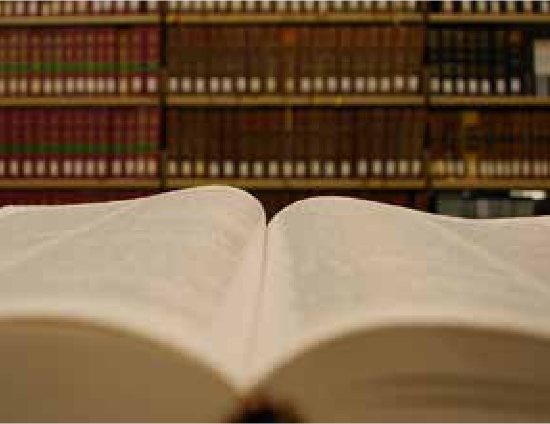

The Battle Between A Parsimonious Municipality and a Covetous Pension Board

By Carolyn Welch Clifford
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Court confirms police officers' salary spikes cannot be factored into retirement pension calculations

A lengthy dispute over spiked pension benefits between a city on one side, and its police pension fund and retirees aligned on the other, was resolved by the First District Appellate Court in the recent case of *City of Countryside v. City of Countryside Police Pension Board of Trustees, et al.*, 2018 IL App (1st) 171029. In a decision written by Justice Mathias W. Delort (a former municipal attorney and pension board trustee), the appellate court considered legal issues ranging from collective bargaining agreements and side letters to the proper funding of pension funds and the constitutional protections of retirement benefits.

While the decision is complicated and lengthy, it provides several fundamental principles of Illinois pension law that are worth reviewing in detail. However, before analyzing these fundamental principles, a review of the underlying facts is necessary.

Background

In 2002 the City of Countryside bargained new contracts for its police officers that contained a longevity benefit of $800 (later, $850) for officers with more than twenty years of service who were "pension-eligible." In order to receive the benefit, the officer had to designate a two-week pay period in which to receive the longevity benefit in either the first half of January or July.

During the negotiation process, the City's labor attorney prepared a memo to City officials indicating that the $850 longevity benefit would increase a retiring officer's salary by $20,400 "for pension purposes." The City's general counsel also opined in writing that the City could bargain with the union for more generous pension benefits than those permitted by state law and that the pension board would be obligated to award pensions based on the collective bargaining agreement.

Later that year, the City's labor attorney and the Fraternal Order of Police's attorney signed a "Side Letter." In the Side Letter, the FOP and City agreed and approved a particular calculation method for the longevity benefit established in the new contracts. Specifically, when an eligible officer took a longevity benefit, the officer's gross salary for pension purposes would be calculated by multiplying the one-time $800 or $850 longevity benefit times twenty-four payroll periods, which resulted in a final salary for pension purposes that was either $19,200 or $20,400 higher than the officer actually received in the prior year. In other words, the Side Letter created a pension benefit spike for police officers at the time of their retirement.

The City adopted a resolution in 2003, authorizing the mayor and clerk to sign the FOP contracts that were attached to the resolution; however, neither the resolution nor the contracts referenced the Side Letter. About ten retiring officers took advantage of the longevity benefit and received retirement pensions calculated under the method described in the Side Letter.

In the years following this agreement, the City's attorneys downplayed any concerns that the Side Letter computation method for spiking retirement benefits might be unlawful. Finally, in 2010, the City's labor attorney requested an advisory opinion from the Illinois Department of Insurance ("DOI") regarding the computation method. The DOI provided a written advisory opinion, in which it noted that under Section 3-125.1 of the Illinois Pension Code, salary for pension purposes is "the annual salary, including longevity, attached to the police officer's rank, as established by the municipality's appropriation ordinance." (40 ILCS 5/3-125.1)

The DOI, however, further noted that under its administrative regulations interpreting the definition of "salary" for pension purposes, when longevity pay is paid in a lump sum, it must be prorated to determine the monthly equivalent. (50 Ill. Adm. Code §4402.35(d)) As a result, the DOI concluded that "only the $850 (1/26th of the annualized increase of $22,100) would be considered pensionable." In a second advisory opinion a few months later, the DOI reiterated its position, adding that the Side Letter had "no bearing" on its interpretation because salary is defined by state law, which cannot be superseded by a collective bargaining agreement.

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Meanwhile, the City retained its own actuary to compute the City's annual contribution to the Fund. In making the calculation, the actuary based the actuarial valuation on the assumption that the Side Letter computation method was illegal and that officer's salary at retirement for pension purposes should be computed by prorating the longevity benefit over twenty-four pay periods rather than annualizing. As a result, the City began funding the Countryside Police Pension Fund at a lower employer contribution amount than the contribution calculation from the Fund's actuary.

In February of 2012, the City filed this lawsuit against the Pension Board. The complaint generally alleged among other things that the Side Letter had created a "systemic miscalculation of benefits" and that the longevity benefit "spikes" were not pensionable salary. The City sought a declaration that the computation method was illegal and a determination that the Pension Board should cease making any further payments to retirees or beneficiaries in which pension spikes had occurred.

The circuit court granted the City's motion for summary judgment, opining that the collective bargaining agreement alone – and not the Side Letter – governed the longevity benefit calculation. The court refused to determine the legality of alleged pension spikes or the issue of funding. It also applied its ruling prospectively only to future retirees and not to any retirees currently receiving benefits. The Pension Board and its retirees eventually filed a counterclaim against the City, alleging that the elimination of the Side Letter computation method was prohibited by the pension protection clause of the Illinois Constitution.

The circuit court again entered an order granting the City's motion for summary judgment. This time, the court rejected the Pension Board's and retirees' reliance on the fact that the City knew about the Side Letter, noting that it was irrelevant because the Side Letter was neither incorporated into any collective bargaining agreement nor adopted by ordinance.

Ultimately, the circuit court concluded: (1) the Pension Board's reliance on the Side Letter was contrary to the Illinois Pension Code; (2) the City was not required to levy taxes or fund the Pension Fund based on the Side Letter; (3) the Pension Board must recalculate the retirees' pension in accordance with the salary in the collective bargaining agreements and award future benefits based on these calculations; and (4) the Pension Board was prohibited from using the Side Letter with respect to any future retirees. The Pension Board and retirees appealed the decision to the First District Appellate Court, which essentially affirmed the circuit court's entire decision. The appellate court determined the Side Letter calculation increasing pension benefits was improper and must be stopped.

Fundamental Principles

Even though the facts and findings of the *City of Countryside* case are complex, they help illustrate seven fundamental principles of Illinois pension law. Each of these principles are reviewed in turn below.

Principle No. 1 – The DOI has the authority to issue regulations governing municipal police and fire pension funds, and its interpretation of statutory provisions should be given substantial weight unless they are arbitrary, capricious or manifestly contrary to the statute.

The Illinois Supreme Court has held that an administrative agency, such as the DOI, has the authority to regulate and execute the provisions of the statute and carry out the powers conferred on it. In this case, the court found that the Illinois Pension Code authorizes the DOI to regulate pension funds, and its conclusions are presumed to be valid so long as they are consistent with the statute's language. The court noted that the DOI's administrative regulation outlining what constitutes salary for pension purposes and how a longevity benefit must be prorated is consistent with the salary-related provisions of the Illinois Pension Code (40 ILCS 5/3-111(a) and 3-125.1). The court also emphasized that the DOI's promulgation of these regulations was a proper exercise of its authority under Section 1A-103 of the Code. Accordingly, the *City of Countryside* serves as a lesson that the DOI's findings will not easily be disturbed on appeal.

Principle No. 2 – "Pensionable salary" must be attached to an officer's rank and specified in the municipality's appropriation ordinance; variable or irregular forms of pay are not pensionable salary.

The court noted that compensation plans for public employees "can be complex," with a variety of new and creative components being created under bargained contracts every year. Sometimes these salary components are pensionable; sometimes they are not. As the court explained:

[W]hile longevity pay can be included in an officer's pensionable salary, both the longevity pay and the base salary used for pension purposes must be attached to the officer's *rank* (that is, not to the officer individually) and, further, that the salary must be that as specified in the municipality's appropriation ordinance . . .

The court further elaborated:

Along the same lines, section 3-125.1 also provides that certain irregular compensation elements, such as overtime, holiday, bonus, and merit pay, are *not* part pensionable salary. The exclusion of these variable or irregular pay elements clearly indicates the legislature's intent that the pensionable salary be based on what the officer regularly received and would continue to receive absent his retirement, and that it not be artificially increased by fortuitous circumstances such as working long overtime hours immediately before retirement.

The court noted that a police officer's contributions to the pension fund are based on the regular salary of the officer. As a result, the DOI's administrative regulation makes it clear that a lump sum longevity benefit must be prorated to a "monthly equivalent to compute all pension contributions and benefits."

Justice Delort noted how "utterly irrational" the Side Letter calculation method was and how it was producing

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"absurd results" when considering the abusive tactics that could be used to provide retiring officers a one-time pay increase during the last hours of an officer's career. Such tactics and calculation methods simply produce pensionable salaries that are unsupported by law, particularly in light of the fact the employee has not made employee contributions into the pension fund for more than a pay period to support the spiked pensionable salary. In short, the retiree pensions in this case were miscalculated by improperly multiplying the longevity benefit by twenty-four pay periods to add it to the pensionable salary of retiring officers.

The court noted that a consistent line of case law has determined that extra pay elements must be duly appropriated by municipal ordinance in order to be considered pensionable salary. In this case, the City never enacted an ordinance appropriating a longevity benefit multiplied by twenty-four pay periods for any of the retirees. The Side Letter was notably never approved by the City Council.

Principle No. 3 – Municipalities have discretion in determining the annual employer contribution to a pension fund, as long as it is computed pursuant to statute, and may use a source of funding other than a property tax levy.

There is a tension in the Illinois Pension Code between the pension board's obligation to request funding and the municipality's obligation to provide funding. Depending on the actuarial assumptions applied, a municipality and pension fund can arrive at different employer contribution requirements. "Not surprisingly, this tension has resulted in litigation grounded in the natural tendency of each side to use actuarial assumptions favorable to its own interests."

Nonetheless, the court found that a municipality is not strictly bound by the actuarially determined calculations for funding generated by the pension board, but instead enjoys some discretion in determining annual employer contribution – as long as it is in accordance with the Illinois Pension Code. In this case, the City provided funding through non-real estate tax sources, and the court concluded that the City was entitled to do so, despite the Pension Board's argument that the statute required the City to levy a property tax to support its annual obligation to the Fund (40 ILCS 5/3-125).

As Justice Delort noted:

> The central holding of cases such as *Evanston, Rockford,* and *Harvey* is that as long as the municipality funds the Board in an amount computed pursuant to section 3-125 of the Pension Code, there is no cause for judicial intervention. The battle between a parsimonious municipality and a covetous pension board over whose actuarial calculations are superior is left to be resolved by the political process, not the courtroom.

Principle No. 4 – The public interest in enforcing the Illinois Pension Code and ensuring the fiscal solvency of a pension fund takes priority over the false expectations of pensioners.

One of the Pension Board's and retirees' arguments was that the City's claims were barred by the doctrine of *laches*, which is an equitable principle that prevents recovery by a litigant whose unreasonable delay in bringing litigation for relief prejudices the rights of another party.

The court concluded that the doctrine of *laches* did not apply in this case, as the case involved the illegal expenditure of public funds. Generally, *laches* is to be applied sparingly against a municipality and only under extraordinary circumstances. As Justice Delort stated:

> While we recognize that the retirees may have proceeded in reliance on the Board's original (but illegal) computations, the public interest in enforcing the Pension Code and ensuring fiscal solvency of the local fund must take priority over the retirees' expectations.

Similarly, the court also concluded the doctrine of equitable estoppel was inapplicable in this case. Equitable estoppel prohibits a party from asserting rights where doing so would create a fraud or injustice on another party. Like *laches*, equitable estoppel also should only be used against a municipality in extraordinary and compelling circumstances.

The Pension Board and retirees argued that the City knew exactly what it was doing in agreeing to the longevity benefit and the cost involved. Furthermore, they argued, the City and the union can agree to give the employees benefits at whatever level they so choose. The court did not agree, finding that the City, the Pension Board, and the employees "all function within a larger system created by state law." To suggest that a city and its union could agree to grant police officers million-dollar-a-year pensions, binding future city administrations, would create an absurd result.

Principle No. 5 – A municipality has the authority to challenge a pension board's fiduciary breaches beyond administrative review.

The Pension Board and retirees had argued that the City waited too long to challenge the Pension Board's decision to grant retirement benefits based on the Side Letter's calculation method. They argued the City was barred by the

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thirty-five-day window under the Illinois Administrative Review Law to appeal the Pension Board's decisions on the retirement benefits. The court disagreed, noting that those cases involve a dispute between a pensioner and the pension fund. Furthermore, other courts have authorized challenges to the actions of pension boards where they involve significant violations of the Illinois Pension Code and seek to ensure the fiscal integrity of the pension fund.

Principle No. 6 – The Pension Protection Clause of the Illinois Constitution does not prevent a court from imposing a remedy to bring retirees' pensions to the correct level permitted by law existing upon their retirements.

The court explicitly rejected the argument that the Illinois Constitution's pension protection clause prevents a court from ever diminishing a retiree's pension, even to eliminate an excess illegal payment or reduce a pension to a level authorized by law. As the court observed:

A host of individuals affiliated with the City, aided by the employees who sat at the bargaining table, constructed a fictitious calculation method based on erroneous advice and used the method to award pensions far higher than those permitted by law. They steadfastly refused to rectify the situation after the DOI admonished them – several times over the course of a number of years – that the method was illegal. Although we understand that some or all of the retirees may have left service in reliance on the advice given to them at the time of retirement, they are nonetheless charged with knowledge of the laws.

In other words, the pension protection clause does not protect against the reduction of a retiree's pension where the basis of that benefit is illegal.

Principle No. 7 – Each monthly benefit payment and annual funding dispute triggers a separate five-year statute of limitations period.

The Pension Fund and retirees had argued that the City's claims were time barred by the five-year statute of limitations applicable to civil actions in Illinois (735 ILCS 5/13-205). The court disagreed. While concerned for the retired officers who had made decisions regarding their retirement and financial plans based on the Side Letter computation method, albeit illegal, the court concluded that the key issue is to apply the five-year limitation based on when the cause of action accrued.

Thus, the court focused on whether the Pension Board's issuance of monthly pension checks to the retirees, based on its

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initial determinations made at the time of retirement for each retiree, is a continuing violation, such that the limitations period would not run until the date of the most recent pension check. The court concluded that each monthly benefit check and annual funding dispute triggers a separate limitations period, and as such, the statute of limitations does not entirely bar the City's claims. In this case, the court limited the City's claims to those arising after February 2007, five years before the City filed the litigation.

The Court's Remedy: Fix the Retirement Benefits Going Forward

Justice Delort noted that counsel for the City confirmed at oral argument that it did not seek to claw back any excess pensions from the retirees, which he opined was fair. He wrote, "It would be manifestly unfair to force the retirees and surviving spouses to pay the City back for pensions received years ago, since the City itself (through the fault of the administration in office in 2002) bears much of the responsibility for this financial fiasco." In summary, the court held:

1. The City's funding may be fulfilled through an actuarial valuation that complies with Section 3-125 of the Pension Code.
2. The retirees' monthly benefits must be recalculated without using the Side Letter calculation method and must be reduced going forward only.
3. Future retirees' benefits must be calculated in the same correct manner, without using the Side Letter calculation method.

The decision settles – hopefully once and for all – many misconceived notions that some municipalities, unions and pension boards have held. They cannot use creative pay schemes and pension spikes to abuse the pension system, and then hide behind procedural limitations and constitutional protections when the unjustly enriched pensions have been called out. Such reliance has always been misplaced; it is refreshing to read Justice Delort's thorough analysis finally dispelling these myths and providing a path to fix these abuses going forward – and hopefully, preventing them in the future. ■

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