COLA Cuts in State and Local Pensions

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Defined benefit promises in the public sector are not as secure as many thought.

One of the more surprising responses of public plan sponsors to the financial crisis and the ensuing recession was their reduction, suspension, or elimination of cost-of-living adjustments (COLA) for current workers and, in a number of cases, current retirees. The response was surprising because it has often been assumed that public plan participants have greater benefit protections than their private sector counterparts. The Employee Retirement Income Security Act of 1974 (ERISA), which governs private pensions, protects accrued benefits but allows employers to change the terms going forward. In contrast, most states have legal provisions that constrain sponsors' ability to make changes to *future* benefits for current workers. Yet they were able to change the COLA for current workers and often for people already receiving it.

Between 2010 and 2013, seventeen states (with a total of 30 plans) enacted legislation that reduced, suspended, or eliminated COLAs for current workers and often for current retirees. The cuts fell into three groups:

1. Three states with seriously underfunded plans – New Jersey, Rhode Island, and Oklahoma – essentially eliminated the COLA for the foreseeable future.
2. Eight states that provided a guaranteed fixed percentage increase each year regardless of inflation – Colorado, Florida, Illinois, Minnesota, Montana, New Mexico, Ohio, and South Dakota — either reduced or temporarily suspended the guarantee or shifted to a Consumer Price Index (CPI)-linked COLA.
3. Six states with CPI-linked COLAs – Connecticut, Maine, Maryland, Oregon,

Washington, and Wyoming – made changes, mainly by reducing minimum or maximum adjustments or linking COLAs to the plan's funded status or the participant's benefit level.

Four states that cut their COLA – Colorado, Illinois, Maine, and Ohio – have plans where workers are not covered by Social Security. If inflation rises to 3 or 4 percent, participants in all four states will see the real value of their entire retirement income erode.

Of the 17 states that changed their COLA, 12 have been challenged in court. The courts have ruled in nine states and in all but one case have upheld the cut. The Rhode Island proposals to cut the COLA withstood the mediation process with only minor changes but police union members subsequently rejected the mediation agreement. The Table summarizes the status of

these suits. Suits have been filed in Illinois and Oregon, but no decisions have been reached.

Table. *Responses to COLA Cuts, 2010-2014*

State	COLA cut upheld	Rationale	Court/process	Date	On appeal
CO	Yes	COLA not a contractual right	State District	2011	Yes
FL	Yes	COLA not protected under applicable State law	State Supreme	2013	
ME	Yes	COLA not a contractual right	US District	2013	
MN	Yes	COLA not a contractual right	State District	2011	
MT	Yes	Complaint dismissed*	State District	2013	
NJ	NA	Complaint dismissed for lack of jurisdiction	US District	2012	
	Yes	Complaint dismissed**	State Superior	2012	Yes
NM	Yes	COLA not a contractual right	State Supreme	2013	
RI	Yes	NA	Mediation	2014	Mediation rejected
SD	Yes	COLA not a contractual right	State Circuit	2012	
WA	No	Illegal impairment of contract	State Superior	2011	Yes

* The court refused to issue a preliminary injunction, finding it was not clear that plaintiffs would be successful in proving that the COLA was protected as a contractual right.
** No written opinion.
Sources: National Association of State Retirement Administrators (2014); National Conference of State Legislatures (1999-2014); Buck (2011 and 2013); and various court cases.

The main rationale for allowing the COLA cut is that COLAs are not considered to be a contractual right. For example, in Colorado, where the decision is currently under appeal, the judge found that the plaintiffs had no vested contract right to a specific COLA amount for life without change and that the plaintiffs could have no reasonable expectation to a specific COLA amount for life given that the General Assembly changed the COLA formula numerous times over the past 40 years. In Minnesota, the judge ruled both that the COLA was not a protected core benefit and that the COLA modification was necessary to prevent the long-term fiscal deterioration of the pension plan. The Courts clearly view COLAs very differently than core

benefits. At this point, the legal hurdles to cutting COLAs appear to be quite low.