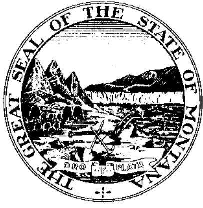

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Legal Services Office

LEGAL MEMORANDUM

TO: State Administration and Veterans' Affairs Committee and Legislative Finance Committee

FROM: David S. Niss, Staff Attorney

RE: Constitutionality of Amendment of GABA Statutes to Tie Amount of GABA to State Investment Earnings for Current Retirement System Members

DATE: January 5, 2012

I
INTRODUCTION

At the close of my previous presentations at the latest meetings of both the State Administration and Veterans' Affairs Committee and the Legislative Finance Committee, the Committees engaged in a general discussion of whether the Legislature may constitutionally amend the current statutory GABA provisions[1] as they apply to current members of the retirement systems to provide that the amount of the GABA is tied to investment earnings. This memorandum summarizes three previous memorandums on this subject (attached).

II
DISCUSSION

As previously pointed out[2], the Contract Clauses in both the U.S.[3] and Montana[4] Constitutions are not absolute. They both allow the amendment of existing contracts for important and necessary public purposes because the state never loses its ability to exercise its police power for the welfare of its residents[5]. However, the Montana Supreme Court has never substantively applied that general theory of contract and

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[1]Sections 19-3-1605, 19-5-901, 19-6-710, 19-6-711, 19-7-711, 19-8-1105, 19-9-1009, 19-9-1010, 19-9-1013, 19-13-1010, and 19-13-1011, MCA.

[2]August 14, 2009, Memorandum, text, page 4, and footnote 12.

[3]Art. I, sec. 10, cls. 1.

[4]Art. II, sec. 31.

[5]See text, page 2.

constitutional law to public employee retirement pension contracts[6]. In order to allow the amendment to the GABA statutes as to existing members of the retirement systems, the Montana Supreme Court must follow the theory of contract amendments announced by the U.S. Supreme Court in U.S. Trust Company of New York v. New Jersey, 431 U.S. 1 (1977), cited on page 6 of the August 14, 2009, memorandum, and hold that either (1) the change in the GABA to make its payment dependent upon investment earnings is not a "substantial" impairment of those contracts, or (2) if the impairment is substantial, it is nevertheless reasonable and necessary under the circumstances[7]. However, because the Montana Supreme Court has adopted the rationale of the U.S. Trust Co. opinion regarding other types of contracts, it would be prudent for the Legislature to deal with that part of the U.S. Trust Co. opinion that holds that the state may not amend its own contracts ahead of other alternatives that do not involve an impairment of contracts in order for the Legislature to reach its goal. In the U.S. Trust Co. opinion, the U.S. Supreme Court said:

> [W]ithout modifying the covenant at all, the States could have adopted alternative means of achieving their twin goals of discouraging automobile use and improving mass transit. Appellees contend, however, that choosing among these alternatives is a matter for legislative discretion. But a State is not completely free to consider impairing the obligations of its own contracts on a par with other policy alternatives.

The reason for the Court's holding, it explained, was that if the law were otherwise, a state could avoid its lawful contractual debts by reasoning that the money could be better used elsewhere.

The Montana Supreme Court has adopted this holding in the U.S. Trust Co. opinion when an impairment of a state's own government contract is at stake. Neel v. First Fed. S. & L Ass'n, 207 Mont. 376, 675 P.2d 96 (1984), Buckman v. Mont. Deaconess Hosp., 224 Mont. 318, 730 P.2d 380 (1986), Billings v. County Water Dist., 281 Mont. 219, 935 P.2d 246 (1997), Seven Up Pete Venture v. St., 2005 MT 146, 327 Mont. 306, 114 P.3d 1009. The analysis and holding in the U.S. Trust Co. opinion means that if there is more than one alternative for the resolution of an issue involving a state contract that does not require an impairment of that contract, the alternative that does not impair the contract must be the alternative chosen by the state ahead of the

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[6]As previously discussed in the August 28, 2009, Memorandum, the Montana Supreme Court came close in one sentence of its opinion in Gulbrandson v. Carey, 272 Mont. 494, 901 P.2d 573 (1995), but ultimately held that the retirement benefit statute in question did not apply to the plaintiff because the statute took effect after the plaintiff retired.

[7]The Montana Supreme Court "must" follow this reasoning because, as pointed out in footnote 8 of the August 14 Memorandum, the Court has held that the Montana and federal contract clauses are interchangeable and that federal case law allowing interference with contracts is therefore of precedential value in Montana. See. E.g., Butte v. Roberts, 94 Mont. 482, 23 P.2d 342 (1933) and Neel v. First Fed. S & L Ass'n, 207 Mont. 376, 675 P.2d 96 (1984).

alternative that does impair the contract. Thus, for example, in Condell v. Bress, 983 F.2d 415 (2d Cir., 1993), the U.S. Court of Appeals for the Second Circuit addressed a "payroll lag" of 5 days for existing employees adopted by the New York Legislature as a money-saving device in the face of a budget deficit estimated at $1.005 billion. Other alternatives such as tax and revenue anticipation notes, levying new taxes, raising rates on existing taxes, or laying off executive branch employees existed, but these alternatives were rejected by the New York Legislature as "unwise social policy". Of that choice by the Legislature, the U.S. Second Circuit said:

> It cannot be said that a lag payroll for only judicial employees was *essential* in order to finance the expansion of the court system. The state could have shifted the seven million dollars from another governmental program, or it could have raised taxes. We recognize that neither alternative would have been popular among politician-legislators, but that is precisely the reason that the contract clause exists--as a "constitutional check on state legislation." In fact, the lag payroll scheme smacks of the political expediency that *United States Trust Co.* warned of: "A governmental entity can always find a use for extra money, especially when taxes do not have to be raised."

In a 1994 opinion on a similar subject, the West Virginia Supreme Court held that a reduction in a cost of living allowance for state troopers from 3.75% per year to 2% per year for troopers currently employed by the state constituted a substantial impairment of the troopers' employment contract and that the reduction in the COLA constituted an unconstitutional impairment of contract under the rationale of the U. S. Trust Co. opinion. The Court said:

> Having read the actuarial studies submitted by respondents, this Court acknowledges the legitimacy of the respondents' concern regarding the future solvency of the public safety pension system. Nevertheless, our holding here still allows the legislature to purchase pension rights of some active employees. Furthermore, the legislature may completely amend pension benefits as they involve persons who may someday *in the future* enter into a public safety employment contract with the state.

Booth v. Sims, 193 W. Va. 323, 456 S.E. 2d 167 (1994).

Because this precise issue has not yet been addressed by the Montana Supreme Court, the Court might, in the alternative, adopt the approach taken by the California appellate courts, reviewed on pages 5 and 6 of the August 14 memorandum[8].

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[8] The California appellate courts, applying what other states refer to as the "California rule", apply more of a balancing test to determine whether a contract may be impaired. This approach has not been followed by many other states. The California courts weigh many other factors in determining whether a contract may be impaired. See the list of factors considered by those courts appearing at page 6 of the August 14, 2009, memorandum.

Regardless of which approach is used by the Court, alternatives to the impairment of pension benefit contracts of existing members of a retirement system covered by a GABA are a factor that the Legislature should prudently consider in order to ensure that any legislation is held to be constitutional by the Montana Supreme Court.

III
CONCLUSION

The Contract Clauses of the U.S. Constitution and the Montana Constitutions are not absolute. Exceptions to the prohibition against impairment of contracts do exist. The Montana Supreme Court has, as previously explained[9], adopted the rationale of the U.S. Supreme Court regarding exceptions to the impairment of contracts and even the rationale of the U.S. Supreme Court regarding impairment of the state's own contracts. How the Montana Court will apply the analysis and reasoning in the U.S. Trust Co. opinion to public employment pension benefit contracts remains to be seen. However, if the Legislature intends to change the current GABA to tie it to investment earnings, it would be prudent for the Legislature to: (1) document that that change is not a "substantial" contract impairment, and (2) document why the change in the GABA must be enacted before all other alternatives that do not impair contracts are utilized.

Cl0425 2005dnba.

[9] August 14, 2009, Memorandum, text, page 4, and footnote 12.