benefits accrues upon acceptance of employment"); Burks v. Bd. of Trs. of Firemen's Pension Fund of City of Atlanta, 104 S.E.2d 225, 227 (Ga. 1958) (establishing that a pension is a contract); Brazelton v. Kansas Pub. Emp. Ret. Sys., 607 P.2d 510, 514 (Kan. 1980) (stating that rights stemming from the statutes that create the retirement system are part of the employment contract); Opinion of the Justices, 303 N.E.2d 320, 327 (Mass. 1973) (interpreting a statutory change to mean "that the 'contract' is formed when a person becomes a member by entering the employment"); Ass'n of Pa. State Coll. & Univ. Faculties v. State Sys. of Higher Educ., 479 A.2d 962, 966 (Pa. 1984) (holding invalid an amendment to a retirement code as applied to all employees who were members of the retirement system); Burlington Fire Fighters' Ass'n v. City of Burlington, 543 A.2d 686, 689 (Vt. 1988) (noting that if an employee "makes mandatory contributions to a pension plan, that pension plan becomes part of the employment contract"); Bakenhus v. City of Seattle, 296 P.2d 536, 540 (Wash. 1956) (stating that when employees accept a job that provides a pension plan, they "contract[] for a substantial pension").

143. *See, e.g.*, Dorsey v. State *ex rel.* Mulrine, 283 A.2d 834, 836 (Del. 1971) (holding that pension rights vest "when the requirements for the grant of a pension have been fulfilled"); Arnold v. Browning, 171 S.W.2d 239, 240 (Ky. 1943) ("It is only when by the terms of the act providing for the fund, the claimant is shown to become entitled to the benefits that the right thereto becomes vested.") (citing Miller v. Price, 139 S.W.2d 450 (Ky. 1940)); Miracle v. North Carolina Local Gov't Emps. Ret. Sys., 477 S.E.2d 204, 207 (N.C. Ct. App. 1996) (stating that an employee's rights had vested because he had fulfilled the requirements necessary to establish entitlement); Payne v. Bd. of Trs. of the Teachers' Ins. & Ret. Fund, 35 N.W.2d 553, 556 (N.D. 1949) (holding that teachers' rights to their benefits becomes protected upon the fulfillment of all requirements for eligibility); Baker v. Okla. Firefighters Pension & Ret. Sys., 718 P.2d 348, 353 (Okla. 1986) (finding absolute protection of benefits for those firefighters and police officers whose benefits had become payable); Tait v. Freeman, 57 N.W.2d 520, 522 (S.D. 1953) (refusing to protect rights to benefits for those employees who had not yet fulfilled all eligibility requirements); Hansen v. Pub. Emps.' Ret. Sys. Bd. of Admin., 246 P.2d 591, 597 (Utah 1952) (refusing to hold that an employee "acquires vested rights in a pension system prior to the fulfillment of the conditions required").

144. *See infra* Part VI.B.1-3.

145. *See* ALASKA CONST. art. XII, § 7; ARIZ. CONST. art. XXIX, § 1(C) ("Membership in a public retirement system is a contractual relationship . . . and public retirement benefits shall not be diminished or impaired."); HAW. CONST. art. XVI, § 2 ("Membership in any employees' retirement system of the

trend in 1938, and the other states have slowly followed suit.[146] Within these seven states, however, there are two different degrees of protection afforded to the constitutionally established contract.[147] The New York and Illinois constitutions contain the broadest language, protecting "benefits," which includes both benefits already earned by the retirement member and those benefits the retirement member will earn in the future.[148] The Alaska constitutional provision contains narrower language, referring specifically to "accrued benefits," but Alaska courts construe the provision broadly to follow New York and Illinois' stricter protection of both previously earned and future earned benefits, rather than only previously earned benefits.[149] Additionally, the Arizona constitutional provision, like New York and Illinois, broadly provides for the protection of "benefits," and even though there is not yet a ruling from Arizona courts as to the construction of the statute, past judicial precedent suggests that Arizona will likely follow New York, Illinois, and Alaska in providing protection for both prior earned and future earned benefits.[150]

The remaining three states adhere to a less expansive form of contractual protection. The constitutions of Michigan, Louisiana, and Hawaii each contain a provision protecting employees' "accrued benefits," which are construed to include only the already earned benefits of

---

State or any political subdivision thereof shall be a contractual relationship, the accrued benefits of which shall not be diminished . . . ."); ILL. CONST. art. XIII, § 5; LA. CONST. art. X, § 29(E)(5) (establishing that membership in a public retirement system constitutes a contractual relationship and providing that "[t]he accrued benefits of members of any state or statewide public retirement system shall not be diminished or impaired"); 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."); N.Y. CONST. art. V, § 7.

146. N.Y. CONST. art. V, § 7. Michigan adopted its constitutional provision in 1963. MICH. CONST. art. IX, § 24. Illinois established its provision in 1970. *See* Felt v. Bd. of Trs. of the Judges Ret. Sys., 481 N.E.2d 698, 699-700 (Ill. 1985). Hawaii ratified its provision in 1978. HAW. CONST. art., XVI, § 2. Louisiana followed in 1974. LA. CONST. art. X, § 29. And, Arizona adhered to the constitutional theory in 1998. ARIZ. CONST. art. XXIX, § 1(C).

147. *See infra* text accompanying notes 148-52.

148. N.Y. CONST. art. V, § 7; ILL. CONST. art. XIII, § 5; *see also* Monahan, *supra* note 139, at 622-25 (discussing the differences between the state constitutions that provide protection for retirement benefits). The Illinois legislature added § 5 in 1970 and modeled the provision after the New York constitutional provision. *See Felt*, 481 N.E.2d at 699-700.

149. ALASKA CONST. art. XII, § 7; *see* Bidwell v. Scheele, 355 P.2d 584, 586 (Alaska 1960) (construing the term "accrued benefits" as synonymous with vested rights); Hammond v. Hoffbeck, 627 P.2d 1052, 1056-57 (Alaska 1981) (holding that public retirement system members' right to their benefits "vests immediately upon an employee's enrollment in that system" and that the state cannot alter the retirement system in a way that would disadvantage employees without also providing offsetting, "comparable new advantages").

150. ARIZ. CONST. art. XXIX, § 1(C); *see also* Monahan, *supra* note 139, at 623-24; Yeazell v. Copins, 402 P.2d 541, 546 (Ariz. 1965) (holding that membership in a retirement system constitutes a contractual relationship, the provisions of which may not be altered without the mutual assent of both parties to the contract).

retirement members.[151] Constitutional provisions represent one way in which states offer both strict and more lenient contractual protection of retirement benefits; the majority of states, however, elect to provide contractual protection without a constitutional provision.[152]

2. Strict Contract Theory

The most expansive form of non-constitutional contract protection is the strict contract theory, which only two states currently elect to follow—Georgia and Pennsylvania.[153] In a strict contract approach, the terms of the contract become fixed upon employment, and the state may not make any changes without consent from the retirement member.[154] This level of protection provides complete security for retirement members, but with no exceptions to the bar on altering the plan, the strict contract theory even prohibits changes that might be necessary to preserve the financial stability of the plan, which many consider to be too harsh.[155] Reluctant to

---

151. HAW. CONST. art. XVI, § 2; LA. CONST. art. X, § 29; MICH. CONST. art. IX, § 24; *see also* Chun v. Emps.' Ret. Sys., 607 P.2d 415, 421 (Haw. 1980) ("[T]he legislature [can] reduce benefits as to (1) new entrants into a retirement system, or (2) as to persons already in the system in so far as their future services were concerned."); Smith v. Bd. of Trs. of La. State Emps.' Ret. Sys., 851 So.2d 1100, 1106 (La. 2003) (defining the term "accrued" benefits as "in the sense of due and payable; vested"); Ass'n of Prof'l & Technical Emps. v. City of Detroit, 398 N.W.2d 436, 439 (Mich. Ct. App. 1986) (agreeing with an advisory opinion of the Michigan Supreme Court, which stated that "the Legislature cannot diminish or impair accrued financial benefits but . . . it may properly attach new conditions for earning financial benefits which have not yet accrued"). In *Kaho'ohanohano v. State*, Hawaii courts also extended constitutional protection to the "sources of funds" for accrued benefits. Kaho'ohanohano v. State, 162 P.3d 696, 732 (Haw. 2007). This limitation could prohibit the use of state funds originally designated for payment of retirement benefits even if use of the funds for purposes other than paying retirement benefits would not diminish or impair the accrued benefits of retirement members. *Id.* at 753-54 (Moon, J., dissenting).

152. *See infra* Part VI.B.2-3.

153. *See, e.g.*, Burks v. Bd. of Trs. of Firemen's Pension Fund of City of Atlanta, 104 S.E.2d 225, 227 (Ga. 1958) (holding that a "contract can not be modified, repealed, or defeated by subsequent acts"); Ass'n of Pa. State Coll. & Univ. Faculties v. State Sys. of Higher Educ., 479 A.2d 962, 966 (Pa. 1984) (stating that the state's "unilateral reduction of retirement benefits arising from the employment contracts cannot pass constitutional muster and must fall"). Arizona also followed the strict contract theory until their adoption, in 1998, of a constitutional provision protecting retirement benefits. *See* ARIZ. CONST. art. XXIX, § 1; *Yeazell*, 402 P.2d at 545 (requiring mutual assent for any modification of a retirement system).

154. *See Yeazell*, 402 P.2d at 545; Rubin G. Cohn, *Public Employee Retirement Plans—The Nature of the Employees' Rights*, 1968 U. ILL. L.F. 32, 44 (1968) (analyzing the complexity of what constitutes employee consent under the strict contract theory); John J. Dwyer, Note, *'Til Death Do Us Part: Pennsylvania's 'Contract' With Public Employees For Pension Benefits*, 59 TEMP. L. Q. 553, 572-73 (1986) (discussing the basics of the strict contract theory as stated in *Yeazell*).

155. *See* Brazelton v. Kan. Pub. Emps. Ret. Sys., 607 P.2d 510, 517 (Kan. 1980) ("There may be times when changes are necessary to protect the financial integrity of the system . . . ."); McGrath v. R.I. Ret. Bd., 906 F. Supp. 749, 760 (D. R.I. 1995) ("[T]he state may occasionally find itself beset with financial burdens that imperil the very pensions system its employees rely on."); Mackenzie, *supra* note 135, at 371 (acknowledging that the "shortcomings" of the strict contract theory "are widely recognized"); Cohn, *supra* note 154, at 46 (stating that courts deciding to adhere to the strict contract theory "exalt labels over substance" and "create or perpetuate dubious law").

completely restrict a legislature's authority to make plan changes, many state courts choose to follow a more relaxed approach.[156]

3. *Modified Contract Theory*

Originating in California, the modified contract approach allows the state to make "reasonable" modifications to its retirement systems.[157] In *Allen v. City of Long Beach*, the California Supreme Court stated that "[t]o be sustained as reasonable, alterations of employees' pension rights must bear some material relation to the theory of a pension system and its successful operation, and changes in a pension plan which result in disadvantage to employees should be accompanied by comparable new advantages."[158] Because the modified contract approach protects retirement members' benefits without removing all of the state's authority to modify the plan, many states have followed California's lead.[159] Some academic writings, however, criticize this approach for various reasons: (1) the ambiguity regarding what exactly constitutes a "comparable new advantage"; (2) the inefficiency of forcing the state to offer new advantages every time the state wishes to make an alteration to a retirement system; and (3) the inconsistency, within contract law, of declaring the existence of a contract but allowing the state to make alterations to the terms of the contract.[160] Despite these criticisms, a majority of the states that provide contractual protection to retirement benefits do so under a modified contract approach.[161] Two states, however, have departed significantly from the traditional forms of retirement benefit protection.[162]

---

156. *See infra* Part VI.B.3.

157. *See* Allen v. City of Long Beach, 287 P.2d 765, 767 (Cal. 1955).

158. *Id.* Some states refer to this standard as the "California Rule." Singer v. City of Topeka, 607 P.2d 467, 475 (Kan. 1980); Calabro v. City of Omaha, 531 N.W.2d 541, 551 (Neb. 1995); Booth v. Sims, 456 S.E.2d 167, 185 (W. Va. 1995).

159. *See, e.g.*, Police Pension & Relief Bd. of City & Cnty. of Denver v. Bills, 366 P.2d 581, 584 (Colo. 1961); Hanson v. City of Idaho Falls, 446 P.2d 634, 636 (Idaho 1968); *Singer*, 607 P.2d at 475; Opinion of the Justices, 303 N.E.2d 320, 329 (Mass. 1973); Davis v. Mayor of City of Annapolis, 635 A.2d 36, 40 (Md. 1994); *Calabro*, 531 N.W.2d at 551; Pub. Emps.' Ret. Bd. v. Washoe Cnty., 615 P.2d 972, 974-75 (Nev. 1980); Burlington Fire Fighters' Ass'n v. City of Burlington, 543 A.2d 686, 690 (Vt. 1988); Bowles v. Wash. Dep't of Ret. Sys., 847 P.2d 440, 447 (Wash. 1993); Wagoner v. Gainer, 279 S.E.2d 636, 645-46 (W. Va. 1981).

160. Cohn, *supra* note 154, at 47 (discussing the difficulty in defining corresponding benefits); Dwyer, *supra* note 154, at 584 (noting that "the legislature may be prevented from making changes that significantly strengthen the pension fund if every time it diminishes one benefit it must increase another"); Note, *Public Employee Pensions in Times of Fiscal Distress*, 90 HARV. L. REV. 992, 1001-02 (1977) ("[T]o find in public pension legislation an implied term permitting the state to make 'reasonable' changes if they are accompanied by 'offsetting advantages' seems inconsistent with the basic view that public employees have a contractual right to benefits.").

161. *See* cases cited *supra* note 159.

162. *See infra* Part VI.C-D.

C. Promissory Estoppel Approach

In 1983, the Minnesota Supreme Court decided *Christiansen v. Minneapolis Municipal Employees Retirement Board*, in which the court elected to provide protection to retirement benefits through a promissory estoppel approach.[163] Noting that promissory estoppel only provides protection in those instances in which it is necessary to avoid injustice, the court provided two factors to aid in determining whether a protected right in retirement benefits exist: "(1) What has been promised by the state? and (2) to what degree and to what aspects of the promise has there been reasonable reliance on the part of the employee?"[164] The court also stated, however, that "[a] promise enforced by estoppel, like a contract, contains an implied condition that the terms are subject to modification under the state's police power," although this power to amend remains subject to the Contract Clause protection of both the United States and Minnesota constitutions.[165] Thus, once a court determines that a state has made a promise warranting promissory estoppel protection, that promise implicates the "normal enforcement remedies of general contract law."[166] Some have criticized this approach as having the potential to create contractual obligations in instances in which the legislature had no intention of binding itself, which "requires the legislature and pension fund administrators to walk a tight rope whenever changes are indicated, and to accept risks which may turn into substantial financial obligations years after the fact."[167] This criticism, in fact, was the exact view taken by the Connecticut Supreme Court when it rejected the promissory estoppel approach in favor of a due process theory previously established in New Jersey.[168]

D. Due Process Approach

The Connecticut Supreme Court case of *Pineman v. Oechslin* involved a question regarding the validity of a unilateral increase in the retirement age for plan members, which led the court to examine the ways in which

---

163. *See* Christiansen v. Minneapolis Mun. Emps. Ret. Bd., 331 N.W.2d 740, 748 (Minn. 1983). "Promissory estoppel is the name applied to a contract implied in law where no contract exists in fact. The effect of promissory estoppel is to imply a contract from a unilateral or otherwise unenforceable promise coupled by detrimental reliance on the part of the promisee." *Id.* at 748 (quoting Del Hayes & Sons, Inc. v. Mitchell, 230 N.W.2d 588, 593 (Minn. 1975)).

164. *Christiansen*, 331 N.W.2d at 749.

165. *Id.* at 749-50; *see supra* text accompanying notes 138-39.

166. *Christiansen*, 331 N.W.2d at 750; *see supra* text accompanying notes 138-39.

167. Cohn, *supra* note 154, at 48; *see also* Mackenzie, *supra* note 135, at 371-72 ("If public employees were able to prevent modifications to their pensions based on 'reasonable reliance,' then a case could be brought against the state for any modification adversely affecting a state employee, and the subjective standards would require a case-by-case analysis for virtually every individual claiming reliance.").

168. *See* Pineman v. Oechslin, 488 A.2d 803, 809 (Conn. 1985).

other states protect retirement benefits.[169] The court found the gratuity, contract, and promissory estoppel theories to be unpersuasive and, opting instead for the due process theory followed in the New Jersey decision *Spina v. Consolidated Police & Firemen's Pension Fund Commission*, the Connecticut court established that retirement members have a property interest in the "existing retirement fund . . . [that] is entitled to protection from arbitrary legislative action under the due process provisions of our state and federal constitutions."[170] These due process provisions can provide both procedural and substantive due process protection, although a substantive due process claim would likely be ineffective with regard to state-created retirement benefits due to the difficulty of classifying the receipt of retirement benefits as a "fundamental right."[171] According to general procedural due process principles, state deprivation of a person's property cannot occur without the state affording that person procedural due process.[172] This theory, therefore, does not necessarily prevent legislatures from making decisions that affect a person's property; it simply lays out the procedural requirements with which legislatures must comply when making such decisions.[173] Because the parties in the *Pineman* case never presented any arguments relating to the due process theory, the court did not reach the issue of whether the raise in retirement age would be constitutional under the new due process theory it had established.[174]

In *Spina*, the New Jersey Supreme Court posed the question of whether a property right in the existing retirement fund extends to the entire fund or only to those contributions a retirement member pays into the fund.[175] Describing the question as "too academic," however, the court determined that an answer to the question was not necessary because the

---

169. *See id.* at 807-10.

170. *Id.* at 810; *see* U.S. CONST. amend. V; U.S. CONST. amend. XIV, § 1; CONN. CONST. art. I, § 8; Spina v. Consol. Police & Firemen's Pension Fund Comm'n, 197 A.2d 169, 175 (N.J. 1964) (finding that employees have a property interest in the existing fund of the retirement system at issue, which "the State could not simply confiscate").

171. *See* Local 342, Long Island Pub. Serv. Emps. v. Town Bd. of Huntington, 31 F.3d 1191, 1196 (2d Cir. 1994) (finding that "simple, state-law contractual rights, without more, are [not] worthy of substantive due process protection"). Substantive due process "forbids the government to infringe certain 'fundamental' liberty interests *at all*, no matter what process is provided, unless the infringement is narrowly tailored to serve a compelling state interest." Reno v. Flores, 507 U.S. 292, 301-02 (1993) (emphasis in original). Moreover, the Supreme Court has defined "fundamental right" as something considered "so rooted in the traditions and conscience of our people as to be ranked as fundamental." Snyder v. Massachusetts, 291 U.S. 97, 105 (1934).

172. *See* Bell v. Burson, 402 U.S. 535, 542 (1971) (stating that "it is fundamental that except in emergency situations . . . due process requires that when a State seeks to terminate an interest . . . it must afford 'notice and opportunity for hearing appropriate to the nature of the case' *before* the termination becomes effective") (emphasis added) (quoting Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 313 (1950)).

173. *See* Monahan, *supra* note 139, at 636.

174. *See Pineman*, 488 A.2d at 810.

175. *Spina*, 197 A.2d at 175.

legislature would never attempt to "mak[e] off" with the fund.[176] Thus, neither the *Pineman* decision nor the *Spina* decision provide a very clear picture of the types of changes the legislature may make to the existing retirement fund as a result of a due process approach, yet one advocate of the due process theory asserts that "[i]t refreshes because it rejects the deadening sterility of alluring but inapt legal concepts" and that "[i]t invigorates because it gives hope that legislative and judicial collaboration can produce constructive and realistic principles which are appropriately responsive to the legitimate need of both employees and government."[177] Along these same lines, the Connecticut court stated that a due process approach "provides the necessary flexibility that the contract approach lacks" because the legislature may make changes to the retirement system without the limitations the contract approach imposes—mutual assent for the strict contract theory and offsetting advantages for the modified contract theory.[178] Further exploration of this theory, however, is necessary for the legislatures to obtain a clearer picture of the options they have for altering retirement plans.

VII. CHOOSING THE BEST APPROACH FOR TEXAS

Texas currently follows two different approaches for public retirement benefit protection: a constitutional approach for non-statewide systems and a gratuity approach for statewide systems.[179] These two approaches, as currently interpreted, rest at both ends of the spectrum of protection that states afford to retirement benefits and fail to adequately balance the competing interests of retirement members and state or local governments.[180] The gratuity approach emphasizes the authority of the legislature at the expense of retirement members' benefit protection while the constitutional approach, as interpreted by the attorney general, emphasizes the rights of retirement members at the expense of legislative authority.[181] Thus, the underlying issue remains: What is the perfect balance between benefit protection and state or local government authority?[182] Although states have attempted to address this issue with a variety of approaches, all of the currently followed approaches fail to

176. *Id.*

177. Cohn, *supra* note 154, at 50.

178. *Pineman*, 488 A.2d at 810; *see supra* Part VI.B.2-3; *see also* Dwyer, *supra* note 154, at 587 ("Under a due process analysis, courts reviewing legislative modifications to the retirement system, would not be required to determine if a disadvantage was offset by a new advantage or if a different alteration would have been less burdensome on the employee.").

179. *See supra* Part IV.A-B.

180. *See supra* Part IV.A-B.

181. *See supra* Parts V.C, IV.A-B.

182. *See infra* Part VII.A-B.

achieve a balance of interests by providing either too little or too much protection to retirement benefits.[183]

A. Evaluation of the Options

The gratuity approach that Texas law currently supports for statewide retirement systems affords too little protection to the earned benefits of vested employees and thus fails to protect the interest of the retirement member.[184] For example, according to Texas law, a legislature facing significant deficits in retirement funds could unilaterally change the method of calculating benefits employees have already earned through their performed service.[185] Although this approach allows the legislature an abundance of freedom when choosing methods to close major funding gaps in retirement funds, it also fails to acknowledge the property right vested employees have in their earned benefits.[186] Moreover, viewing retirement benefits strictly as a gratuity from the government, alterable at will, undermines the purpose of a retirement system—providing employees the certainty of future financial security.[187] Legislatures should not have the option, as they do under the gratuity approach, of depriving vested members of their earned benefits, and although it is possible a Texas court, if faced with the issue today, would depart from the reasoning in *Trammell*, the legislature should not wait for the issue to come before a court.[188] In times of economic distress when the legislature must take drastic measures to ensure fiscal stability, statewide retirement members should have the assurance of knowing the benefits they have already earned are safe from any actions taken to reduce unfunded liabilities.[189] The legislature, therefore, should expressly abandon the gratuity approach for statewide systems, as they have for non-statewide systems, by placing some limitations on the legislature's authority to alter statewide plans.[190] The attorney general's interpretation of the constitutional approach Texas adopted for non-statewide systems, however, goes too far in limiting the legislature's authority.[191]

Although Texas's constitutional provision is inherently different than the provisions of all other states using the constitutional theory because the Texas provision does not expressly create a contractual relationship, the attorney general found persuasive the "New York, Illinois, and Alaska court

183. *See supra* Part VI.A-D.
184. *See supra* Part VI.A.
185. *See supra* Part VI.A.
186. *See supra* Part VI.A.
187. *See supra* Part VI.A.
188. *See supra* notes 75-76 and accompanying text.
189. *See supra* Part VI.A.
190. *See supra* Part VI.A.
191. *See supra* Part V.C.

decisions [that] suggest that the authorized method for determining the base compensation of vested employees is a constitutionally protected 'right' that 'accrues' upon vesting" and thus interpreted the Texas constitutional phrase "benefits accrued" to include the method for calculating employees' benefits.[192] But, the reason retirement members in New York, Illinois, and Alaska have a "constitutionally protected right" in the method used for determining their benefits is the fact that, upon joining a retirement system, their respective constitutions deem them to be parties to a contract with the state, which, pursuant to basic contract principles, freezes the terms of their plan at the time they become members of the system and only permits altering of the plan's terms upon mutual assent of both parties.[193] Because the Texas Legislature intentionally avoided the contract approach during the drafting of the constitutional amendment and because of the heavy restrictions a contract approach imposes on the governing entities of plans, Texas should continue to avoid this approach.[194] Those responsible for retirement systems must retain the authority necessary to alter the future terms of retirement plans in order to ensure retirement funds remain fiscally sound and able to fulfill the financial obligations they owe to all of their members, and the retirement benefit protection theories that establish a contractual relationship between the state and retirement member give so much protection to retirement benefits that they fail to provide the legislature that authority.[195]

The constitutional contract theory followed in New York, Illinois, and Alaska is very similar to the strict contract theory in that both approaches establish a contract between the state and the retirement member and both maintain that any alterations to the terms of the plan must comply with contract principles.[196] These approaches place too many restrictions on the city or state fiscally responsible for the plan.[197] If state law creates a contract with every member of a retirement plan upon that member's employment, the legislature generally must resort to restricting the application of any plan changes to future-hired employees, which does little to stabilize retirement funds facing significant deficits.[198] It is, in fact, very similar to a person with enormous amounts of debt on several credit cards

192. Tex. Att'y Gen. Op. No. GA-0615, at 10 (2008); TEX. CONST. art. XVI, § 66; *supra* Part V.C.3.

193. *See* ALASKA CONST. art XII, § 7; ILL. CONST. art. XIII, § 5; N.Y. CONST. art. V, § 7; *supra* Part VI.B.1.

194. *See supra* text accompanying note 130.

195. *See supra* Part VI.B.1.

196. *See supra* Part VI.B.1-2. Arizona will also likely construe its constitutional provision to create a strict contractual relationship. *See supra* text accompanying note 150.

197. *See supra* Part VI.B.2.

198. *See, e.g.*, FORT WORTH EMPLOYEES' RET. FUND, *supra* note 93, at 29. Following the attorney general's opinion, Fort Worth applied the change in retirement benefit calculation only to future hires. *Id.*

trying to become more financially stable by ensuring that the new credit cards he applies for have lower interest rates; lowering the interest rates on the cards with the debt would be much more effective and also would not absolve the person from paying the money already owed to the credit card company. Just as a credit card holder, however, is generally not free to lower the interest rate stated in the applicable contract, a legislature bound by a contract to a retirement member is not free to make the alterations necessary to ensure that the fund will be stable enough to support its members.[199]

Additionally, the constitutional contract theory followed in Michigan, Louisiana, and Hawaii is very similar to the modified contract theory in that both establish a contractual relationship, but both also allow the state to make limited types of changes.[200] Although these approaches allow the governing authorities of a plan more options for addressing pension fund liabilities, they also inject a considerable amount of unnecessary uncertainty into an already tedious issue.[201] At the foundation of both of these approaches lies a contradictory principle: the formation of a binding contract, the terms of which the state may alter—albeit for specific purposes—despite the protection from such action issued in the Contract Clauses of both the United States' and individual states' constitutions.[202] Moreover, even if, as is the case within a modified contract approach, a state must provide an offsetting, comparable advantage for any disadvantage caused by an alteration in a plan, the precise meaning of what exactly constitutes a comparable advantage is an illusive concept that can deprive state legislatures and plan administrators of the knowledge necessary to effectively oversee and administer retirement systems and could lead to a three steps forward, two steps back pace during times when progress is essential to facing significant financial deficits.[203]

The promissory estoppel approach followed in Minnesota also applies general contract principles upon a determination that the state has made a promise warranting promissory estoppel protection.[204] Beyond the disadvantages resulting from a legislature bound by a contractual relationship, a promissory estoppel approach can add the additional burden of declaring the existence of a binding promise in instances in which the legislature had no intention of becoming bound contractually to retirement members.[205] Furthermore, this approach often requires a case-by-case analysis to determine whether a binding promise exists, which can

199. *See supra* Part VI.B.2.
200. *See supra* Part VI.B.1, 3.
201. *See supra* Part VI.B.3.
202. *See Public Employee Pensions in Times of Fiscal Distress*, *supra* note 160, at 1001.
203. *See* Cohn, *supra* note 154, at 47.
204. *See supra* note 166 and accompanying text.
205. *See supra* note 167 and accompanying text.

immobilize legislatures and plan administrators with the uncertainty of whether they are party to a promise that courts will deem protected by promissory estoppel.[206] Thus, in both the indirect application of contract principles in the promissory estoppel approach and the more direct application of contract principles in the constitutional, strict, and modified contract approaches, retirement members acquire great protection of their benefits at the expense of the governing entity, which, when faced with unfunded liabilities in retirement plans, can only make limited changes—reducing allowed overtime, limiting salary increases, or altering plan terms for future hires—that do not always have enough of an impact to significantly affect growing deficits.[207] Texas, therefore, must strike a balance and adopt a policy that protects earned benefits without tying the hands of state and local governments.[208]

B. Recommendation

Texas should abandon the two extreme approaches it has adopted—the gratuity approach applicable to statewide systems and the strict interpretation of the constitutional provision applicable to non-statewide systems—and should instead take the more balanced approach of establishing a revised constitutional provision.[209] This provision would, essentially, track very closely with the 2003 amendment but would contain two significant differences.[210] First, it would apply to all public retirement systems in Texas, not only non-statewide systems, thereby explicitly eliminating Texas's adherence to the gratuity approach and streamlining Texas's protection of retirement benefits.[211] Second, it would specifically define "benefits accrued" as the amount of benefits an employee has earned up to the effective date of a proposed change, so that the governing entities would be free to alter the methods for calculating the benefits an employee will earn from future service performed after the effective date of a change.[212] This approach would protect the state and local governments' interest in being able to manage retirement funds, which is especially important in times of economic distress, and would also protect the

206. *See supra* note 167 and accompanying text.

207. *See, e.g.*, FORT WORTH EMPLOYEES' RET. FUND, *supra* note 93, at 29. The FWERF had to resort to applying the salary cap to future hires. *Id.* In October of 2010, the FWERF also increased the amount of city contributions to the fund. *Guide to Public Retirement Systems of Texas 2011*, *supra* note 56, at 13 n.3. The plan, however, still has an amortization period of over forty years. *Id.*

208. *See supra* notes 184-207 and accompanying text.

209. *See supra* Part IV.A-B.

210. *See supra* notes 211-12.

211. *See supra* Part IV.B.

212. *See supra* Part V.

retirement members' interest in preserving those benefits in which they have a property right.[213]

Protecting the benefits in which members have a property right would, at its most basic level, mirror the reasoning established in the due process theory followed in Connecticut and New Jersey.[214] Both approaches must begin with a determination of what elements of a retirement system qualify as a member's property.[215] The United States Supreme Court in *Board of Regents of State Colleges v. Roth* described the "attributes of 'property' interests" warranting procedural due process protection:

> To have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it. . . .
>
> Property interests, of course, are not created by the Constitution. Rather they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law—rules or understandings that secure certain benefits and that support claims of entitlement to those benefits.[216]

According to this explanation of what constitutes a property interest, only vested members can have a property right in earned benefits; unvested members have not yet fulfilled all the requirements to receive benefits and, therefore, only have a "unilateral expectation" that they might one day receive the benefits they are accruing.[217] Furthermore, vested members can only have a legitimate claim of entitlement to those benefits they have earned.[218]

The methods and rules governing the creation of a benefit serve to "secure certain benefits and . . . support claims of entitlement to those benefits," but the methods and rules do not, in themselves, become a benefit that a retirement member can then claim.[219] Indeed, retirement members likely have the expectation, desire, and need for the methods and rules creating their benefits to continue unchanged, but the Supreme Court stated clearly in *Roth* that expectations, desires, and needs do not suffice to create a property interest.[220] Legislatures have the authority to create laws that result in entitlements, and although the benefits flowing from those entitlements fall under the protection of due process, the laws creating those

213. *See supra* Part VI.D.

214. *See supra* Part VI.D.

215. *See supra* Part VI.D.

216. Bd. of Regents of State Colls. v. Roth, 408 U.S. 564, 577 (1972).

217. *See id.* Members who are not yet eligible to receive benefits, however, always have a property interest in the member's own contributions to the fund. *See supra* notes 49-50 and accompanying text.

218. *See Roth*, 408 U.S. at 577.

219. *Id.*

220. *See id.*

entitlements remain subject to change under the authority of the legislature.[221]

Both the due process theory and a constitutional provision that protects benefits in which retirement members have a property right would rely on this determination of what constitutes a property interest; the difference, however, lies in the degree of protection afforded to that property.[222] Under the due process theory, state deprivation of a person's property cannot occur unless the state affords that person procedural due process.[223] This theory, therefore, does not necessarily prevent legislatures from making decisions that affect a person's property, it simply lays out the procedural requirements with which legislatures must comply when making such decisions.[224] Although procedural requirements provide some layer of protection, retirement members should have the assurance of knowing that the benefits they have worked for will be safe from the governing entities' attempts to make retirement funds more financially sound.[225] The legislature provided this protection to non-statewide members in the 2003 constitutional amendment, and there is no reason that protection should not also extend to statewide members as well.[226] The Texas Legislature, therefore, should propose a constitutional amendment that achieves two objectives: (1) completely prohibit the legislature from reducing the accrued benefits of vested employees in *all* public retirement systems in Texas and (2) specifically define accrued benefits to apply exclusively to the amount of benefits earned from service performed prior to the effective date of any change in a plan's terms.[227] This approach would protect the earned benefits of all retirement members without prohibiting changes in the calculation of benefits accruing from future service, thereby striking the necessary balance between the interests of the retirement member and the state or local government responsible for the plan.[228]

VIII. CONCLUSION

Approximately 2.3 million Texans are either active or retired members of Texas public retirement systems.[229] The reality is that, at current funding levels, not all of these state and local retirement systems have enough assets

---

221. *See id.*

222. *See supra* Parts VI.B.1, VI.D.

223. *See supra* notes 171-73 and accompanying text. Theoretically, substantive due process could also protect retirement benefits, but the difficulty of establishing a retirement benefit as a fundamental right makes substantive due process protection unlikely. *See supra* note 171 and accompanying text.

224. *See supra* notes 171-73 and accompanying text.

225. *See supra* Part VI.D.

226. *See* Tex. H.R.J. Res. 54, 78th Leg., R.S. (2003).

227. *See supra* Part VI.A-D; *infra* Part VIII.

228. *See supra* Part VII.A.

229. *Guide to Public Retirement Systems of Texas 2011*, *supra* note 56, at 8.

to meet all of the financial obligations that will eventually become due to their members.[230] Furthermore, both the house and senate budget proposals for the 2012–2013 fiscal years propose to reduce the rate of state contributions to statewide systems, which makes it likely that, without other changes to plan terms, unfunded liabilities in those plans will increase.[231] With reduced tax revenues, the legislature must make difficult choices in how to spend taxpayer dollars.[232] Although increasing state contributions to retirement funds would aid in reducing some of the plans' unfunded liabilities, money allocated to retirement funds would be money not allocated to education, healthcare, or other vital public programs.[233] It is crucial, therefore, to provide the legislature and local governments with other means of reducing retirement system deficits so that they have the freedom to use taxpayer dollars for other important needs without having to sacrifice the future financial security of public retirement members.[234]

All retirement members, however, deserve the peace of mind that comes with knowing the benefits they have worked for will not diminish during rough economic times. The legislature saw the importance in protecting the earned benefits of non-statewide retirement members when it drafted the 2003 constitutional amendment, and it should make the effort now to extend that protection to all 2.3 million Texans who rely on these systems for future financial security.[235] Ideally, the legislature would retreat from the two extreme approaches to retirement benefit protection currently followed in Texas and propose the type of constitutional amendment recommended in Part VII that protects the interests of the retirement member without sacrificing the ability of governing entities to efficiently manage the financial health of retirement plans for years to come.

230. *See supra* note 5 and accompanying text.

231. *See* Tex. S.B. 1, 82nd Leg., R.S. I-38, III-38 (2011); Tex. H.B. 1, 82nd Leg., R.S. I-37, III-38 (2011).

232. *Guide to Public Retirement Systems of Texas 2011*, *supra* note 56, at 30.

233. *Id.*

234. *See supra* notes 5, 229-33 and accompanying texts.

235. *See* Tex. H.R.J. Res. 54, 78th Leg., R.S. (2003); *Guide to Public Retirement Systems of Texas 2011*, *supra* note 56, at *Executive Summary*.