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OFFICE OF THE ATTORNEY GENERAL
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**THIS CORRESPONDENCE IS A LEGAL GUIDELINE OF THE
ATTORNEY GENERAL SUBMITTED FOR YOUR GUIDANCE**

Re: PERSI 1% Mandatory Cost of Living Adjustment (COLA)

Dear Mr. Drum:

When the inflationary requirements are met, Idaho Code § 59-1355 of the Public Employee Retirement System of Idaho (PERSI) statutes provides for a 1% mandatory cost of living adjustment to retiree benefit payments (the "1% COLA").¹

QUESTIONS PRESENTED

1. Do current PERSI retirees have a vested (contractually protected) right to the 1% COLA?
2. Do non-retiree members of PERSI have a vested right to the 1% COLA (after retirement)?
3. If there is a vested right to the 1% COLA, under what circumstances, if any, can the 1% COLA be eliminated for either current PERSI retirees or non-retiree PERSI members?

¹ The PERSI COLA is tied to inflation/deflation based on the Consumer Price Index – Urban (CPI-U) for the 12 months ending August of the current year and becomes effective the following March. Idaho Code § 59-1355 provides for a mandatory COLA ranging from -6% to 1% if the CPI-U is between -94% and 101%. If the CPI-U is above 101%, the statute provides that the COLA shall be 1% (called the 1% COLA). The 1% COLA is not subject to Legislative review. If the CPI-U is above 101%, the PERSI Board can provide a greater COLA (called a discretionary COLA) (not to exceed 6%) if it finds that the Fund's actuarial assets exceed its actuarial liabilities (including the increased liability that would be created by the COLA). The discretionary COLA is subject to Legislative review.

CONCLUSIONS

1. Current PERSI retirees have a vested right to the 1% COLA.
2. A non-retiree PERSI member has a vested right to the 1% COLA (after retirement) if he has worked for a legally significant time in reliance on the belief that he will receive the COLA. If a court were to determine, as a matter of law, that the statutory vesting period (five years) was legally significant, a member who has worked for five years could have a protected right to the 1% COLA.
3. Assuming the COLA is a vested right, it is subject only to reasonable modification for the purpose of keeping the pension flexible and maintaining its integrity.

ANALYSIS

There are few reported Idaho cases related to public pensions. From these cases, it is clear that that the Idaho Supreme Court has found that:

- Public pension benefits are a form of deferred compensation. Deferred compensation arrangements lead to reasonable expectations on the part of participants and such reasonable expectations are vested and entitled to contractual protection.
- Contractual protection begins when a person has worked for a legally significant time in reliance on the benefit. A person need not work all the way to retirement for the protection to begin.
- Contractually protected (vested) rights are subject only to reasonable modification for the purpose of keeping the pension flexible and maintaining its integrity.
- Whether a person has worked long enough to have a protected right and whether a modification to that right would be sustained as reasonable would require a fact-specific analysis.²

Since the Idaho cases are few in number, a brief review of the cases is informative.

In Hanson v. City of Idaho Falls, 92 Idaho 512, 446 P.2d 634 (1968), the Idaho Supreme Court rejected an argument that the Police Retirement Fund Act³ violated art. VIII, sec. 3 of the Idaho Constitution limiting debt of political subdivisions. The Court found that the Act was within the exception for “ordinary and necessary expenses.” In so holding, the Court stated that

² If a court were to determine, as a matter of law, that a certain term of employment was legally significant, such as the five-year vesting period as discussed below, a factual analysis of that aspect would likely be unnecessary.

³ The Police Retirement Fund Act was enacted in 1947 and under the Act local municipalities could establish a retirement fund for police officers.

it “could not be argued in good faith” that the weekly/monthly pay of police did not constitute an ordinary and necessary expense. Thus, the Court rejected plaintiffs’ argument that because a small portion (4%) of this pay was withheld and contributed to the Idaho Falls police retirement fund it did not constitute compensation. Rather, the Court stated that the pension plan funded by the 4% “must be considered compensatory in nature.” In so stating, the Court rejected the gratuities rule of public pensions (that a pension is a gift from the sovereign subject to change at any time) in favor of “the better reasoned rule in most American jurisdictions” which is that “the rights of the employees in pension plans such as Idaho’s Retirement Fund are vested, subject only to reasonable modification for the purpose of keeping the pension system flexible and maintaining its integrity.” *Id.* at 514, 446 P.2d at 636. The Court further spoke to the expectations aspect of public pensions when it stated “[w]e expect much from our law enforcement staffs; we should not lightly impair their expectations, or the expectations of their widows and children, for whatever additional compensation to which they are entitled under the P.R.F. Act.” *Id.* at 515, 446 P.2d at 637. *See also Booth v. Sims*, 193 W. Va. 323, 338 (1995) (“the deferred compensation embodied in a pension entitlement creates a reliance interest in the state employee that the law of contract protects”).⁴

In *Engen v. James*, 92 Idaho 690, 448 P.2d 977 (1969), there was a dispute about the applicability of a 1965 statutory change to Engen, a police member of the Coeur d’Alene Police Retirement Fund, who was receiving a disability retirement in 1965 but was not permanently retired under the statute. Rejecting a jurisdictional challenge because the statute was repealed in 1967, the Court cited *Hanson* approvingly, stating “this court recently held that ‘the rights of the employees in pension plans such as Idaho’s Retirement Fund Act are vested, subject only to reasonable modification for the purpose of keeping the pension system flexible and maintaining its integrity.’” 92 Idaho at 693, 448 P.2d at 980. With regard to Engen, the Court stated that “[i]f respondent had acquired pension rights under I.C. s 50-2116(i), those existing rights could not be taken from him by a later act of the legislature. This follows from the compensatory nature of pension plans, as this court held in [*Hanson*].” *Id.*

In 1976, the Court decided *Lynn v. Kootenai County Fire Protective District #1*, 97 Idaho 623, 550 P.2d 126 (1976). *Lynn* involved a constitutional challenge to a change to the Firemen’s Retirement Fund (FRF) statute, title 72, chapter 14, Idaho Code. Mr. Lynn had over 23 years of service as a paid fireman when he retired in September of 1974 because of a non-service disability. He challenged the constitutionality of a change to the FRF statutes that reduced his

⁴ The use of the term “vested” does not refer to a statutory vesting period (such as the five-year vesting period for PERSI members). In pension cases, there are two distinct issues of contract: (1) an employee’s contract right to collect a pension after statutory eligibility requirements have been met; and (2) the employee’s legitimate expectations, also contractual in nature, that the government will not detrimentally alter the pension once the employee has spent sufficient time in the system to have substantially relied to his or her detriment. The first issue involves whether the employee has remained in government service for such a length of time that he or she can collect benefits; the second issue involves the employee’s reliance on promised government benefits after years of government service but before actual retirement age. Pension eligibility and reasonable expectations about the system’s continued benefits are entirely separate issues. *Booth v. Sims*, 193 W. Va. at 337. In *Hanson*, the Court used the term “vested” in the second sense to denote that the member had a legally protected contract right. *See also Calabro v. City of Omaha*, 247 Neb. 955, 966-967 (1995) (discussing difference between vesting for eligibility purposes and vesting for contractual protection purposes).

retirement allowance from what it would have been had he retired prior to the effective date of the amendment (which was January 1, 1974). The Court held that the amendment violated the equal protection clause of the Fourteenth Amendment in that it resulted in firemen with less service receiving more benefits. The Court also stated:

It should be noted that S.L.1973, Ch. 105, s 3, may have unconstitutionally infringed upon Lynn's vested rights to retirement benefits from the Firemen's Retirement Fund. This court has adopted the rule 'the rights of the employees in pension plans such as Idaho's Retirement Fund Act are vested, subject only to reasonable modification for the purpose of keeping the pension system flexible and maintaining its integrity.' Hanson v. City of Idaho Falls, 92 Idaho 512, 514, 446 P.2d 634, 636 (1968). See, Pearson v. County of Los Angeles, 49 Cal.2d 523, 319 P.2d 624 (1957); Bakenhus v. City of Seattle, 48 Wash.2d 695, 296 P.2d 536 (1956).

Lynn is entitled to retirement benefits pursuant to I.C. s 72-1429F as it existed prior to amendment in 1973. Therefore, we remand the case to the Industrial Commission and order the Commission to enter an award of benefits pursuant to statute.

97 Idaho at 627, 550 P.2d at 130 (emphasis added).

In the 1983 case of Nash v. Boise City Fire Department, 104 Idaho 803, 663 P.2d 1105 (1983), the Idaho Supreme Court considered whether a statutorily imposed 3% cap on the cost of living adjustment (COLA) could be applied to Nash, who had been a full time fire fighter from 1953 to October of 1978 and who retired after the effective date of the change (July 1, 1978). Prior to the legislative change, the COLA was determined in relation to the increase or decrease in wages paid to working firemen, but there was no cap. The question before the Court was whether the new 3% cap applied to firefighters retiring after July 1, 1978 "who earned benefits by virtue of service prior to that date." 104 Idaho at 803, 663 P.2d at 1105. The Court held that the 3% cap could not be applied to Nash. *Id.* at 808, 663 P.2d at 1110.

In considering the nature of public employee pension rights in Idaho, the Nash Court stated that the "issue presented requires a determination of whether the level of a public employee's rights in a pension plan which has vested may be unilaterally altered by a subsequent legislative act." *Id.* at 804, 663 P.2d at 1106. The Court made specific reference to Hanson and Engen:

In Hanson v. City of Idaho Falls, 92 Idaho 512, 514, 446 P.2d 634 (1968), this court placed Idaho squarely in line with Massachusetts and other jurisdictions which reject both the gratuity and the strict contract theory, holding further that reasonable modification can be made to keep the plan flexible:

The better reasoned rule in most American jurisdictions today is

that the rights of the employees in pension plans such as Idaho's Retirement Fund Act are vested, subject only to reasonable modification for the purpose of keeping the pension system flexible and maintaining its integrity. [Citations omitted.] Since the employee's rights are vested, the pension plan cannot be deemed to provide gratuities. Instead it must be considered compensatory in nature.

In *Engen v. James*, 92 Idaho 690, 693, 448 P.2d 977, (1969), we held that the legislature could not by later act take away vested retirement rights of a Coeur d'Alene policeman, stating, "Thus, if respondent had acquired pension rights under I.C. § 50-2116(i), those existing rights could not be taken from him by a later act of the legislature. This follows from the compensatory nature of pension plans, as this court held in [*Hanson*]."

104 Idaho at 806, 663 P.2d at 1108 (emphasis added; internal citations omitted). See also *Mickey v. Mickey*, 292 Conn. 597, 620-621 (2009) ("[p]ension benefits represent a form of deferred compensation for services rendered.... [T]he employee receives a lesser present compensation plus the contractual right to the future benefits payable under the pension plan." (Citations omitted; internal quotation marks omitted.)

The Nash court quoted at some length from Hanson, in which the Idaho Supreme Court quoted with approval the reasoning of a 1958 California case:

Abbott v. City of San Diego, 165 Cal.App.2d 511, 332 P.2d 324 (Cal.App.1958), cited in *Hanson* concerned a modification of a pension plan, changing it from a plan whereunder the benefit fluctuated with prevailing salary scales to a plan for payment on a fixed formula basis. The court held that the modifications could not be applied to firemen employed before the effective date of the modification. The court stated at 332 P.2d 328:

"To 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.' *Allen v. City of Long Beach*, 45 Cal.2d 128, 131, 287 P.2d 765, 767. ' * * * it is advantage or disadvantage to the particular employees whose own contractual pension rights, already earned, are involved which are the criteria by which modifications to pension plans must be measured' (*Abbott v. City of Los Angeles*, 50 Cal.2d 438, 326 P.2d 484, 489)...."

104 Idaho at 806, 663 P.2d at 1108 (emphasis added). The Nash Court further cited Abbott:

The pension fund in *Abbott* argued, as the Fund here argues, that the modification

was necessary to keep the fund flexible and actuarially solvent. The court rejected this argument, stating,

“This argument neglects consideration of the requirement that any such change must be reasonable and must be related to the integrity of the system as applied to the vested rights under consideration. [Citations] There is no showing in the instant case that the amendments under consideration ‘bear any material relation to the integrity or successful operation or to the preservation or protection of the *pension program applicable to these plaintiffs*.’” (Emphasis in original.) *Id.* 332 P.2d at 330.

104 Idaho at 806, 663 P.2d at 1108 (emphasis added).

The Nash Court also relied on a Massachusetts case from 1981, Dullea v. Massachusetts Bay Transportation Authority, 421 N.E.2d 1228 (Mass. App.1981). Citing Dullea, the Nash Court stated that “an employee’s rights to a pension will not vest until he has worked for a legally significant period of time in reliance on the belief that he will be protected by a pension.” 104 Idaho at 807, 663 P.2d at 1109. The Nash Court rejected Appellants’ reliance on cases from Louisiana and Florida cited for the proposition that modifications acting to the detriment of the employee can be made without providing corresponding benefits, stating “[t]hose cases involved jurisdictions where the employee’s rights do not vest until retirement.” *Id.* at 808, 663 P.2d at 1110.

After this discussion of the guiding principles, the Court applied them to Mr. Nash’s case, first noting that:

(1) The rights of Nash are unquestionably vested, he having worked twenty-five years, the last fifteen of which included the period when the pension plan provided for a fluctuating formula free of the 3% “cap.”⁵

⁵ In neither Lynn nor Nash, was there discussion of what effect, if any, a statutory vesting period would have on the court’s analysis of whether a person had worked for a “legally significant” period to warrant contractual protection. In 1977, the Court decided Jackson v. Minidoka Irrigation District, 98 Idaho 330, 563 P.2d 54 (1977). Jackson claimed wrongful discharge and, among other things, claimed a loss of retirement benefits. In rejecting the claim for retirement benefits, the court stated:

It is true that employer contributory retirement benefits constitute deferred compensation to the employee. *Hanson v. City of Idaho Falls*, 92 Idaho 512, 446 P.2d 634 (1968); *Jacoby v. Grays Harbor Chair and Mfg. Co.*, 77 Wash.2d 911, 468 P.2d 666 (1970). The pension plan becomes part of the contract of employment and contractual rights to the retirement benefits can thus be created between an employer and his employees. *Muggill v. Reuben H. Donnelley Corp.*, 62 Cal.2d 239, 42 Cal.Rptr. 107, 398 P.2d 147 (1965); *Taylor v. Multnomah County Deputy Sheriff’s Retirement Board*, 265 Or. 445, 510 P.2d 339 (1973). The contractual right is vested in the employee subject, however, to reasonable contingencies such as continued employment, which are necessary to keep the pension system flexible and maintain its integrity.

98 Idaho at 335, 563 P.2d at 59 (emphasis added). Under the applicable provisions of the Idaho Public Employee Retirement System, a participant in the program is not eligible for retirement benefits unless the member has

(2) The Firemen's Retirement Fund is not insolvent or unable to meet its obligations either now or in the near future.

(3) The Fund, assuming the present levels of income to it, will grow for fifteen or twenty years, then level off and then become zero within another ten years. (It would appear the Fund's growth period will include the period of Nash's life expectancy.)

Under these facts, the Court held that the 3% cap could not be applied to Nash. *Id.* See also Board of Trustees v. Carenbauer, 211 W. Va. 602, 618 (2002) (where police officer had been a contributing member of plan for 12 years prior to statutory amendment at issue, although he was not yet eligible to retire, he detrimentally relied on the plan's prior provisions). Implicit in the holding in Nash is that the Court recognized that the COLA is part of the pension contract. See also Calabro v. City of Omaha, 247 Neb. 955, 962-963 (1995).⁶

The Nash Court specifically stated that it was not adopting two rules, apparently enunciated Dullea:

The first is the suggestion in Dullea that the government can reduce benefits when the plan becomes "financially burdensome" to an employer. Once the employee's rights have vested, it is not unreasonable to expect that under some circumstances an increased level of employer contribution (requiring increased tax levies) might be required without looking to increased employee contributions or a reduction of benefits.

Conversely, there can be extraordinary circumstances where the employee may be required to increase his contributions without a corresponding increase in benefits in order to preserve the financial integrity of the system. However, those circumstances are not presented by this record.

104 Idaho at 808, 663 P.2d at 1110.

In 1988, the Idaho Supreme Court considered a public pension issue directly involving PERSI. In McNichols v. Public Employee Retirement System of Idaho, 114 Idaho 247, 755 P.2d 1285 (1988), the plaintiffs had been misclassified for many years by their employer as police officer members. Classification as a police officer member requires the member and the

accumulated five years of membership service. Since Ms. Jackson had not complied with that contingency, the Court held that "she has stated no claim to retirement benefits." *Id.* The challenged action in Jackson was an employment decision not a legislative act, so it is not clear if an Idaho court would consider the five-year statutory vesting period in a challenge to a legislative change to the COLA statute. If an Idaho court were to determine that the right to contractual protection is triggered by the statutory five-year vesting period in the PERSI statutes, a member with five years' credited service could be entitled to contractual protection.

⁶ The PERSI COLA statute was first enacted in 1969 at which time it provided for an adjustment between -3% to 3%. In 1979, the statute was amended to provide for the 1% COLA and to read, in relevant part, as it does today.

employer pay a higher contribution rate than is paid for and by non-police officer members (called general members). Police officer members can retire earlier than general members with full pension benefits.

In 1985, the Idaho Legislature amended the definition of police officer member to delineate various specific employee positions to be included within that definition. Neither of the plaintiffs' positions was included in the statutory definition of police officer. Plaintiffs argued that the legislative change did not satisfy the tests of Hanson and Nash. The Court acknowledged that Idaho had adopted the compensatory theory of public pension plans and that Nash was a correct application of that theory. 114 Idaho at 249, 755 P.2d at 1287. However, the Court rejected plaintiffs' argument that the definitional change violated Hanson and Nash, finding that neither of those cases dealt with the issue before it of whether the state can reduce, on a prospective basis, the "rate at which the employees earn retirement benefits." *Id.* at 248, 755 P.2d at 1286.

While the McNichols Court phrased the issue in terms of whether the Legislature could prospectively reduce the rate at which an employee earns retirement benefits, the Court's actual holding does not shed significant light on what exactly a Legislature could do on a prospective basis in this regard. The Court discussed at length the fact that the plaintiffs were misclassified for years and so the prospective classification of them as general members (as opposed to police officer members) was not to be questioned. "It does not seem logical to hold that once an administrative agency misinterprets a legislative mandate, the legislature is powerless to alter or amend the misinterpretation. Thus, prospectively from July 1, 1985, Smith and McNichols would continue to earn retirement benefits, but only at the general member rate, and not at the rates previously earned while classified as a 'police officer member.'" *Id.* at 251, 755 P.2d at 1289.

The McNichols Court was not faced with the question of whether the Legislature could modify previously earned benefits since the statute at issue provided that no retroactive changes would result. "[T]he earned and accrued benefits of McNichols and Smith are preserved by statute, even if initially accrued in error." *Id.*⁷ The Court did not discuss what other changes, besides correcting an earlier misclassification, might constitute an acceptable prospective change. While McNichols can be cited for the proposition that the Legislature can modify the rate at which employees accrue future benefits, it is not clear what that statement might mean if and when the issue were something beyond the prospective classification as a police officer member versus a general member.⁸

⁷ Since the legislation at issue provided that those benefits earned during the period of the misclassification would not be changed, the Court did not have to address whether there were earned benefits requiring protection. However, the Court's emphasis on the misclassification of the plaintiffs suggests that the Court may have considered, without stating, that Plaintiffs could not have reasonably relied on a classification to which they were not legitimately entitled.

⁸ Once the classification statute was applied to plaintiffs in McNichols, they began to pay a lower employee contribution rate and accrued future service as general members. Upon retirement, their allowance would be based on a combination of police officer and general member service (called mixed service). With regard to the 1% COLA, an argument could be made that retirees and non-retiree members have *already earned* the 1% COLA. Contribution rates are reviewed and set each year after receipt by the PERSI Board of the annual actuarial valuation.

A. Current PERSI Retirees Have a Contractual Right to the 1% COLA

Based on the Idaho Supreme Court's holdings discussed above, in particular its holding in Nash, it is the opinion of this author that current PERSI retirees have a contractual right to the 1% COLA. The Court in Nash held that a firefighter who retired after the statutory change at issue had a right to the COLA. A person who retired prior to a statutory change would have at least as protected a right if not better.⁹ See, e.g., Allen v. Board of Administration, 34 Cal.3d 114, 121 (1983) (as to retired employees, the government's power to change a pension may be even more restricted (than for current employees), the retiree being entitled to the fulfillment without detrimental modification of the contract which he already has performed); Andrews v. Anne Arundel County, Maryland, 931 F. Supp 1255, 1265 (D. Md. 1996) *aff'd* 113 F.3d 1175 (4th Cir), *cert. denied* 522 U.S. 1015, 118 S. Ct. 600, 139 L.Ed.2d 489 (1997) (a diminution of pension benefits is more likely than not an even *more* substantial impairment than a diminution of annual salary because the individual receiving pension benefits is typically already living on a reduced income as compared to her pre-retirement earnings. Thus, a decrease in benefits would potentially have a greater impact.)¹⁰

A non-retiree PERSI member has a contractually protected right to the 1% COLA if he has worked for a legally significant time in reliance on the belief that he will receive the 1% COLA. In Lynn, the plaintiff had 23 years of service. In Nash, the plaintiff had 25 years of service. In neither case did the Court say specifically how much service would be enough to satisfy that requirement and the Court's analysis and holdings suggest that the determination would be made on a case by case basis. However, neither case addressed what effect, if any, a statutory vesting period would have on the analysis. If the PERSI statutory five-year vesting period were determined, as a matter of law, to be a legally significant time, a member with five years' of credited service could have a contractually protected right to the 1% COLA. See Booth v. Sims, 193 W. Va. at 340 ("[l]ine drawing in this ... regard must be made on a case-by-case basis, but after ten years of state service detrimental reliance is presumed.")

When rights in a pension plan are vested (afforded contractual protection), the Legislature may modify those rights only if the modifications are reasonable and are necessary to keep the fund flexible and to maintain the fund's integrity. To be reasonable, alterations must

A COLA was first provided for in the PERSI statutes in 1969. Our understanding is that since 1976, the annual actuarial valuation has assumed a 1% COLA. Contribution rates reflect that assumption and could support an argument that the 1% COLA is an earned benefit because prior employee contributions (of both retirees and non-retirees) have paid for it, at least in part.

⁹ In Attorney General Opinion No. 96-1, the Attorney General concluded that Idaho Courts would not recognize a member's right to "future accrual of benefits" as distinguished from previously earned benefits. 1996 Idaho Att'y Gen. Ann. Rpt. 5. The specific context of the opinion involved a political subdivision's right to withdraw from PERSI and the effect of such withdrawal on its employees vis-à-vis pension rights. In Nash, the Court found that Mr. Nash had a protected right to a certain COLA and that the COLA was a previously earned benefit by virtue of prior service.

¹⁰ Over the past two to three years, three states (Colorado, Minnesota and South Dakota) have legislatively changed (reduced or temporarily reduced) retiree COLAs. Lawsuits are pending in each state, which lawsuits include claims of contracts and/or takings clause violations. Idaho cases suggest a contract clause analysis, but it is not clear that a takings challenge has been rejected per se since it does not appear as if a takings clause claim has been made. The takings clause prohibits the state from taking property without due process and without just compensation.

bear some material relation to the theory of a pension system and its successful operation and changes in a plan which disadvantage employees should be accompanied by comparable new advantages to the particular employee being affected. Nash, 104 Idaho at 806, 663 P.2d at 1108. The validity of a legislative modification to the COLA statute would require factual findings and determinations regarding the reasonableness of the modification and its necessity for maintaining the integrity of the retirement fund.

Nash provides some insight into how an Idaho court would apply the “reasonable modification/necessary to keep the fund flexible and to maintain its integrity” criteria. In Nash, the Fund had argued that the cap was needed to keep the fund flexible and actuarially solvent. The Nash Court rejected this argument, specifically noting that the Fund itself was neither insolvent nor unable to meet its obligations “either now or in the near future” and that it would be able to pay benefits for the period of Nash’s life expectancy. Based on Nash, it appears that for a statute eliminating the 1% COLA to be found reasonable (vis-à-vis current retirees and those non-retiree members who had worked a “legally significant” period in reliance), the PERSI Fund would have to be insolvent or unable to meet current or near future obligations. That the COLA might be considered financially burdensome was not deemed sufficient to warrant modification by the Nash Court.¹¹

B. Any Challenge to a Change to the COLA Statute That Would Reduce or Eliminate the 1% COLA for Retirees or Non-Retiree Members Would Likely Include an Impairment Claim

If a change to the COLA statute were made that would reduce or eliminate the 1% COLA for retirees or non-retiree members, any challenge would likely include an impairment claim based on the contract clauses of the U.S. and Idaho Constitutions (Article I, Section 10 of the U.S. Constitution, and art. I, sec. 16 of the Idaho Constitution, prohibiting states from passing laws impairing contractual obligations). While not specifically articulated as such, the Court’s analysis in Nash is analogous to a constitutional contractual impairment analysis. Consideration of Nash in that context, therefore, may provide useful insight. *See also* Engen, 92 Idaho at 693, 448 P.2d at 980 (referring to rights being taken away by legislative act).

When an impairment claim is made, courts generally use a three-pronged analysis in reviewing the claim. The first question involves the existence of a contract (is there a contract, when was it formed and what are its terms). If a contract exists, the court next analyzes whether the challenged state act substantially impairs the contract. If a substantial impairment is found, the court considers whether the impairment can be justified by an important public purpose. *See generally* United States Trust Co. of New York v. New Jersey, 431 U.S. 1, 97 S. Ct. 1505, 52 L. Ed.2d 92 (1977); General Motors Corp. v. Romein, 503 U.S. 181, 186, 112 S. Ct. 1105, 1109, 117 L. Ed.2d 328 (1992).

¹¹ The Nash Court’s analysis is consistent with cases from other states that have adopted the same or similar reasoning, including states relied upon by Idaho courts, including Washington, Oregon and California. *See, e.g.*, Bakenhus v. City of Seattle, 48 Wash.2d 695 (1956) (cited in Lynn); Taylor v. Multnomah County Deputy Sheriff’s Retirement Board, 265 Or. 445 (1973) (cited in Jackson); Abbott v. City of San Diego, 165 Cal.App.2d 511 (1958) (cited in Nash).

In general, a statute is itself treated as a contract when the language and circumstances evince a legislative intent to create private rights of a contractual nature enforceable against the state. United States Trust, 431 U.S. at 17, n. 14. Legislation that deprives a person of the benefit of a contract, or adds new duties or obligations, necessarily impairs the contract. Northern Pac. Ry. Co. v. State of Minnesota, 208 U.S. 583, 591, 28 S. Ct. 341, 343, 52 L. Ed. 630 (1908). *See also* Curr v. Curr, 124 Idaho 686, 692, 864 P.2d 132, 138, n. 3 (1993) (internal citations omitted) (a legislative act impairs the obligation of a contract when it attempts to take from a party a right to which he is entitled by the contract or which deprives him of the means of enforcing the right). An impairment appears to be substantial where the right abridged was one that induced the parties to contract in the first place or where the impaired right was one on which there had been reasonable and specific reliance. Baltimore Teachers Union v. Mayor and City Council of Baltimore, 6 F.3d 1012, 1017 (4th Cir. 1993), *cert. denied* 510 U.S. 1141, 114 S. Ct. 1127, 127 L. Ed.2d 435 (1994). To be justified by an important public purpose, the challenged action must be reasonable and necessary to serve that purpose. City of Omaha, 247 Neb. at 969 (citing United States Trust). To be reasonable, the action must have a material relation to the theory of the pension system and its successful operation, and any disadvantages created by a change should be accompanied by comparable new advantages. The necessity inquiry is tested at two levels: (i) whether a less drastic modification available to accomplish the purpose; and (ii) whether the government could have adopted alternative means to achieve its goals (a means that did not involve changing the contract). City of Omaha, 247 Neb. at 969.

Reviewing Nash with an eye toward a contract impairment analysis, the following conclusions appear reasonable:

- The Idaho Supreme Court has apparently determined that a statutory contract does exist for retirees and for those persons who have worked for a legally significant period of time in reliance on the benefit. Under Nash, the contract included a COLA and the COLA was a previously earned benefit. *See also* Strunk v. Public Employees Retirement Board, 338 Or. 145 (2005) (en banc) (statute mandating an annual cost of living adjustment was part of statutory contract).
- In Nash, the state's act of capping the COLA at 3% was a substantial impairment (the Court would not go to the third test, requiring justification, if the second were not met). *See also* City of Omaha, 247 Neb. at 968 (court did not hesitate to find that by eliminating the supplemental payment (COLA) plan, the city enacted a *substantial* impairment on the plaintiffs' contractual rights). *See also* United Firefighters of Los Angeles City v. City of Los Angeles, 210 Cal.App.3d 1095 (2 Dist. 1989), *cert. denied* 493 U.S. 1045, 110 S. Ct. 843, 107 L. Ed.2d 837 (1990) (3% cap on cost-of-living adjustment held to be a substantial impairment).
- Finally, in Nash, the Court determined that the impairment was not justified. The Court specifically stated that the fund was not insolvent or unable to meet its obligations, current or in the near future and also noted that the fund would be able to pay Nash's benefit for the duration of his expected lifetime. The Nash Court specifically noted that it

would not adopt the suggestion that the government could reduce benefits when the plan becomes “financially burdensome” to an employer and noted that “[o]nce the employee’s rights have vested, it is not unreasonable to expect that under some circumstances an increased level of employer contribution ...might be required without looking to increased employee contributions or a reduction of benefits.”¹² See also United States Trust, 431 U.S. at 26, 29 (“[a] governmental entity can always find a use for extra money, ... [i]f a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as a public purpose, the Contract Clause would provide no protection at all[.]. ...a State cannot refuse to meet its legitimate financial obligations simply because it would prefer to spend the money to promote the public good rather than the private welfare of its creditors.”)

While not binding on an Idaho Court, other courts have also considered contract clause challenges to changes to retirement statutes. In Strunk v. Public Employees Retirement Board, 338 Or. 145 (2005) (en banc), at issue were a number of changes to the Oregon public employee retirement statute including, inter alia, a change to the application to members’ accounts of an assumed rate of return and a temporary suspension of an annual statutory cost of living adjustment provision. In finding that the change to the application of the assumed rate of return was an unconstitutional impairment, the Court rejected the state’s economic hardship defense. The Court stated that were it to recognize an economic hardship defense to a challenge to a change in the assumed earnings rate guarantee (which it did not), there would be a very high threshold for such a defense to succeed, noting “we emphasize that we are not dealing here with legislation that impairs private contracts. Instead, we are dealing with a statutory contract. In other words, it is one of the *parties* to the contract (the state) that now is attempting to rely on a change in circumstances to permit it to alter its contractual obligations in a constitutional manner.” *Id.* at 207 (emphasis in original). The Court also discussed the report of an assigned Special Master that “demonstrate[d] that the state’s recent fiscal status is both serious and has resulted in substantial detriments to the provision of governmental services across the state.” However, the Court held that those findings did “not justify a rewriting of the assumed earnings rate guarantee in a manner that would result in the elimination of earnings both promised and actually credited over time to Tier One members’ regular accounts.” *Id.* at 208. As to the temporary suspension of the COLA, the Strunk Court found that suspension was a breach of the PERS contract (as opposed to an impairment) applicable to the affected members. *Id.* at 224.¹³

See also City of Omaha, 247 Neb. 955 (elimination of a cost of living supplemental payment was an unconstitutional impairment; while bankruptcy threat was well documented, the county did not show that termination of the payment was the only viable alternative to addressing its fiscal problems and there was no new comparable advantage to offset the

¹² The reasonable modification/flexible and integrity criteria applied by Idaho and other courts appears to be an interpretation, specific to public pensions, of the reasonable/necessary for an important public purpose prong of a contractual impairment analysis. See City of Omaha, 247 Neb. at 969; Andrews, 931 F. Supp at 1265. The reference in Nash to a potential increase in employer contributions appears to go to the ability to address the perceived problem through alternative means as discussed in contract impairment cases.

¹³ The Oregon COLA statute at issue was similar to Idaho Code § 59-1355 in that it mandated a yearly COLA determination and provided for an increase or decrease, subject to a 2% cap.

disadvantage caused by elimination of the payment); United Firefighters of Los Angeles City v. City of Los Angeles, 210 Cal.App.3d 1095 (2 Dist. 1989) (city charter amendment placing a 3% cap on COLA was unconstitutional where city failed to justify the impairment); Maryland State Teachers Assoc., Inc. v. Hughes, 594 F. Supp. 1353, 1364-68 (D. Md. 1984), *cert. denied* 475 U.S. 1140, 106 S. Ct. 1790, 90 L.Ed.2d 336 (1986) (the County has failed to make a sufficient showing that the means which it has adopted to address its "problem" is the least drastic available).

C. Current PERSI Retirees and Non-Retiree PERSI Members Who Have Worked for a Legally Significant Time in Reliance on the COLA Have a Vested Right to the 1% COLA

In conclusion, it is the opinion of this author that current PERSI retirees and non-retiree PERSI members who have worked for a legally significant time in reliance on the COLA have a vested (contractually protected) right to the 1% COLA. The right can be altered only if modifications are reasonable and for the purpose of keeping the pension flexible and maintaining its integrity.

In Nash v. Boise City Fire Department, a case involving the Firemen's Retirement Fund and a cap imposed on its statutory COLA, the Idaho Court found the cap could not be applied to the challenging member when the member was found to have worked long enough to have a vested (protected) right to the COLA; the Firemen's Retirement Fund was not insolvent or unable to meet current or near future obligations and the Fund would grow for the remainder of the member's life.

Sincerely,



BRIAN KANE
Assistant Chief Deputy

BK/tjn