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Right to Retirement Benefits: McDermott v. Regan

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RIGHT TO RETIREMENT BENEFITS

N.Y. CONST. art. V, § 7:

After, July first, nineteen hundred forty, membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired.

COURT OF APPEALS

McDermott v. Regan²¹²⁷
(decided November 16, 1993)

Four public employees brought an action under the Nonimpairment Clause of the New York State Constitution²¹²⁸ challenging the constitutionality of Chapter 210 of the Laws of 1990.²¹²⁹ Chapter 210 required the state comptroller to adopt a new method of calculating employer pension contributions.²¹³⁰ The court of appeals held that Chapter 210 violated the Nonimpairment Clause of the New York State Constitution because it expressly adopted a method of computing contributions to the pension fund that significantly increased the level of risk, thus impairing the funds available to meet contractual obligations.²¹³¹ Additionally, it held that Chapter 210 divested the state comptroller of his exercise of autonomous judgment as a trustee over the pension funds for the benefit of the participants.²¹³²

2127. 82 N.Y.2d 354, 624 N.E.2d 985, 604 N.Y.S.2d 890 (1993).

2128. N.Y. CONST. art. V, § 7. The article states in pertinent part: "After July first, nineteen hundred forty, membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired." *Id.*

2129. *McDermott*, 82 N.Y.2d at 358, 624 N.E.2d at 986, 604 N.Y.S.2d at 891. *See also* 1990 N.Y. Laws 210.

2130. 1990 N.Y. Laws 210.

2131. *McDermott*, 82 N.Y.2d at 361, 363, 624 N.E.2d at 989-90, 604 N.Y.S.2d at 894-95.

2132. *Id.* at 360, 624 N.E.2d at 988, 604 N.Y.S.2d at 893.

Between 1921 and 1990, the funding method used by the New York State Retirement System was the Aggregate Cost (AC) method.²¹³³ The AC method resulted in the funding of some benefits before they accrued.²¹³⁴ That created a stable retirement system.²¹³⁵ In 1990, however, the Legislature mandated a change in the funding from the AC method to the Projected Unit Credit (PUC) method.²¹³⁶ The new PUC method required the funding of benefits only after they had accrued.²¹³⁷ The moneys contained in the existing fund exceeded the accrued benefits and therefore created a surplus.²¹³⁸ The state was to return such surplus to the governmental entities in the form of a reduced annual contribution to be paid by the governmental entities.²¹³⁹

In *McDermott*, the court explained that section 11 of the Retirement and Social Security Law²¹⁴⁰ expressly granted the comptroller primary authority and control over the pension fund as trustee.²¹⁴¹ The *McDermott* court stated that the Legislature, by enacting Chapter 210, dictated to the state comptroller the

2133. *Id.* at 358, 624 N.E.2d at 987, 604 N.Y.S.2d at 892.

2134. *Id.*

2135. *Id.* at 359, 624 N.E.2d at 987, 604 N.Y.S.2d at 892.

2136. *Id.*

2137. *Id.*

2138. *Id.*

2139. *Id.*

2140. N.Y. RETIRE. & SOC. SEC. LAW § 11 (McKinney 1987) The statute provides in pertinent part:

The comptroller shall be the administrative head of the retirement system. Subject to the limitations of this article and of law, he shall adopt and may amend, from time to time, rules and regulations for the administration and transaction of the business of the retirement system and for the custody and control of its funds.

Id. Furthermore section 11(g) provides that “The comptroller shall adopt and amend pursuant to this article only such rules and regulations as he determines to be for the best interests of the retirement system and its members.” *Id.*

2141. *McDermott*, 82 N.Y.2d at 363, 624 N.E.2d at 989, 604 N.Y.S.2d at 894; *see also* N.Y. RETIRE. & SOC. SEC. LAW § 13b (McKinney 1987) (“The comptroller shall be trustee of the several funds of the retirement system.”); N.Y. RETIRE. & SOC. SEC. LAW § 313b (McKinney 1987) (“The comptroller shall be trustee of the several funds of the policemen’s and firemen’s retirement system.”).

accounting method to be used to calculate employer pension contributions.²¹⁴² Therefore, the court concluded, Chapter 210 stripped the state comptroller of his authority as a trustee, prevented him from exercising his autonomous judgment in the best interest of the fund, and thus impaired the pension fund in violation of the New York State Constitution Nonimpairment Clause.²¹⁴³

The court said that “close examination is therefore required of any radical change in means chosen to maintain the integrity and security of the [funds].”²¹⁴⁴ Applying the above rule, the court concluded that the implementation of Chapter 210 would require a “radical change.”²¹⁴⁵ “The statute depletes several years of accrued retirement benefits involving millions of dollars and arguably destabilizes the fund.”²¹⁴⁶ In support of its conclusion, the court referred to the Mercer Report relied upon by the state that “warn[ed] that the amortization procedure inherent in the present PUC method, creates an inappropriate level of risk.”²¹⁴⁷ In addition, the risk created by the PUC method, when compared with the AC method which had been used successfully since 1921, led to the conclusion that implementation of the new PUC method would indeed be a “radical change.”²¹⁴⁸

Appellant argued that article V, section 1, of the New York State Constitution²¹⁴⁹ empowered the state to define the state comptroller’s “powers and duties.”²¹⁵⁰ The court, however,

2142. *McDermott*, 82 N.Y.2d at 363, 624 N.E.2d at 989, 604 N.Y.S.2d at 894.

2143. *Id.* at 360, 624 N.E.2d at 988, 604 N.Y.S.2d at 893.

2144. *Id.* at 361, 624 N.E.2d at 988, 604 N.Y.S.2d at 893 (quoting *Sgaglione*, 37 N.Y.2d 507, 512, 337 N.E.2d 592, 595, 375 N.Y.S.2d 79, 83).

2145. *Id.*

2146. *Id.*

2147. *Id.*

2148. *Id.*

2149. N.Y. CONST. art. V, § 1.

2150. *McDermott*, 82 N.Y.2d at 360-61, 624 N.E.2d at 988, 604 N.Y.S.2d at 893. The state argued that the Legislature had the authority, pursuant to article V, section 1, of the New York State Constitution, to define the responsibilities and powers of the State Comptroller, and that under sections 13 and 313 of the Retirement and Social Security Law the comptroller’s duties are

stated that the state must act as a trustee and thus has a fiduciary duty to act in the best interest of the fund in those areas where it has independent authority or where it exercised limited oversight over the comptroller and over the fund.²¹⁵¹ Then, it pointed out that the fiduciary duty was breached here since the fiscal crisis facing the state was the only factor considered by the state when it implemented Chapter 210.²¹⁵² Thus, the court determined that the state failed to act in the best interest of the participants of the fund but instead acted in its own best interest.²¹⁵³

Section 210 of the Laws of 1990 allows the employers to deplete moneys in the existing pension, and thus destabilizes the fund.²¹⁵⁴ The new PUC method reduces the amount of employer contributions, by giving them “credit of a portion of the existing moneys.”²¹⁵⁵ Once the moneys in the fund are reduced, the employers will have to increase their contributions, since less moneys will be available for investment.²¹⁵⁶ Therefore, “return on investment of moneys” will be reduced, and the stability and security provided by the present size of the fund will be impaired.²¹⁵⁷

Therefore, whenever the state enacts legislation that impairs the benefits of the pension fund by divesting the comptroller of his exercise of autonomous judgment for the benefit of the trust and by mandating a procedure that increases the risk factor involved, such legislation will be held unconstitutional.

In *Sgaglione v. Levitt*,²¹⁵⁸ the New York Court of Appeals upheld the comptroller as trustee of certain retirement funds, emphasizing the fact that it included the authority to exercise

limited to management, distribution and investment. *Id.* The court, however, rejected that argument and stated that such provisions are not inconsistent with and do not limit the comptroller’s duty as a trustee. *Id.* at 361-62, 624 N.E.2d at 988-89, 604 N.Y.S.2d at 893-94.

2151. *Id.*

2152. *Id.* at 362, 624 N.E.2d at 989, 604 N.Y.S.2d at 894.

2153. *Id.*

2154. *Id.* at 363, 624 N.E.2d at 989-90, 604 N.Y.S.2d at 894-95.

2155. *Id.*

2156. *Id.*

2157. *Id.*

2158. 37 N.Y.2d 507, 337 N.E.2d 592, 375 N.Y.S.2d 79 (1975).

independent judgment.²¹⁵⁹ In *Sgaglione*, civil service employees' organizations challenged the constitutionality of section 14 of the New York State Financial Emergency Act for the City of New York under the Nonimpairment Clause of the New York State Constitution.²¹⁶⁰ Section 14 mandated that the state comptroller purchase Municipal Assistance Corporation (MAC) bonds with moneys from the employees' retirement fund.²¹⁶¹ The real question, according to the court, was whether such mandate would impair the reserve funds by "depriving the state comptroller of freedom to exercise his independent judgment whether to invest in MAC bonds."²¹⁶² In striking down section 14, the court concluded that because the mandate stripped the state comptroller of any exercise of independent judgment and forced him to follow such mandate, regardless of whether he deemed it advisable or in the interest of the fund, the reserve funds would be impaired.²¹⁶³

According to Federal law, a claim may also be brought against the state under article I, section 10, of the United States Constitution.²¹⁶⁴ That section prohibits states from passing any "Law impairing the Obligation of Contracts."²¹⁶⁵ The analysis under the Contract Clause consists of a two step inquiry. Under this two step analysis, the court must first determine whether there is a substantial impairment of the State's contractual obligations. Second, if there is such an impairment, the court must then determine whether it is "reasonable and necessary to serve an important public purpose."²¹⁶⁶

2159. *Id.* at 513-14, 337 N.E.2d at 596, 375 N.Y.S.2d at 84.

2160. *Id.* at 510, 337 N.E.2d at 594, 375 N.Y.S.2d at 82.

2161. *Id.* at 511, 337 N.E.2d at 594, 375 N.Y.S.2d at 82.

2162. *Id.* at 513-14, 337 N.E.2d at 596, 375 N.Y.S.2d at 84.

2163. *Id.*

2164. U.S. CONST. art. I, § 10.

2165. *Id.*

2166. *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1, 25 (1977) (holding a New Jersey statute unconstitutional because it impaired the state's contractual obligations to bondholders of The Port Authority of New York and New Jersey).

In *Castellano v. Board of Trustees*,²¹⁶⁷ retired police officers challenged the constitutionality of Chapter 876 of the New York Laws of 1970²¹⁶⁸ which confined the benefits of the Variable Supplements Fund (VSF) only to officers retiring after 20 years of service and not under a disability.²¹⁶⁹ Plaintiffs retired early with service related injuries, and thus were not entitled to VSF benefits.²¹⁷⁰ The Second Circuit found “absolutely no impairment of [the] city’s obligation under the collective bargaining agreement.”²¹⁷¹ The court reasoned that the collective bargaining agreement between the city and the Patrolmen Benevolent Association did not determine who would be a beneficiary under VSF, it merely created the fund.²¹⁷² Therefore, the court held, the city did not impair any of its obligations under the collective bargaining agreement, and found no violation of the Contract Clause.²¹⁷³

In conclusion, a plaintiff must keep in mind article I, section 10, of the United States Constitution as well as article V, section 7, of the New York State Constitution when challenging the constitutionality of a statute affecting a pension fund under which he is a beneficiary.

2167. 937 F.2d 752 (2d Cir. 1991).

2168. 1970 N.Y. Laws 876.

2169. *Castellano*, 937 F.2d at 753.

2170. *Id.* at 755.

2171. *Id.* at 757.

2172. *Id.* Chapter 876 confined the benefits to those officers who served at least 20 years and who did not retire because of a disability. 1970 N.Y. Laws 876.

2173. *Castellano*, 937 F.2d at 757.