Kansas Legislature's Legal Authority to Modify the Kansas Public Employees Retirement System (KPERS)

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Executive Summary

Conclusion. There are two primary constraints on the ability of the Kansas legislature to modify benefits under KPERS. The first is a statutory provision limiting the legislature's ability to modify "existing rights" of members. The second is the obligation not to violate the Contract Clause of the U.S. Constitution. Although taken in tandem these substantially constrain the legislature in its ability to make modifications to KPERS benefits, there are some modifications that would seem permissible. The modifications that would seem permissible are as follows (and as more fully discussed below):

- New hires: the reduction or elimination of benefits
- Possibly, the elimination of features not in place at the time of a member's hire, but only as applied to future benefit accruals
- Possibly, the reduction or elimination of future benefit accruals for employees who have not yet vested under KPERS' terms
- Changes in future benefit accruals necessary to serve an important public purpose
- Insubstantial modifications to future benefit accruals
- Changes to future benefit accruals where added advantages offset the resulting disadvantages

The types of changes that could be made for new hires (see the first bullet above) would, for example, include eliminating or modifying the ability to purchase service credits, increasing the early retirement age, eliminating or modifying any rule of 85, increasing employee contribution rates, requiring more years to fully vest, increasing the age for normal retirement, increasing the number of years used in determining final average salary, and not annualizing pay in calculating benefits for elected officials.

Any changes permissible under the second, third, and fourth bullets above, could probably be made with only respect to future benefit accruals. As to those future benefit accruals, the types of changes that could be made would, for example, again include eliminating or modifying the

ability to purchase service credits, increasing the early retirement age, eliminating or modifying any rule of 85, increasing employee contribution rates, requiring more years to fully vest, increasing the age for normal retirement, increasing the number of years used in determining final average salary, and not annualizing pay in calculating benefits for elected officials.

Introduction.

Media have reported often over the past many months on the financial distress in which many public employee retirement systems find themselves. These reports concern "defined benefit" pension plans covering employees of state governments, school districts or local governments. Defined benefit plans guarantee employees a particular level of benefit at retirement, often using a formula that depends on the number of years the employee has worked and his or her compensation while employed. This is in contrast to a "defined contribution" 401(k)-type plan, under which retirement benefits are determined by the amount accumulated in an account established for the employee, including contributions by the employer and the employee, adjusted for earnings and losses.

A number of states have recently modified their public employee retirement systems in an effort to reduce billions of dollars in unfunded liabilities to ensure plan solvency without large tax increases or spending reductions. These modifications have typically included some type of reduction in future benefits (particularly cost of living adjustments), increased employee contributions, or both. Some of these changes have been challenged in court. Two recent state trial courts have upheld the validity of changes made to retirement systems in Minnesota and Colorado (more on this later).

The purpose of this paper is to describe the ability of the Kansas legislature to make modifications to benefits under the Kansas Public Employees Retirement System ("KPERS") (KSA § 74-4901 *et seq*), and specifically to describe the legislature's ability to provide for lesser benefits than are currently provided under KPERS.

Statutory Limitation on Ability to Change Benefits.

There are two primary constraints on the ability of the Kansas legislature to make modifications to benefits under KPERS where the modified benefits are less advantageous to members than those provided for under the current KPERS provisions. The first of these constraints is a prohibition (the "Statutory Prohibition") found within the KPERS statutory provisions themselves. This prohibition, which is found in KSA Section 74-4923(a), provides as follows:

> *No alteration, amendment or repeal of this act shall affect the then existing rights of members and beneficiaries but shall be effective only as to rights which would otherwise accrue under this act as a result of services rendered by an employee after the alteration, amendment or repeal.* This subsection shall not apply to any alteration or amendment of this act which provides greater benefits to members or beneficiaries, but any increase of benefits shall only be applicable to benefits payable on the first day of the month coinciding with or following the effective date of the alteration or amendment. (Emphasis added.)

The first sentence of the quoted provision above means, at least in part, that no amendment to KPERS may adversely affect the "existing rights" of a KPERS member (or his or her beneficiaries) as those rights relate to services already provided by the member. So, for example, consider a member with 10 years of participating service (and no prior service), who is entitled to a retirement benefit at his or her normal retirement date equal to 1.75 percent of the member's final average salary for each of those 10 years. This would give the member a benefit equal to 17.5 percent of the member's final average salary. The statutory provision above, which prohibits amending KPERS to affect the "existing rights" of the member with respect to services already rendered, would likely prohibit the legislature from reducing the 1.75 percent multiplier to, say, 1.5 percent, with respect to the 10 years of participating service the member has already provided. It would also likely prohibit the legislature from changing the compensation counted as final average salary with respect to the 17.5 percent benefit already earned by the member by, say, no longer counting one component of compensation that had previously been counted.

To make this more concrete, assume the final average salary for the member in the example above at the time the legislature modifies KPERS is $40,000. This would produce an annual benefit at normal retirement date for the member of $7,000 (this is 17.5 percent x $40,000). The statutory provision quoted above would very likely make it impermissible for any modification to KPERS to reduce this member's benefit at normal retirement date below an annual benefit of $7,000.

Recall that this Statutory Prohibition protects a member's (and beneficiary's) "existing rights" that have accrued as a result of services already provided by the member. Although the term "existing rights" is ambiguous, it presumably protects the right of members to the most substantial features associated with the benefit they have already earned through their service to date. So, with respect to a benefit a member has already earned due to service the member has already provided, the Statutory Prohibition would, for example, presumably prohibit the legislature from eliminating the member's current right to retire and begin receiving retirement benefits <u>prior</u> to his or her normal retirement date. In our example above, this would be an early retirement benefit relating to the $7,000 benefit payable upon normal retirement date that the member had already earned. So, for example, if the member in the example above were age 60, and if he or she were entitled to retire and begin receiving an annual retirement benefit equal to the member's benefit payable at normal retirement date ($7,000) reduced by .2 percent for each month by which his or her attained age at the time of retirement preceded age 62, the legislature would seem to be unable to increase the actuarial reduction for early retirement from .2 percent per month to, say, .3 percent, as it relates to the benefit the member has already earned (based on the member's participating service already credited (10 years) and the member's current final average salary ($40,000)).

<u>Prospective Changes</u>. Although the term "existing rights" is ambiguous, and therefore the ability of the legislature to make modifications without running afoul of the statutory provision is unclear, the better reading of the law is that the Statutory Prohibition should not prevent the legislature from making modifications that would reduce the rate at which benefits accrue in the future. For example, the Statutory Prohibition would not seem to prevent the legislature from reducing the 1.75 percent benefit multiplier for determining benefits at a member's normal retirement date to, say, 1.5 percent, <u>as applied to service provided by a member after the legislature makes the reduction</u>. To go back to our prior example, if the legislature were to reduce the

multiplier for future service from 1.75 percent to 1.5 percent, and if the member in our example above were to work an additional five years (after the 10 years he or she had already worked), the percentage benefit to which the member would be entitled would be 25 percent, which is 10 years at 1.75 percent plus five years at 1.5 percent.

One reason it appears that the legislature can make modifications to future benefit accruals without violating the Statutory Prohibition is that if, instead, the term "existing rights" is understood to prevent the legislature from making modifications even to benefits accruing with respect to future service, the statutory language stating that any amendment "shall be effective . . . as to rights which would otherwise accrue . . . as a result of services rendered by an employee after the . . . amendment" would seem to have little or no meaning. That is, it seems clear from the words of the Statutory Prohibition that an amendment can (and in fact will) be effective to change the rights members that accrue as a result of the members' services rendered after the time of the amendment.

The best reading of the Statutory Prohibition, therefore, is to subject the legislature to rules akin to those applicable to private employers in terms of their ability to reduce pension benefits. Generally speaking – and this is a vast oversimplification – pension changes may not be made by private employers if they would adversely affect fundamental aspects of the benefits already earned by employees, taking into account for this purpose only the employees' prior service and compensation already earned to date. This leaves an employer, and presumably the legislature, free to make modifications relating to future services provided by employees. This would include the ability to reduce the benefit multiplier applicable to future service, or even to provide for no benefit accruals whatsoever with respect to future service.

Contract Clause of U.S. Constitution. Very importantly, and as noted earlier, there is a second constraint on the legislature's ability to make modifications to benefits provided under KPERS. This second constraint is in many respects more limiting than the first. That is, it effectively constrains the legislature's ability to make changes to KPERS to a greater degree than does the Statutory Prohibition discussed above.

This second constraint is a prohibition under the U.S. Constitution against the state impairing a contractual obligation. The Supreme Court of Kansas has interpreted this Constitutional limitation on the legislature's ability to make modifications to KPERS in a way that constrains the Kansas legislature to a greater degree than would seem to be the case under the interpretations of this Constitutional provision by the supreme courts of certain other states. This paper will describe those constraints on the Kansas legislature as developed under the existing decisions of the Supreme Court of Kansas. It is, however, worth noting that courts can and do refine their analysis over time, and sometimes simply change their points of view. We will nevertheless assume for purposes of this paper that the Supreme Court of Kansas will not modify its prior analysis to give the legislature more, or less, freedom to make modifications to KPERS.

The reason the provision of the U.S. Constitution (Article I, Section 10) prohibiting the impairment of contracts – sometimes referred to as the "Contract Clause" – is relevant in the KPERS context is that the Supreme Court of Kansas considers participating members of KPERS (and KP&F – that is, the Kansas Police and Firemen's Retirement System) to have certain contractual rights based upon the statutes that create those retirement systems. The court considers

those rights to be a part of an employee's employment contract. This principle that the state retirement systems create contracts between the state and its employees who are members of the system was established by the Supreme Court of Kansas in 1975 in the case of *Shapiro v. Kansas Public Employees Retirement System,* 216 Kan. 353, 532 P.2d 1081 (1975). It was reiterated in two important decisions decided on the same day in 1980, *Singer v. Topeka*, 227 Kan. 356, 607 P.2d 467 (1980) and *Brazelton v. Kansas Public Employees Retirement System*, 227 Kan. 443, 607 P.2d 510 (1980). Further, the Supreme Court of Kansas has said that "when a person accepts employment with a governmental entity and becomes a participating member of the retirement system, he or she gains certain rights which may not be eliminated or substantially changed by unilateral action of the governmental employer to the detriment of the member." *Brazelton, supra*, 227 Kan. at 448, 607 P.2d at 514.

It is this view that employees have a contractual right to retirement benefits that causes the contract clause of the U.S. Constitution to be relevant. The Contract Clause is found in Article I, Section 10, of the Constitution and provides as follows:

> No state shall . . . pass any . . . law impairing the obligation of contracts . . . .

As noted earlier, the Supreme Court of Kansas has interpreted this U.S. Constitutional prohibition in a way that constrains the Kansas legislature in its ability to make modifications to KPERS to a greater degree than would be the case under the analysis of courts of certain other states. To a large degree, the Kansas court has been guided in its analysis by a decision of the Supreme Court of California dating from 1947. That case is *Kern v. City of Long Beach*, 29 Cal. 2d 848, 179 P.2d 799 (Cal. 1947). It is sometimes referred to simply as *Long Beach.*

Although the Kansas court interprets the contract clause of the U.S. Constitution to impose a considerable limitation on the ability of the legislature to make modifications to KPERS, there are modifications the legislature can make consistent with the Kansas court's rulings. Listed below are some guiding principles, describing those modifications that can be made consistent with existing Kansas court decisions:

1. New Hires. The legislature may make modifications that apply only to employees hired in the future. In particular, the legislature may provide for a lower rate of benefit accruals for employees hired in the future, or even provide that new hires will not be covered at all. (An employer's decision to provide no pension benefits to new hires is sometimes referred to as a "soft freeze" of the employer's pension plan). The Supreme Court of Kansas has approved of making modifications for new hires, including changes of a type that could not be made for current employees due to the U.S. Constitution's Contract Clause. It did so in *Brazelton*, referred to above.

   If new hires continue to be covered, in addition to the permissibility of providing benefits for those members at a lower rate than under current KPERS provisions, the legislature could provide for other deviations from the current KPERS rules. For new hires, the legislature could, for example, eliminate or modify the ability to purchase service credits, increase the early retirement age, eliminate or modify any rule of 85, increase employee contribution rates, require more years to fully vest,

increase the age for normal retirement, increase the number of years used in determining final average salary, or not annualize pay in calculating benefits for elected officials.

2. Benefits Added After Hire. See also *Denning v. Kansas Public Employees Retirement System*, 285 Kan. 1045, 180 P.3d 564 (Kan. 2008), where the court seemed to indicate that a feature that was not part of KPERS when an employee was hired could be eliminated. Although the court had other grounds for permitting the modification at issue in *Denning*, the court seemed to suggest that benefit features added after a member's acceptance of employment can later be taken away, at least if they are taken away before the member retires. Because this was only one of the grounds for the court's ruling, the ability of the legislature to strip away options or features added after a member's employment first commenced is certainly not clear, though it is at least arguably permissible. In addition, the court in *Denning* was addressing only potential violations of the Contract Clause of the U.S. Constitution, and not the Statutory Prohibition on retroactively eliminating a member's existing rights (discussed earlier). Importantly, the Statutory Prohibition would seem to prohibit the elimination of benefits features added after a member's date of hire if those benefits or features are considered "existing rights" (see the discussion above concerning the ambiguity of the term "existing rights"). So, for example, if an employee had been hired at a time when the KPERS multiplier was 1.4 percent, it would at least arguably be permissible for the legislature to provide that future accruals for that employee be at the 1.4 percent level (but without reducing the employee's benefit multiplier for years of service already provided).

3. Employees with No Vested Contract Rights. The Kansas court cases, and the Supreme Court of California case that serves as their foundation, protects only an employee's "vested contract rights." It is not clear when an employee gains vested contract rights for this purpose. The Kansas court has said it is not convinced "all elements" of an employee's pension contract "vest upon the employee's first day of employment. *Singer*, *supra*, 227 Kan. at 365, 607 P.2d at 474. It appears, though, that employees will generally gain vested contract rights at some point prior to their actual retirement, rather than gaining vested contract rights only when they retire. The Supreme Court of Kansas has, in this regard, said the following:

> Continued employment over a reasonable period of time during which substantial services are furnished to the employer, plan membership is maintained, and regular contribution into the fund are made . . . cause the employee to acquire a contract right in the pension plan.

Singer, 227 Kan. at 365, 607 P.2d at 474. In *Singer*, individuals who had been employed as city police or firemen for over 11 years when they filed their lawsuit were considered to have vested contract rights.

Since only an employee's "vested contract rights" are protected under the Contract Clause, it may be possible to make modifications to benefits that would accrue in

the future (that is, to benefits that relate to services a member will provide in the future) if the member is not yet vested under the operative KPERS provisions at the time the change is made. So, for example, for a KPERS member who needs five years of service to have a vested benefit under the terms of KPERS, it is possible that modifications could be made to that member's future benefit accruals, for example by lowering the benefit formula with respect to that future service (or providing no benefit whatsoever with respect to that future service), or by modifying the rules relating to early retirement benefits with respect to the member's benefits accrued in the future. Whether, in fact, this would be permissible will depend on when the Supreme Court of Kansas determines that an individual has a "vested contract right" with respect to future benefit accruals. This is simply not clear from the cases the Kansas court has decided to date.

It does seem likely that once a member has enough years to be vested under the terms of KPERS (five years in the example above), the individual will be considered to have a vested contract right that would limit the legislature's ability to make changes with respect to that member's benefits, including limiting the legislature's ability to make changes to benefits relating to the member's future service.

Even if the Kansas court were to conclude that a KPERS member who is not yet vested under the terms of KPERS does not have a vested contract right, it is important to remember that the legislature will still be subject to the statutory constraint on its ability to make modifications discussed above (that is, the Statutory Prohibition). This means that even for a non-vested member of KPERS, the legislature very likely cannot reduce the KPERS benefit relating to service the member has already provided. This would be true even though the member was not yet vested in any benefit under the terms of KPERS.

The types of changes the legislature could make with respect to future benefit accruals for an employee not considered to have "vested contract rights" would include those described at the end of the discussion on "New Hires" (in paragraph 1 above).

4. Changes Necessary to Serve an Important Public Purpose. The U.S. Supreme Court, in explaining the Contract Clause and its limitation on the ability of states to impair a contractual relationship, has indicated that there can be circumstances in which impairing a contractual relationship will not violate the U.S. Constitution. Specifically, the U.S. Supreme Court said the following in *U. S. Trust Co. of New York v. New Jersey*, 431 U.S. 1, 97 S. Ct. 1505 (1977):

> The Contract Clause is not an absolute bar to subsequent modification of a State's own financial obligations. . . . [A]n impairment may be constitutional if it is reasonable and necessary to serve an important public purpose. In applying this standard, however, complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's

> self-interest is at stake. A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all.

413 U.S. 18, 91 S. Ct. 1519.

So, a state may change a contract, such as a contract promising pension benefits, without violating the U.S. Constitution, if doing so is "reasonable and necessary to serve an important public purpose." As it turns out, this appears to be a pretty high bar to clear. That is because, as the U.S. Supreme Court has indicated, simply saving the state money would not, by itself, justify reductions in future benefit accruals for members with vested contract rights.

Though not at all clear, one might expect the Supreme Court of Kansas to permit a reduction in the rate of future benefit accruals for vested members (or an elimination of future accruals altogether) under the "important public policy" exception to the Contract Clause only upon a showing of clear financial need and the unavailability of less drastic alternatives for improving the financial condition of the retirement system. The key question is whether the court would permit a modification to the rules for future benefit accruals without requiring the legislature to consider other ways of improving the funding of the retirement system (which might involve the re-allocation of other state monies or the possibility of a tax increase). It is simply not clear whether the court would, due to financial stress on the retirement system, allow the legislature to reduce the rate of future benefit accruals (or eliminate them altogether) for current members with vested contract rights.

The Supreme Court of Kansas has spoken to the issue of the legislature's ability to make changes to serve an important public purpose, but largely only in abstract terms. For example, the court said the following in *Denning v. Kansas Public Employees Retirement System*, 285 Kan. 1045, 180 P.3d 564 (Kan. 2008):

> [O]ur precedent has recognized that there may be times when pension system changes are necessary for the greater good, even if an individual employee or retirant may suffer some marginal disadvantage. Changes may be made, for example, "to protect the financial integrity of the system or for some other compelling reason." *Brazelto*n, 227 Kan. at 453. Changes may be "necessary to preserve or protect the pension system; to maintain flexibility; to permit necessary adjustments due to changing conditions; to protect the beneficial purpose of the system; to maintain the system on a sound actuarial basis or by reason of administrative necessity." 227 Kan. at 454. This is in keeping with our view that the Contract Clause must be considered in conjunction with the reserved power of the State to protect the vital interests of its citizens. Federal Land

> *Bank of Wichita v. Bott*, 240 Kan. at 632; see also Young Partners, 284 Kan. at 403 ("'[f]reedom of contract . . . implies the absence of arbitrary restraint, not immunity from reasonable regulations and prohibitions imposed in the interests of the community'" [quoting *Kansas City Power & Light Co. v. Kansas Corporation Comm'n*, 238 Kan. 842, 853, 715 P.2d 19 (1986)]).

It is hard to gauge the precise meaning of the general statements made above because the court has not been called on to provide much in the way of concrete guidance on when, if ever, a financial strain on KPERS or the state itself would justify changes in the rate of (or elimination of) future benefit accruals.

In the event changes were necessary to serve an important public purpose, and therefore could be made without violating the Contract Clause, the types of changes the legislature could make with respect to future benefit accruals would include those described at the end of the discussion on "New Hires" (in paragraph 1 above).

5. Insubstantial Modifications. Any modification to KPERS that does not operate as a "substantial" impairment of a member's vested contract rights should not violate the Contract Clause of the U.S. Constitution.* *Denning*, *supra*, 285 Kan. at 1051, 180 P.3d at 569, citing *U.S.D. No. 443 v. Kansas State Board of Education*, 266 Kan. 75, 84, 966 P.2d 68 (1998). There is very little authority of what constitutes a "substantial" impairment with respect to a modification of a retirement system. It seems likely, though, that any meaningful reduction in the rate of future benefit accruals, or other primary features of the system such as the entitlement to, or amount of, early retirement benefits, would be substantial, and therefore not qualify for the exception permitting the legislature to make insubstantial changes.

6. Offsetting Benefits and Detriments. In looking to the California Supreme Court's interpretation to the Contract Clause in *Long Beach*, the Supreme Court of Kansas indicated that changes may be made in retirement benefits even for members with a vested contract right, if those modifications are made prior to retirement and those modifications are reasonable. To be reasonable, though, any changes that result in a disadvantage to employees must be accompanied by comparable new advantages. More specifically, the Kansas Supreme Court has quoted with approval the following language from the *Long Beach* decision by the California court:

> An employee's vested contractual pension rights may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions

* The Supreme Court of Kansas stated in 2008 in *Denning* that there can be no Contract Clause violation unless the state law operates as a substantial impairment of a contractual relationship. Note, though, that in an earlier decision from 1980 (*Brazelton*), the court stated, somewhat gratuitously, that "any . . . impairment is constitutionally prohibited and 'the magnitude or degree of the impairment is of no consequence.'" *Brazelton*, 227 Kan. at 451, 607 P.2d at 516, citing *State, ex rel., v. Paulsen*, 204 Kan. 857, 861, 465 P.2d 982 (Kan. 1970). The more recent statement in *Denning* that there is no constitutional violation absent a substantial impairment is presumably the correct standard both because it is stated in a more recent case and because it drew on more recent authority than did the 1980 *Brazelton* decision.

> and at the same time maintain the integrity of the system. Such modifications must be reasonable, and it is for the courts to determine upon the facts of each case what constitutes a permissible change. 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....*

Brazelton, supra, 227 Kan. at 453, 607 P.2d at 518, quoting *Long Beach, supra*, 29 Cal. 2d at 853, 179 P.2d at 802.

The Supreme Court of Kansas applied this principle to permit a modification to KPERS benefits in *Denning, supra*. In that case, the legislature had made two KPERS changes. First, it had eliminated the ability of a retiree to return to work, elect to revoke retirement, and again become an active KP&F participant with the ability to contribute a portion of his or her earnings and earn additional service credit. Second, the legislature had changed the standard for determining whether retirement payments must be suspended upon reemployment. Prior to this change, KPERS imposed a 30-day limit on collecting retirement benefits once a retiree returned to work. After 30 days, benefits were suspended. The legislature replaced this time limitation with a dollar limitation on the amount of compensation a rehired retiree could earn without having his or her retirement payments suspended. That dollar limit was $15,000 at the time of the lawsuit.

The plaintiff in *Denning* conceded that the replacement of a time limitation with an earnings limitation constituted an exchange with offsetting benefits and detriments, which meant it did not violate the Contract Clause of the U.S. Constitution. He argued, however, that the elimination of a retiree's right to revoke retirement and return to participation in KP&F lacked a corresponding advantage, and therefore was unconstitutional.

The court rejected this argument because it said it was to look at all the changes made by the legislature as a whole in deciding whether there was an offsetting advantage. The court concluded that the deletion of the revocation option "was not uncompensated." That is because the other change – the replacement of the 30-day limitation with a dollar limitation – not only resulted in a direct offset of one for the other (the 30-day limit for the dollar limit), but also increased the annual total of KP&F retirement benefits that the majority of retirees returning to work would draw. The court apparently saw this as an advantage that justified the other change – the elimination of the right to again accrue benefits upon rehire (by revoking the decision to retire). For this reason, the <u>set</u> of modifications was permissible.

The rule permitting the offsetting of detriments and advantages without running afoul of the Contract Clause of the U.S. Constitution does, of course, in fact require that there be advantages to offset any disadvantages. Although it is not apparent from the Kansas cases that there is any direct dollar for dollar cost offset required,

one assumes any modifications to future benefit accruals that would, on a net basis, save the system substantial amounts might not pass muster (that is, might not pass muster under the rule permitting changes where disadvantages are accompanied by comparable new advantages, though those changes might be justified under other of the rules described above). And it is important to remember that the Statutory Prohibition on the elimination of members' "existing rights" would also seem to apply. The court in *Denning* seems not to have been asked to consider the application of that statutory provision. This is notable because in *Denning* the court permitted the modification of rehire and suspension of benefit rules, even though those rights related to benefits already accrued.

Although it is not clear from the Kansas cases that there is any direct dollar-for-dollar cost offset required where disadvantages are accompanied by advantages, the Supreme Court of Kansas has indicated that this determination is made by looking at the effect of advantages and disadvantages on members as a whole. That is, it is not necessary that for each individual member the disadvantages be accompanied by comparable new advantages for that member. The court put it this way:

> [W]e hold that, in so far as the rights of active employees in and to pension plans are concerned, the reasonableness of legislative changes is to be measured by the advantage or disadvantage to the affected employees as a group or groups; validity of change is not dependent on the effect upon each employee.

Singer, *supra*, 227 Kan. at 367, 607 P.2d at 475.

Recent Minnesota and Colorado Cases. Of interest, but of no legal authority in Kansas, are two recent trial court decisions from Colorado and Minnesota. These courts upheld changes in public employee retirement systems. One of the cases, *Justus v. Colorado*, Case No. 2010 cv 1589 (Dist. Ct., City and County of Denver, Colo. 2011), involved a modification to Colorado's public employees retirement system. The challenged law was designed to address severe underfunding in the Colorado system. The law modified the rules concerning employee and employer contributions, put a cap on cost of living increases for retirees, created new contributions for working retirees, and increased the age and service requirements of certain groups of employees before they would be eligible to receive retirement benefits.

The lawsuit concerned a challenge to the provisions of the law modifying cost of living adjustments payable to retirees. The plaintiffs argued that not only was their base compensation amount protected by the Contract Clause of the U.S. Constitution, so was their entitlement to a specific cost of living adjustment. The court rejected this argument, holding that although the plaintiffs had a contractual right to their base pension, they did not have a contractual right to receive the specific cost of living adjustment formula in place at the time of their retirement for life without change. Important to the court, over a period of four decades the cost of living adjustment formula applied to retirees had repeatedly been changed and had never been frozen at the date of an employee's retirement. The Colorado legislature had repeatedly modified the formula for existing retirees, and the court concluded that retirees had no contract right to a

particular cost of living adjustment. Since retirees had no contract right, the change in the cost of living adjustment formula did not violate the Contract Clause.

The second case is *Swanson v. Minnesota*, No. 62-cv-10-05285 (Dist. Ct. 2d Jud. Dist. Minn. 2011). There, the court dismissed a putative class action contending that the Minnesota legislature's reduction of the formula for post-retirement cost of living adjustments was unconstitutional. As in *Justus*, the plaintiffs argued that they were entitled to receive pension increases based on the statutory post-retirement adjustment formula that was in effect at the time they retired.

Various public retirement systems were subject to the Minnesota legislation, including the Teachers Retirement Association ("TRA"), Minnesota State Retirement System ("MSRS"), and the Public Employees Retirement Association ("PERA"). The 2010 Minnesota legislature amended the pension plans' contribution rates, vesting periods, annuity formulas, interest rates, and the post-retirement adjustment formula, with the changes made for each plan depending on the plan's individual economic and demographic circumstances.

By way of background, by mid-2009 it appears that the TRA's funding ratio on a market valuation basis was 60 percent, leaving TRA with an unfunded liability of over $9 billion. That system's actuary warned that fund exhaustion, or insolvency, could be reached by 2013. The funding ratio for PERA's "general fund" had fallen to less than 54 percent in fiscal year 2009. The PERA's Police & Fire and Correctional Plans had funding ratios well under 75 percent, with the PERA's actuary projecting a continuing downward trend in funding ratios. MSRS had a funding ratio of under 66 percent. An actuarial projection showed funding levels falling below 20 percent in less than 20 years if no corrective measures were taken.

The court said each plan "concluded that attempting to ride out the market downturn was inconsistent with the statutory fiduciary duty owed to members, the State, and the State's taxpayers." The court concluded that the legislature had neither contracted to use, nor promised to use, the formula in effect on the date of retirement for future post-retirement adjustments to retirement annuities. Since the court concluded that there was no enforceable contract with members, there could be no violation of the Contract Clause.

Conclusion. There are two primary constraints on the ability of the Kansas legislature to modify benefits under KPERS. The first is a statutory provision limiting the legislature's ability to modify "existing rights" of members. The second is the obligation not to violate the Contract Clause of the U.S. Constitution. Although taken in tandem these substantially constrain the legislature in its ability to make modifications to KPERS benefits, there are some modifications that would seem permissible. The modifications that would seem permissible are as follows (and as more fully discussed above):

- New hires: the reduction or elimination of benefits
- Possibly, the elimination of features not in place at the time of a member's hire, but only as applied to future benefit accruals
- Possibly, the reduction or elimination of future benefit accruals for employees who have not yet vested under KPERS' terms
- Changes in future benefit accruals necessary to serve an important public purpose

- Insubstantial modifications to future benefit accruals
- Changes to future benefit accruals where added advantages offset the resulting disadvantages

The types of changes that could be made for new hires (see the first bullet above) would, for example, include eliminating or modifying the ability to purchase service credits, increasing the early retirement age, eliminating or modifying any rule of 85, increasing employee contribution rates, requiring more years to fully vest, increasing the age for normal retirement, increasing the number of years used in determining final average salary, and not annualizing pay in calculating benefits for elected officials.

Any changes permissible under the second, third, and fourth bullets above, could probably be made with only respect to future benefit accruals. As to those future benefit accruals, the types of changes that could be made would, for example, again include eliminating or modifying the ability to purchase service credits, increasing the early retirement age, eliminating or modifying any rule of 85, increasing employee contribution rates, requiring more years to fully vest, increasing the age for normal retirement, increasing the number of years used in determining final average salary, and not annualizing pay in calculating benefits for elected officials.