When Needed Public Pension Reforms Fail or Appear to Be Legally Impossible, What Then?

Are Unbalanced Budgets, Deficits and Government Collapse the Only Answer?

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# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>I.</td>
<td>COMPETING INTERESTS</td>
<td>1</td>
</tr>
<tr>
<td>II.</td>
<td>SHORTCOMINGS OF CURRENT METHODS OF DEALING WITH UNAFFORDABLE AND UNSUSTAINABLE PENSION AND OPEB OBLIGATIONS</td>
<td>3</td>
</tr>
<tr>
<td>A.</td>
<td>Legislation Imposing Pension Adjustment</td>
<td>4</td>
</tr>
<tr>
<td>B.</td>
<td>The Unplanned, Free-Fall Chapter 9 Problem</td>
<td>11</td>
</tr>
<tr>
<td>C.</td>
<td>Treatment of Public Pension Obligations in Chapter 9</td>
<td>12</td>
</tr>
<tr>
<td>1.</td>
<td>The Vallejo Experience</td>
<td>13</td>
</tr>
<tr>
<td>2.</td>
<td>The Stockton Experience</td>
<td>14</td>
</tr>
<tr>
<td>3.</td>
<td>The Detroit Experience</td>
<td>16</td>
</tr>
<tr>
<td>III.</td>
<td>THE PUBLIC PENSION PROBLEM IS NOT SO MUCH A WILLINGNESS TO PAY PROBLEM AS AN INABILITY TO PAY</td>
<td>18</td>
</tr>
<tr>
<td>IV.</td>
<td>POSSIBLE APPROACHES WHEN PENSION REFORM EFFORTS FAIL OR APPEAR TO BE LEGALLY IMPOSSIBLE</td>
<td>19</td>
</tr>
<tr>
<td>A.</td>
<td>Prepackaged Chapter 9</td>
<td>19</td>
</tr>
<tr>
<td>B.</td>
<td>Creation of a Special Federal Bankruptcy Court for Insolvent Public Pension Funds</td>
<td>22</td>
</tr>
<tr>
<td>C.</td>
<td>Government Oversight, Refinance and Debt Adjustment Commission to Assist Where Public Pension Reform Is Otherwise Legally or Practically Impossible</td>
<td>25</td>
</tr>
<tr>
<td>D.</td>
<td>Model Guidelines for a Constitutional Amendment or Legislative Public Pension Funding Policy Where State Constitutional and Statutory Provisions and Court Rulings Appear to Prohibit or Impair Needed Pension Reform</td>
<td>28</td>
</tr>
<tr>
<td>1.</td>
<td>Proposed Model Guidelines for Pension Protection Provisions in State Constitution or Statue</td>
<td>29</td>
</tr>
<tr>
<td>2.</td>
<td>Discussion of Justification and Balancing of Interest for the Proposed Model Guidelines for Constitutional Amendment and Legislation for Public Pension Funding</td>
<td>34</td>
</tr>
<tr>
<td>a.</td>
<td>Existence of a Governmental Emergency</td>
<td>34</td>
</tr>
<tr>
<td>b.</td>
<td>The Amendment Is Required for an Important Public Purpose of Continued Governmental Services at an...</td>
<td></td>
</tr>
</tbody>
</table>
Acceptable Level When Current Pension Obligations Are Not Sustainable and Affordable ........................................34
c. Any Modification or Reduction of Pension Benefits Must Be Appropriate to Preventing the Harm to Public Health, Safety and Welfare .................................................................36
d. Under the Model Guidelines, Any Modification or Reduction of Pension Benefits Must Be Reasonable, Appropriate and Balance the Welfare of Citizens with any Harm to Pension Beneficiaries .........................................................37
   (i) Defaulting on Public Debt Has a Price Paid by All ........................................................................38
   (ii) Mandated Annual Payment of the Actuarially Determined Contributions ....................................39
   (iii) Deference to Legislative Findings .........................................................................................40
3. If No Constitutional Amendment Pursuant to the Model Guidelines to the Pension Protection Clause Is Possible or Required Then the Proposed Model Guidelines Can Be Adopted by Governmental Entities as a Legislative Statement of Public Pension Funding Policy and Enforced Through Litigation, If Necessary .....................................................................................41

V. THE LEGAL JUSTIFICATION FOR THE MODEL GUIDELINES’ PERMITTED IMPAIRMENT OF CONTRACTUAL PUBLIC PENSION RIGHTS FOR A HIGHER PUBLIC PURPOSE: STATES AND LOCAL GOVERNMENT CANNOT ABDICATE THEIR INALIENABLE GOVERNMENTAL POWER TO PROVIDE ESSENTIAL GOVERNMENTAL SERVICES ..................................................................................42

A. The Contract Clause of the United States Constitution Does Not Prevent the Exercise of Police Power ........................................................................................................42

B. In a Government Contractual Relationship, the Government Does Not Surrender Essential Governmental Powers .............................................................................43

B. The United States Supreme Court Recognizes Balancing of Interests as Applied to the Contract Clause .....................................................................................46

VI. CONCLUSION .........................................................................................................................................49
WHEN NEEDED PUBLIC PENSION REFORMS FAIL OR APPEAR TO BE LEGALLY IMPOSSIBLE, WHAT THEN?

The problem of underfunded public pensions confronts a number of states and local governments in the United States. In the past, numerous public employers in the United States have agreed to pension benefits that now appear challenging to afford given current revenues and the increased cost of providing governmental services. Further, this challenge has been exacerbated by past failures to set aside sufficient moneys to meet the pension benefits obligations incurred to date. All of this is occurring on the heels of the Great Recession of 2007, followed by an anemic recovery, and at a time many states and local governments are faced with an aging infrastructure that must be attended to and increased demands for basic public services (sanitation, water, streets, schools, food inspection, fire department, police, ambulance, health and transportation) that must be met. Because the public pension underfunding problem pits the requirement of meeting pension obligations against the need to provide for essential public services, all citizens have an interest in the fair and equitable solution to the dilemma.

Unfortunately, a just and effective method of resolving unaffordable public pension obligations has been elusive for some public governmental employers and employees. This is due in part to promised pension benefits costs exceeding the government’s ability to pay and the failure to fund promptly the incurred obligations. In some cases, solving the problem has been complicated by the lack of any ability to adjust or modify pension benefits to those that are sustainable and affordable to the fullest extent possible without adversely affecting the funding of essential public services. This paper will provide a review of some legal and practical obstacles that have been making needed pension reform and balancing the budget difficult, if not impossible, and will suggest possible new approaches to the problem that have not yet been tried.

I. COMPETING INTERESTS

Just as the federal government was created to establish justice, provide for the common defense and promote the general welfare,¹ the states as co-sovereigns² and municipalities pursuant to state law are expected to serve the citizenry by providing necessary public services in

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¹ U.S. CONSTIT. pmbl.
exchange for the payment of taxes. Generally, public employees, often union members, have performed the public services expected of states and local governments. Those public employees are entitled to be the recipients of pensions upon retirement payable by their public employer. Prior to the mid-1900’s in this country, most public pensions were treated as gratuities, namely, a pay as you go if you desire obligation, that could be modified or eliminated at any time.

It is widely accepted today that public pensions are in the nature of a contract\(^3\) and thus entitled to the benefits of the Contract Clause of the United States, which provides that “[n]o [s]tate shall … pass any … [l]aw impairing the [o]bligation of [c]ontracts.”\(^4\) Despite significant United States Supreme Court jurisprudence that the Contract Clause is qualified by the authority the state possesses to serve the health, safety and welfare of its citizens, an important public purpose,\(^5\) resolution of the competing interests of public pensions and the police power of state and local governments has proved challenging. This is true regardless of arguments that the public safety and welfare require that unaffordable and unsustainable public pension benefits must be addressed successfully.

To the extent a public employer has the ability to meet promised pension benefits, even if it means raising taxes, it should do so. But if raising taxes ultimately will have a negative effect on the financial health of the employer, with a flight of business and individual taxpayers resulting in loss of revenues and less ability to pay pension benefits, raising taxes can result in the dreaded “death spiral.” A balance must be struck so that the public employer can pay public pension obligations to the fullest extent financially possible and assure full funding of necessary services to attract new businesses and increased new, good jobs, thereby creating new tax revenue sources to solve the pension funding issue.\(^6\) Actually, the interests of taxpayers, public

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6. While the National Conference on Public Employee Retirement Systems has released a study purporting to demonstrate that public pensions are net contributors to state and local economies through the investment of pension fund assets, https://www.businesswire.com/news/home/20180516005930/en/NCPERS-Study-Shows-Public-Pensions-Net-Contributors, the study only goes so far. Further analysis must be conducted as
employees, retirees and creditors of the public employer should be aligned in supporting the provision of adequate public services to assure all parties receive what they need. Unfortunately, in the past, some public employers have been unable to strike the necessary balance because of the practical inability of the parties to negotiate needed pension adjustments, as well as the legal obstacles of state constitutional and statutory provisions as well as court rulings that prevent needed pension reform from being enacted and enforced.

II. **SHORTCOMINGS OF CURRENT METHODS OF DEALING WITH UNAFFORDABLE AND UNSUSTAINABLE PENSION AND OPEB OBLIGATIONS**

In the best of all possible worlds, when essential services of a government cannot be appropriately funded due to unaffordable public pension benefits despite raising taxes and reducing unnecessary expenses, voluntarily effective pension reform would occur. Specifically, the beneficiaries of pensions and other post-employment benefits would agree with public employers to voluntary adjustments to maximize the ultimate benefit to all. Some states successfully have implemented constructive pension reform.\(^7\) Since 2009, nearly every state has made meaningful changes to its pension plan benefits structure, financing arrangements or both.\(^8\) However, some of those efforts have faced obstacles in carrying out their goals, and a number of state and local governments have been unable to make sufficient modification or changes to

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\(^7\) See Jean-Pierre Aubry and Caroline V. Crawford, *State and Local Pension Reform Since the Financial Crisis*, 54 CENTER FOR RETIREMENT RESEARCH at BOSTON COLLEGE (Jan. 2017).

public pension benefits to assure that they are sustainable, affordable and do not threaten funding of needed governmental services and infrastructure.9

A. Legislation Imposing Pension Adjustment

The state or municipality by legislation or executive order can enact an adjustment to pension benefits and defend it as an important public purpose and an exercise of police power in order to preserve its essential function of providing governmental services that are affordable and sustainable at an acceptable level. Such pension adjustments must be justified as necessary to

9 While some state and local governments have made progress and have solved, for the most part, any pension underfunding issue that may exist, there still remain a considerable number of about 4,000 public pension plans on behalf of 19.5 million active and former employees that are still troubled by significant underfunding of public pension liabilities. State and Local Government Pensions at a Crossroads, the CPA Journal (April 2017) https://www.cpajournal.com/2017/05/08/state-local-government-pensions-crossroads/; State and Local Government Pensions, Urban Institute http://www.urban.org/policy-centers/cross-center-initiatives/state-local-finance-initiative/projects/state-and-local-backgrounders/state-and-local-government-pensions:

As Bloomberg has reported:

“According to Hidden Debt, Hidden Deficits, a 2017 data-rich study of US pension systems by Hoover Institution Senior Fellow Joshua Rauh, almost every state or local government has an unbalanced budget–due to runaway pension fund costs that are continually chipping away at already inadequate budgets.

In 2016, Rauh stated, “while state and local governments across the US largely claimed they ran balanced budgets, in fact they ran deficits through their pension systems of $167 billion.” That amounts to 189.2% of state and local governments’ total tax revenue.

According to the 2017 report, total unfunded pension liabilities have reached $3.85 trillion. That’s 434 billion more than last year. Amazingly, of that $3.85 trillion, only $1.38 trillion was recognized by state and local governments.”


According to Bloomberg, as of 2016, five states have pension funding level of less than 50% (namely New Jersey, Kentucky, Illinois, Connecticut and Colorado), six additional states had public pension funding below 60% and above 50% (Pennsylvania, Minnesota, South Carolina, Rhode Island, Massachusetts and New Hampshire). Another nine states had pension funding below 70% and above 60% (Louisiana, Indiana, Michigan, Vermont, Maryland, Kansas, New Mexico, North Dakota and Alabama). Twenty-two states have public pension funding of less than 70% of liabilities as of 2016. Id.

make the pensions sustainable and affordable and the least drastic action available.\textsuperscript{10} As noted, since the crisis of 2008, many states have enacted meaningful reform to pension plans.\textsuperscript{11}

Further, since 2009, there have been over twenty-six major state court decisions dealing with pension reforms by state and local governments.\textsuperscript{12} Over seventy-five percent (20 out of 26) of those decisions affirmed the pension reform, which covered reduction of benefits, including cost of living adjustments, or increase of employee contributions, as well as plan conversion and other necessary reforms.\textsuperscript{13} Many times, those decisions cited the higher public purpose of assuring funding for essential governmental services and infrastructure. Many of the cases where pension reform was approved cited United States Supreme Court decisions that contracts can be impaired by state and local governments for a higher public purpose of the health, safety and welfare of their citizens that outweighs any legal argument that the contracts are sacrosanct.\textsuperscript{14} In a government contractual relationship, the government does not surrender its essential

\begin{itemize}
  \item \textsuperscript{10} See \textit{U.S. Trust Co. of N.Y. v. N.J.}, 431 U.S. 1 (1977).
  \item \textsuperscript{11} Keith Brainard and Alex Brown, \textit{Spotlight on Significant Reforms to State Retirement Systems}, NATIONAL ASSOCIATION OF STATE RETIREMENT ADMINISTRATORS (June 2016), www.nasra.org/files/spotlight/significant%20reforms.pdf.
  \item \textsuperscript{12} See Id., WILAMETTE, fn. 29.
  \item \textsuperscript{13} Between 2009-2016, there were 20 states with courts that ruled in favor of pension reform out of over 26 states that had courts that ruled on pension reform issues. These decisions dealt with increased employee contributions, suspended or reduced cost of living adjustments, elimination of spiking, plan conversion, elimination of early retirement incentives, changes in final salary calculation and elimination of gainsharing. Some of the states that ruled favorably on some form of pension reform were Alabama, California, Colorado, Florida, Georgia, Idaho, Kentucky, Maine, Massachusetts, Michigan, New Hampshire, New Jersey, New Mexico, Ohio, Rhode Island, South Dakota, Tennessee, Texas, Washington, and Wisconsin. Also, the territory of Puerto Rico had a favorable ruling on pension reform. Hernandez v. Commonwealth, 188 D.P.R. 828 (2013) (translation).
  \item \textsuperscript{14} For nearly 200 years, courts have held that legislatures lack the power to “surrende[r] an essential attribute of [their] sovereignty” or “bargain away the police power of a State” \textit{U.S. Trust Co. of N.Y. v. N.J.}, 431 U.S. 1, 23 (1977) (quoting \textit{Stone v. Miss.}, 101 U.S. 814, 817 (1880)). As the U.S. Supreme Court explained in \textit{Butchers’ Union Slaughter-House & Live-Stock Landing Co. v. Crescent City Live-Stock Landing & Slaughter-House Co.}, 111 U.S. 746, 751 (1884), “[t]he preservation of [the public health and morals] is so necessary to the best interests of social organization, that a wise policy forbids the legislative body to divest itself of the power to enact laws for the preservation of health and the repression of crime.” \textit{See also Home Bldg. & Loan Ass’n v. Blaisdell}, 290 U.S. 398, 436-437 (1934) (collecting Supreme Court authority). This has been recognized by recent state court rulings. \textit{See e.g. Justus v. State of Colo.}, 336 P.3d 202 (Colo. 2014) (distinguishing true contract obligations from public policy to be changed by the legislature). Hernandez v. Commonwealth, 188 D.P.R. 828 (2013) (translation) (recognizing U.S. Supreme Court precedent for impairing pension contractual rights for a higher public purpose).
\end{itemize}
governmental power such as the police power to protect the health, safety and welfare of its citizens.15

However, the ability of state legislation modifying pension obligations to withstand legal challenges is by no means assured. This is particularly true in states that have constitutional provisions that prohibit the state from reducing pension benefits. The State of New York’s Constitution provides “…membership in any pension or retirement systems of the state or of a work division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired.”16 The highest court of that state has found that legislation that reduced benefits payable upon the death of employees violated the Constitution.17

The Illinois State Constitution contains similar language: “Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which

15 This principle that a state may not alienate the basic police power “is one of the great purposes for which the State government was brought into existence” and has been recognized by the courts of various states. E.G., Chicago, R. I. & P. Ry. Co. v. Taylor, 192 P. 349,356 (Okl. 1920) (“As neither the state nor the municipality can surrender by contract the [police] power ***, a contract purporting to do so is void ab initio, and, being void, it is impossible to speak of laws in conflict with its terms as impairing the obligations of a contract”); Brick Presbyterian Church v. City of N.Y., 5 Cow. 538, 542 (N.Y. Sup. Ct. 1826). It has been described in leading treatises. E.g., Thomas M. Cooley, A TREATISE ON THE CONSTITUTIONAL LIMITATIONS WHICH REST UPON THE LEGISLATIVE POWER OF THE STATES OF THE AMERICAN UNION 283 (1868) (“the prevailing opinion” is “that the state could not barter away, or in any manner abridge or weaken, any of those essential powers which are inherent in all governments” and “that any contracts to that end cannot be enforced under the provision of the national Constitution now under consideration”); Christopher G. Tiedman, A TREATISE ON THE LIMITATIONS OF POLICE POWER IN THE UNITED STATES 580-581 (1886) (it has “been often decided, in the American courts, federal and state, that the state cannot *** in any way curtail its exercise of any of those powers, which are essential attributes of sovereignty, and particularly the police power”). The very “maintenance of a government” at all requires that a state “retain[n] adequate authority to secure the peace and good order of society”: the “necessary residuum of state power” is that “the state *** continues to possess authority to safeguard the vital interests of its people.” Home Bldg. & Loan Ass’n, 290 U.S. 398, 434-435 (1934). And those vital interests extend to the economic well-being of the state as well as to public order and safety. As the Supreme Court has said, “[t]he economic interests of the state may justify the exercise of its continuing and dominant protective power ***.” Id. at 437.


shall not be diminished or impaired.” The history of the application of that pension protection clause by the Illinois courts demonstrates the challenge that pension reform legislation may face.

In 2013, Illinois enacted pension reform legislation that provided an estimated $160 billion in savings over a 30-year period. The legislation was struck down by the Illinois Supreme Court as unconstitutional. The Illinois Supreme Court held the reform legislation was unconstitutional under the pension protection clause of the Illinois Constitution Art. XIII § 5 whereby, according to the Illinois court, benefits accrue to the public worker once an individual begins work and becomes a member of a public retirement system, and those contractual provisions cannot be impaired or diminished even in the face of an important public purpose argument. The court held that there could be no exercise of police power to disregard the express provision of the pension protection clause, and the failure of the legislature to act consistent with the pension protection clause in the face of the well-known need for funding of the unfunded pension obligations undermines the police power argument.

The state had argued as an affirmative defense the police power of the state, namely that funding for the pension systems and state finances in general have become so dire that the Illinois General Assembly is authorized, even compelled, to invoke the state’s “reserved sovereign powers,” its police powers, to override the rights and protections set forth in the pension protection clause of the Illinois Constitution in the interests of the greater public good. In dismissing this affirmative defense, the Illinois Supreme Court found that the funding problems were clearly foreseeable and due in large part to the prior actions of the Illinois General Assembly. The Illinois Supreme Court appeared to be preoccupied with the failure of the Illinois legislature to raise taxes and address the pension underfunding issue as opposed to the adverse

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19 In re Pension Reform Litg., 2015 IL 118585 (2015). In this state pension reform case, over ten separate amicus curiae briefs in support of the state reforms were filed with the court but, in an unusual move by the Illinois Supreme Court, each of these amicus curiae briefs was stricken and not considered due to the objection of the labor representatives that it would take too much time for the labor representatives to respond to the amici curiae arguments. Some of the arguments and footnotes herein are taken from those amici curiae briefs. We may wonder if the result or language of the court’s opinion would have changed if the amici curiae arguments were considered by the court.
effect to citizens due to the crowding out of funding for essential governmental services caused by paying unaffordable pension benefits.\textsuperscript{20}

The following year, the Illinois Supreme Court invalidated the City of Chicago Labor Pension Reform.\textsuperscript{21} The Illinois Supreme Court, consistent with its earlier decision, ruled that the annuity reducing provisions of a public act, which amended the Illinois Pension Code as it pertains to certain City of Chicago pension funds, contravened the pension protection clause and that exigent circumstances were no justification for such reduction. The argument that the public act contained a number of provisions which in sum provided a net benefit to employees by strengthening the system was rejected.\textsuperscript{22} The court found that there can be no net benefit when the legislation was only offering what the employees were already guaranteed.

\textsuperscript{20} From the State of Illinois’ perspective, pension contributions from general funds more than quadrupled to $6.9 billion in FY2017 from $1.6 billion in FY2008 and are expected to increase to $7.0 billion in FY2018 or approaching 23% of the general fund revenues in FY2018. The State of Illinois’ unpaid bills reached $6.997 billion by FY2016 and were, as of the end of FY2017, approximately $14.7 billion. According to the Civic Federation, by the end of FY2016, the State of Illinois unfunded liability had grown to $129.1 billion based on the market value of assets and funded ratio about 40%, which is one of the lowest among the states.

In 1995, when the state enacted previous pension reform legislation, the unfunded pension obligation for the State of Illinois was $19.8 billion. There has been a 650% increase in the unfunded pension obligations over the last 20 years to $129.1 billion. The unfunded pension fund liability for the state’s pension plans as of FY2016 is approximately 333% of the State of Illinois general fund revenues for FY2016. Pension obligations being underfunded by 100% to 200% of annual revenues collected by government is a very difficult challenge but underfunding exceeding 300% of a government’s annual revenues collected is fatal to government services and clearly unaffordable and unsustainable. See Civic Federation, State of Illinois FY2019 Budget Roadmap (February 9, 2018) (https://civicfed.org/sites/default/files/1320668288866.pdf).

Michael Cembalest of J.P. Morgan Asset Management, in his 2014 Report (https://www.jpmorgan.com/jpmpdf/1320668288866.pdf) and 2016 Report (https://www.jpmorgan.com/jpmpdf/1320702681156.pdf), calculated that approximately 40% of Illinois’ state revenue collected over the next 30-year period would be required to pay (a) interest on bonded debt, and the state’s share of (b) defined benefit plan actuarially required contributions (ARC), (c) retiree health care costs, and (d) defined contribution plan expenses with level payments and a 6% pension investment return. This is a clear demonstration of crowding out needed funding of governmental services. Only eleven other states are above 15% of state revenues collected, and only three states, including Illinois, are above 25%. Illinois had the highest percentage of revenues collected required to pay pension underfunding obligations at approximately 40% of state revenues collected over a 30-year period.


\textsuperscript{22} The City had interesting and appealing arguments that it had offered new consideration in increased pension payments above those required by statutes and that, under Illinois law, the City was not liable to pay more than the statutory formula required, which they had fully complied with each year. See Section
Efforts to legislate pension reform in California are restricted by the so-called “California Rule,” a court-imposed principle which limits the ability to modify pension obligations. The California Rule provides that while pensions may be modified in “reasonable” ways, 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.”

The California Public Employee Pension Reform Act of 2012 (“PEPRA”) has been estimated to save between $42 billion to $55 billion for the California Public Employees’ Retirement System (“CalPERS”) and $27.7 billion for the California State Teachers’ Retirement System (“CalSTRS”). PEPRA is now being attacked in the CalFire, Marin County and Alameda County litigation regarding PEPRA’s prohibition on pension spiking. The application of the California Rule, that any change in pension benefits that results in a disadvantage cannot be made without an accompanying advantage, was rejected by the California Appellate Court in several recent decisions, and appeals to the California Supreme Court raise the issue of reversal or modification of the California Rule that creates an obstacle to prospective modification of pension benefits. The appellate court in the Marin County case, explaining the Allen decision, declared: “There is nothing in the opinion linking the reduction to provision of

22-403 of the Illinois Pension Code. The State of Illinois in legislation has set forth for Chicago a statutory formula for the annual funding payment for pension liability. The City had dutifully paid what the state statute mandated. However, the legislative formula bore no practical relationship to the actual pension liabilities incurred in that year or prior years, so this mismatch created a significant amount of underfunding over the years. The City in its proposed pension reform offered to make payments significantly in excess of the statutory formula amount that were not required by statute to be made. This was a real benefit to the public workers since state court rulings prohibited courts from ordering public employers to make additional payments absent the insolvency of the pension fund. See McNamee v. The State of Ill., 173 Ill. 2d 433 (1996), People ex rel. Sklodowski v. State of Ill., 182 Ill. 2d 220 (1998).


some new compensating benefit … In the light of the foregoing, we cannot conclude that Allen v. Board of Administration in 1983 was meant to introduce an inflexible hardening of the traditional formula for public employee pension modification.  

26 The Appellate Court in the Marin County case also declared: “… while a public employee does have a ‘vested right’ to a pension, that right is only to a ‘reasonable’ pension – not an immutable entitlement to the most optimal formula of calculating the pension. And the Legislature may, prior to the employee’s retirement, alter the formula, thereby reducing the anticipated pension. So long as the Legislature’s modifications do not deprive the employee of a ‘reasonable’ pension, there is no constitutional violation.” 27 This Marin County litigation has been pending for a number of years with no prompt resolution in sight. The CalFire appeal to the California Supreme Court is now fully briefed and ready for oral arguments and ruling.

Illinois and California are not the only states that have struggled post-2008 to validate public pension reform. Oregon and Montana courts cited the failure of the proponents of reform to prove a balancing of equities in favor of reform for a higher public purpose. 28 Another state, Arizona, included state court judges in the reform that increased employee contributions and reduced cost of living increases, which was found to have violated the Contract Clause and another of that state’s constitutional provisions about improper influence over judicial officers

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26 Marin Assoc. of Public Emp. v. Marin Cnty. Emp. Retirement Assoc., 2 Cal. App. 5th at 699. The need in California for reasonable flexibility for needed public pension modification was demonstrated in a recent study examining 14 California jurisdictions. This study found that, from 2002-03 to 2017-18, these jurisdictions were forced to increase pension contributions by more than 400% on average. Joe Nation, Pension Math: Public Pension Spending and Service Crowd Out in California, 2003-2030, at x (2018) (hereinafter, “Nation Report”), available at https://siepr.stanford.edu/research/publications/pension-math-public-spending-and-service-crowd-out-california-2003/. The result of such drastic increased pension contribution was that these local government were forced to cut important programs, such as “social, welfare and educational services, as well as … libraries, recreation, and community services.” Id. at xi. Some local governments were forced to threaten public safety such as the City of Valeho experienced, in large part because of rising pension costs. The City of Vallejo was forced to slash employment in its police department from 221 to 143, and in its fire department from 133 to 94. Id. at 60. These drastic measures were not enough to keep pension costs under control. Between 2008 and 2015, debt for these 14 local government pension systems soared from $11.8 billion to nearly $120 billion—an increase of more than 900%. Id. at 84.

27 Id. at 680.

during service.\textsuperscript{29} The Arizona Supreme Court ruled the “needed” reform unconstitutional. Recently, police and firefighters in Arizona recognized the need for a sustainable and affordable pension fund, in the best interest of both themselves as the employees and their government employers, and agreed to pension adjustments with a one-time constitutional amendment setting forth the sustainable and needed pension reform.\textsuperscript{30} However, the Arizona Supreme Court decision still stands as a possible obstacle to any future public employer public pension reform efforts other than as accomplished by the Proposition 124 method. The Illinois Supreme Court rulings on state and local government pension reform efforts appear to stand strongly against pension reform even for a higher public purpose or as a reasonable effort to save an insolvent public employer and its pension system.

What is clear from the foregoing discussion of legislation to impose pension reform is that, depending upon the legal and political climate in the state, this path is time-consuming, subject to lengthy and expensive litigation, and not the most effective forum to resolve the competing interests. Does the use of Chapter 9 municipal bankruptcy provide an acceptable solution?

\textbf{B. The Unplanned, Free-Fall Chapter 9 Problem}

While the case law emerging from recent Chapter 9 cases has reinforced the ability to modify pension obligations in the proceeding, political pressure has diluted the Chapter’s effectiveness. Chapter 9 of the United States Bankruptcy Code,\textsuperscript{31} governs the adjustment of debt

\begin{itemize}
\item \textsuperscript{31} 11 U.S.C. § 901 \textit{et seq.}
\end{itemize}
of municipalities. Only the municipality itself can initiate a Chapter 9 proceeding; there can be no involuntary case. In order to be able to institute a Chapter 9 proceeding, the municipality must be specifically authorized by state law and less than half of states have generally authorized their municipalities to file Chapter 9. While Chapter 9 cases are rare (only 680 cases since 1937), some municipalities, faced with debt obligations, including public pensions that dwarf their resources, have resorted to Chapter 9 protection without any prior extensive planning or effort to resolve their financial difficulties or agreement with creditor constituencies as to the resolution of debts. In bankruptcy parlance, such a filing is deemed “free-fall” since the fate of the municipality and its competing creditors is played out in the unscripted drama of the bankruptcy court without any prior agreement or pre-planning of the intended result and subject to the uncertainty of court rulings and the aggressive arguments of various stakeholders. As a result, a free-fall Chapter 9 case by a city of any size is likely to be lengthy and costly. Interestingly, the legal treatment of the ability to adjust public pensions by the courts in Chapter 9 cases has been fairly consistent.

C. Treatment of Public Pension Obligations in Chapter 9

The bankruptcy proceedings involving the City of Stockton, California and the City of Detroit, Michigan have brought to the forefront the treatment of municipal pensions as a matter of law in a Chapter 9 bankruptcy proceeding. In these proceedings, the bankruptcy courts

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32 For a detailed discussion of Chapter 9 and its unique characteristics, particularly regarding secured claims see James E. Spiotto, MUNICIPALITIES IN DISTRESS (2d ed.) (Chapman and Cutler LLP 2016) available at Amazon.


34 Twelve states have statutory provisions specifically authorizing the filing of a Chapter 9 petition by an in-state municipality: Alabama, Arizona, Arkansas, Idaho, Minnesota, Missouri, Montana, Nebraska, Oklahoma, South Carolina, Texas and Washington. Another 12 states authorizing a filing conditioned on a further act of the state, an elected official or a state entity or through some other required process like use of a neutral evaluator mechanism: California, Connecticut, Florida, Kentucky, Louisiana, Michigan, New Jersey, New York, North Carolina, Ohio, Pennsylvania and Rhode Island. Three states grant limited authorization: Colorado, Illinois and Oregon and two states prohibit filing (Georgia and Iowa), but Iowa has an exception to the prohibition. The remaining 21 states either are unclear or do not provide specific authorization with respect to filing as part of their state law. The District of Columbia and Puerto Rico, including municipalities in Puerto Rico, are not permitted to file Chapter 9 pursuant to the terms of the Bankruptcy Code although a special statute known as PROMESA governs the insolvency of Puerto Rico. Pub. L. No. 114-187, 130 Stat. 549 (2016).
determined that the pension agreements were executory contracts and thus a municipality could alter its pension obligations in a Chapter 9 proceeding, even if a constitutional provision existed providing that such contractual obligations could not be altered.\textsuperscript{35} These cases have shown that, absent a settlement, pension obligations of a municipality, as a matter of law, can be treated equally with other unsecured debt with limited recovery. An earlier case set the stage for this result.

1. The Vallejo Experience

The City of Vallejo, California, filed for Chapter 9 in 2008. The principal causes of the filing were unsustainable public employee compensation and pension packages. In the Vallejo case, the debtor filed a motion to reject collective bargaining agreements, which was met by protracted litigation and ultimately with the unions agreeing to certain modifications of benefits given the court’s ruling that the agreements could be rejected. However, Vallejo chose not to adjust the pension payments for current retirees because of the penalties CalPERS would impose in the event of failure to make the originally scheduled payments. This policy prohibited altering benefits of those already in the system even though benefit reduction was a part of the rationale for the bankruptcy filing. Current employees were asked to pay an increasing cost of their medical coverage. Further, for current employees, Vallejo was able to do away with such contractual obligations as binding arbitration and minimum manning for the fire department. The city also eliminated a contract provision that required the city to pay firefighters an average of what their peers made in ten area cities, including major cities like Sacramento, the state capital. There were dramatic cuts in public safety with the budgets of the police and fire departments slashed by almost 50 percent and resulting response times by first responders rivalling the worst anywhere.\textsuperscript{36} Interest payments to bondholders were to be suspended for three and half years. About ten million dollars in legal fees were spent by the city in the process.\textsuperscript{37} Unfortunately, the


austerity required by the plan of adjustment did not lead to prompt economic recovery or even a balanced budget. By 2014, Vallejo had a budget deficit, and there were claims that municipal services were less than during the crisis.38 Thus, in Vallejo, even where the court held that public pensions could be impaired, the bargaining power by CalPERS to increase required pension payments if reduction was attempted by the public employer debtor essentially precluded any resolution of the pension crisis through Chapter 9. After Vallejo confirmed a plan of debt adjustment with changes to labor costs but no impairment of pension benefits, it still could not provide essential services at an acceptable level and there was talk of a second bankruptcy filing.39

2. The Stockton Experience

In the Vallejo case, at issue was the collective bargaining agreement affecting current employees. The pension benefits that were the subject of Stockton and Detroit Chapter 9’s included accrued benefits. The Stockton court’s initial opinion ruled that the bankruptcy court had no power to require the debtor to keep paying for retirees’ health benefits in Chapter 9.40 In the decision confirming the plan of debt adjustment, the Stockton bankruptcy court held that, as a


Melanie Hicken, Once Bankrupt, Vallejo Still Can’t Afford Its Pricey Pensions, CNN MONEY (March 10, 2014). The adverse effect of unaffordable public pension costs for Vallejo has continued. The City of Vallejo saw its pension contributions zoom from 3.1% of operating expenses in 2003-04 to 15.2% in 2017-18. Nation Report at 58. As noted above, in footnote 26, to pay for that astronomical increase and other rising costs, the City had no choice but to slash its workforce from 2004 to 2014. Id. at 60. By 2029-30, the City will likely be spending between 23.7% and 27.3% of its total budget on pensions—an increase of 665% to 781%. Id. That could force the City to cut the police and fire departments by another 33%, or cut the budget by 12% across the board. Id. at 61. This threatens not only the health and safety of its citizens but the long-term sustainability of government which is the predicate for continued public employment and pension payments.

matter of law, the city’s pension administration contract with CalPERS, as well as the city-sponsored pensions themselves, may be adjusted as part of a Chapter 9 plan.\textsuperscript{41} Stockton chose to adjust health care payments but not to impair or adjust pension payments to retirees despite the court’s recognition that both could be impaired. The purported reasoning of the city was that, under the terms of contractual arrangements with CalPERS, penalties imposed on any modification of pension benefits were too severe to justify impairment. Despite protests from a large debt holder, the court found that employees and retirees were sharing the pain with capital market creditors at least as to the treatment of healthcare benefit claims. At the same time, pensions received more than certain other unsecured creditor groups due to the municipality’s fear that, as a practical matter, no modification could be made because failure to make CalPERS’ required payment on the originally scheduled unadjusted pension benefit would subject the municipal pension fund to a penalty for changes or termination of the old pension plan, namely, a very unfavorable discounted value of pension assets is used for a re-evaluation of pension assets thereby significantly increasing unfunded liabilities.\textsuperscript{42} A similar result was achieved in the San

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41 AMENDED OPINION REGARDING CONFIRMATION AND STATUS OF CALPERS, In re City of Stockton, Cal., 526 B.R. 35 (Bankr. E.D. Cal. 2015, aff’d 542 B.R. 261 (9th Cir. BAP Dec. 11, 2015).

42 Mary Williams Walsh, Judge Approves Bankruptcy Exit for Stockton, Calif., NEW YORK TIMES (Oct. 30, 2014), https://dealbook.nytimes.com/2014/10/30/judge-approves-bankruptcy-exit-for-stockton-calif/. In Stockton, “The termination fee has been contentious issue for years, surfacing most notably in the Stockton bankruptcy case. The city tried to get out from underneath its $370 million unfunded liabilities by switching pension providers. In response, CalPERS produced a bill for $1.6 billion, which Judge Christopher Klein likened to at ‘poison pill’.”

“Out of the ashes of the Great Recession – after losing about $100 billion in investments – CalPERS began thinking more conservatively. In 2011, it slashed the anticipated rate of returns on investments. From 7.75 to 3.8 percent, for agencies looking to quite the system. In which case CalPERS would continue to manage the pensions of retired employees but shift the funds to a lower yield account. It wound up raising the termination fee. By a lot.”

Jesse Marx, “Leaving CalPERS Could Cost Agency One-Third of Its Budget” Desert Sun (May 17, 2016) https://www.desert sun.com/story/news/2016/05/12/leave-calpers-citrus-district-nees-half-million/81666626/ ("J. Marx"). Four retired city employees of the town of Loyalton, California had their pension sliced by CalPERS because the town defaulted on its payment to the fund. CalPERS levied a $1.66 million “termination fee” on the town of Loyalton with about 760 population and an annual budget of less than $1 million and “hundreds of other government employees across the state may soon face a similar fate.” Phil Willon, “This Tiny Sierra Valley Town Voted to Pull Out of CalPERS: Now Retirees Are Seeing Their Pensions Slashed” L.A. Times (August 2017),https://www.latimes.com/politics/la-pol-ca-loyalton-calpers-pension-problems-20170806-htmlstory.html; see also, How to Leave CalPERS Without Paying a
Bernardino Chapter 9, where the court confirmed a plan in which retiree pension benefits were not modified and where the court found that the City was unable to maintain a sustainable workforce without providing CalPERS pension benefits.

3. The Detroit Experience

Citing Stockton, the bankruptcy court in the Detroit, Michigan Chapter 9 proceeding specifically held that, in Chapter 9, the bankruptcy court had the power “to impair contracts and to impair contractual rights relating to accrued vested pension benefits. Impairing contracts is what the bankruptcy process does.” Nonetheless, under the negotiated compromise plan of debt adjustment in Detroit, certain unsecured creditor groups received less than the beneficiaries of the pension plans.

In the city of Detroit’s bankruptcy, as a part of a settlement with the city, the city’s pensioners recovered an initial 82 percent of the amount which they had been promised by the city before its bankruptcy proceeding. With respect to the city of Stockton, although Stockton’s bankruptcy plan of adjustment did not impair the city’s pension obligations, as a part of a settlement with the city, the lifetime health care that had been promised to certain retirees was eliminated in exchange for a onetime payment of $5.1 million into a retirees’ health care trust. As indicated above, the court in Stockton repeatedly noted that the obligation to CalPERS


Riverside County Pest Control District #2 in September 2015 “decided to walk away from California Public Employees’ Retirement System which manages the investment and retirement benefits. Although the District account was more than 140 percent funded in 2014.” The District thought the termination fee would be $90,000 but by March 2016 “the fee climbed to $447,000 – a third of the agency’s annual budget.” J.Marx


could be impaired if necessary to have a viable plan but because of the cost to Stockton in failing to make original unadjusted scheduled pension payments would result in a “penalty” discount to the valuation of pension assets and increased future costs, Stockton chose in its plan of debt adjustment not to impair the prepetition obligation to CalPERS.\footnote{Marc Lifsher and Melody Petersen, Judge Approves Stockton Bankruptcy Plan; Worker’s Pensions Safe, LA Times (Oct. 30, 2014), http://www.latimes.com/business/la-fi-stockton-pension-court-ruling-cuts-20141029-story.html.}

The Detroit case in particular demonstrates the inefficiency of a free-fall Chapter 9 as a vehicle to resolve the pension problems of major cities. The Detroit bankruptcy proceedings were contentious and ultimately resulted in settlements among the various constituencies, providing little in guidance for future Chapter 9 proceedings by similar-sized municipalities, should such filings occur. Indeed, professional fees of over $170 million were paid by the city or by the state of Michigan in connection with the Detroit bankruptcy.\footnote{See Amended Opinion and Order Regarding the Reasonableness of Fees Under 11 U.S.C. Sec. 943(b)(3), In re City of Detroit, Mich., Case No. 13-53846 (Bankr. E.D. Mich. Feb. 12, 2015), ECF No. 9257.} This figure should and has provided pause to both municipalities and creditors and evidence that if they can, the various constituencies with respect to a municipal restructuring should attempt to reach a consensus on pension issues outside of the free-fall Chapter 9 process.\footnote{It should be noted that since July 2013, when Detroit filed for Chapter 9, no city, county, village or town has filed for Chapter 9 except Hillview, Kentucky, a town of a population of approximately 8,000. Hillview dismissed the case without filing a plan of debt adjustment (having settled with a judgment creditor that was the primary cause for filing the Chapter 9). In re City of Hillview, Ken., Case No. 15-32679 (Bankr. W.D. Ken. 2015).}

Neither a resort to legislation imposing pension adjustments nor the institution of a free-fall Chapter 9 proceeding to impose adjustment on inflexible public pension rights have proven particularly suited to resolving the complex problem of dealing with promised pensions that simply are unaffordable. Ultimately, these methods are less than successful because they do not focus on or do not mitigate the real source of the problem.
III. **THE PUBLIC PENSION PROBLEM IS NOT SO MUCH A WILLINGNESS TO PAY PROBLEM AS AN INABILITY TO PAY**

While failure of a state or local government to fully fund its annual actuarially determined contribution should never be condoned, it many times can be explained. Efforts to offset the effects of: (a) economic downturns, (b) lack of economic growth, (c) losses of population, jobs and related business, and (d) increased costs of services, infrastructure improvements and repairs have resulted in budget crises and deficits and accompanying underfunded pension obligations. The saga of Detroit and many other cities has demonstrated that raising taxes and lowering services do not produce more tax revenues and a balanced budget. In fact, this process causes citizens and businesses to flee with the resulting reduction in tax revenues collected due to the loss of taxpayers and a corresponding loss of economic growth. The resulting practical reality is state and local governments cannot pay what they do not have funds to pay. Demanding full payment of unaffordable pension benefits many times means shorting the funding of essential services and needed infrastructure improvements. This results in the economic meltdown of the government employer and continuing decreasing funds available to pay employees and pension obligations. The only real solution to economic meltdown of a state or local government is economic development and growth through reinvestment in the government and providing the services and infrastructure at an acceptable level to attract new businesses, jobs, and residents with the resulting increase in taxpayers and tax revenues. The inability to enact needed public pension reform can be fatal to this needed economic recovery that would benefit workers, retirees, taxpayers and creditors.

If reform efforts fail or necessary constructive reform appears to be legally impossible (such as in Illinois given the state Supreme Court decisions and in California due to CalPERS’ required contributions and the California Rule etc.), what can be done? The reality of public pension reform is that the problem has been percolating for so long there may well be situations where voluntary reform is not possible, any actual reforms on a prospective basis or on what appears to be within the restrictions of state laws are not sufficient to be sustainable or

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49 As noted above, the *Marin County* and *CalFire* cases, pending in the California Supreme Court, will provide the opportunity for the clarification of the California Rule to eliminate the need for a comparable new advantage for any disadvantage the pension beneficiary may suffer, thereby allowing reasonable and necessary modification of the pension benefits.
affordable, and even the higher public purpose argument (calling for reduction of pension benefits that crowd out funding for essential services and needed infrastructure) is not effective or practically possible. In such situations, new approaches to modifying unaffordable pension benefits on a prospective basis should be considered as a last resort to prevent government service meltdown. This paper proposes four possible alternatives to public employers who face this serious problem. These alternatives assume that all traditional pension reform efforts have been explored including raising taxes and reducing expenditures to the extent possible and more needed pension plan adjustments and modifications appear to be impossible legally or on a consensual basis. The four alternatives to be considered by the state or local government employees are:

(A) Prepackaged Chapter 9 plan of debt adjustment,

(B) Creation of a special federal bankruptcy court for insolvent public pension funds,

(C) Government Oversight, Refinance and Debt Adjustment Commission ("GORDAC") to assist where public pension reform is otherwise legally or practically impossible, and

(D) Model Guidelines for a state constitutional amendment or legislative public pension funding policy for a higher public good: the necessity of pension benefits adjustment for the public safety and welfare in those situations where state constitutions, statutes or case law appear to prohibit any impairment or reduction of pension benefits.

IV. POSSIBLE APPROACHES WHEN PENSION REFORM EFFORTS FAIL OR APPEAR TO BE LEGALLY IMPOSSIBLE

A. Prepackaged Chapter 9

As corporations confronted the time and cost of the traditional Chapter 11 case, troubled businesses and their counsel considered the use of a prepackaged plan of reorganization to reduce the time and expense of bankruptcy.\(^\text{50}\) Section 1126(b) of the Bankruptcy Code provides

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an expedited process by which a debtor may propose and confirm a Chapter 11 plan. Under this provision, a prospective debtor may solicit consents for a proposed plan from its major creditor constituencies prior to filing a petition under Chapter 11. After filing for Chapter 11, the debtor schedules a single bankruptcy court hearing to pass on the adequacy of its prepetition disclosure materials and confirmation of its proposed plan. A “prepackaged” bankruptcy reorganization is one method of binding all of the security holders and other creditors to a restructuring.

A summary of steps involved in a prepackaged reorganization include:

1. The negotiation of a plan with major creditor constituencies;

2. Preparation and dissemination of a proposed plan, disclosure statement and voting ballot to solicit creditor votes;

3. All parties with impaired interests under the reorganization plan are entitled to vote. In order for a class to accept the plan, at least two-thirds in amount and more than one-half in number of the class voting must vote to accept the plan. Only claims actually voted are computed in determining creditor acceptance;

4. After the development of the prepackaged plan, the solicitation of votes with full disclosure and the vote tally (ideally showing at least one class of creditors voted to accept the plan), the bankruptcy petition is filed, together with the prepackaged plan and creditor acceptances thereof; and

5. The bankruptcy court holds a hearing to consider whether the prepetition disclosure materials meet the requirements for adequate disclosure as set forth in the Bankruptcy Code and any applicable rules of the SEC. If disclosure is found adequate, as well as compliance with the requirements of the Bankruptcy Code for confirmation of a plan, the debtor presents a certification of creditor acceptances and the court considers whether the proposed plan can be confirmed under the requirements of the Bankruptcy Code.

Prepackaged plans are particularly suited to situations in which a debtor public employer intends to leave many creditor classes virtually untouched or with the consideration negotiated pre-filing but desires to modify the terms of judgments, contractual relationships, public debt or
pension obligations that adversely affect the public safety and welfare of its citizens and the full funding and provision of essential governmental services and infrastructure improvements. A principal benefit of a prepackaged plan is the speed of the proceeding which necessarily reduces costs, uncertainty and anxiety. In addition, the relatively brief time in bankruptcy (often less than three months) minimizes disruption of the debtor’s operations and relationships with needed creditor constituencies. Of course, the prepetition negotiation and solicitation may take substantial time.

Section 1126(b) of the Bankruptcy Code is applicable in a Chapter 9 municipal bankruptcy.\textsuperscript{51} Municipalities authorized by their states to file Chapter 9 should consider using such an approach to provide effective pension reforms where efforts at voluntary reform fail and state courts are hostile to reform efforts. This prepackaged Chapter 9 municipal debt adjustment plan can provide the needed pension obligation reform to save the municipality, its taxpayers, public workers, retirees and creditors. As previously noted, courts hearing Chapter 9, municipal debt adjustment cases, have unanimously ruled that the labor and pension contract obligations can be impaired where impairing pension benefits was necessary to save the municipality’s financial and operational future.\textsuperscript{52} Although a prepackaged Chapter 9 will not resolve the threat that CalPERS may not accept the reduced pension obligation modified public pension plan in its calculation of pension obligations due without a “penalty” reduction in the present value of assets from prior present values, this issue can be addressed as to the binding effect of court’s order on CalPERS or other pension fund administrators. It is clear that a prepackaged plan will greatly reduce costs, delay and uncertainty of results to the municipality.

Since 2013 and the Detroit Chapter 9 filing, no city, town, village or county has filed for Chapter 9 relief (except Hillview, Kentucky). Some of the reasons for this are the stigma of Chapter 9, its cost and expense, the uncertainty of the process and results and the general delay of years before a resolution is reached. The expense of Chapter 9 is a problem as demonstrated by the fact that, as previously noted, the professional fees incurred in Chapter 9 for Detroit were

\textsuperscript{51} 11 U.S.C. § 901.

\textsuperscript{52} See the City of Detroit and City of Stockton cases cited in n. 35 and \textit{In re City of San Bernardino, Cal.}, 530 B.R. 474 (Bankr. C.D. Cal. 2015).
over $170 million, for Jefferson County were over $30 million\textsuperscript{53} and for even smaller Vallejo were over $10 million.\textsuperscript{54} The benefit of the brevity of a prepackaged Chapter 9 should reduce any stigma, resolve any uncertainty as to the result, reduce if not eliminate strain on operations and key relationships and drastically reduce costs and expense to the municipality. Further, the savings of time, effort and costs all can aid in the financial recovery of the municipality. There should be further development of the use of a prepackaged Chapter 9 for municipalities suffering from such an impossible situation in order to save the municipality, its taxpayers, public workers, retirees and creditors. However, since less than half the states authorize their municipalities to file a Chapter 9 proceeding and states cannot file Chapter 9, other alternatives should be explored.

B. Creation of a Special Federal Bankruptcy Court for Insolvent Public Pension Funds

The United States Congress has the exclusive power under the United States Constitution to establish uniform laws on the subject of bankruptcy.\textsuperscript{55} The notion of a consistent bankruptcy law throughout the United States was part of the drafters’ goal to establish the framework for a successful commercial republic. The rationale was summarized by James Madison in The Federalist No. 42: “The power of establishing uniform laws on bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question.”\textsuperscript{56}


\textsuperscript{55} “The Congress shall have Power To … establish uniform Laws on the subject of Bankruptcies throughout the United States …” U.S. Const. Art. I, § 8, Cl. 4.

The Chapter 9 cases involving public pension issues have been filed in various courts throughout the United States. Judges with an extensive background in corporate restructuring are many times faced with a once in a lifetime experience in municipal and public employee benefit law and have been forced to deal with the complicated issues of analyzing what constitutes unaffordable and unsustainable pensions when municipal services are maintained at an acceptable level and when they are not. While these judges have done an admirable job educating themselves in these relatively specialized, and for them, untraveled areas of expertise, the results have not always been uniform and the burden on the courts has been challenging. Further, the filing of a Chapter 9 for the entire municipality, plunging a whole city into crisis when the principal problem is a pension obligation that cannot be met, can be inefficient and more complicated than necessary. In furtherance of the uniform bankruptcy law ideal to strengthen the economy of the United States and the goal of limited disruption of the government and affairs of the municipality, the creation of a new separate federal court to hear public pension fund bankruptcy is appropriate. Public pension funds are separate and distinct legal entities, and the assets they hold in trust are not part of the government employer’s assets.

A separate federal bankruptcy court could be established for public pension funds ("Public Pension Fund Bankruptcy Court") that are deemed insolvent as determined by a specified ratio of funding or demonstrated inability by the public employer to be able to fully fund the pension obligations or to pay benefits as they become due. The inability to pay the actuarially required payments due to lack of revenues sufficient to fully fund the cost of essential government services and needed infrastructure improvements and also fully fund the required pension benefits would qualify as insolvency. It could be a separate title of the United States Code or a new, separate chapter of the Bankruptcy Code. The specialized court could be located in Washington, D.C. or in several locations across the country.

Federal legislation would preempt any other laws and would give exclusive jurisdiction to the Pension Fund Bankruptcy Court to deal with pension fund insolvency. Just like a municipality’s ability to use Chapter 9, states would have to specifically authorize local

58 11 U.S.C. § 1 et seq.
government pension funds or state pension funds to file for relief before the Public Pension Fund Bankruptcy Court. This court would be composed of judges who understand principles of municipal finance and the relationship between a well-functioning municipality and funding public pension obligations. To avoid jurisdictional issues, the judges for the separate court could be Article III judges selected like federal district court judges and not an adjunct to the federal district court like the current Article I bankruptcy judges in the bankruptcy court that are subject to federal district court delegation or approval of their actions.59

A plan of adjustment for the pension obligations would be proposed by the employer governmental body based upon what is affordable while permitting the adequate funding of governmental services and infrastructure.60 The pension fund and other parties in interest would be able to comment on or object to the proposed plan. The Public Pension Fund Bankruptcy Court would determine if the plan is sustainable, affordable and in the best interest of the pension fund and its beneficiaries (workers and retirees), as well as other parties in interest such as creditors, taxpayers, and businesses of the governmental body and employer. The statute could also provide for a mediation process with court supervision if the pension fund and the governmental body reasonably believe they can reach agreement on the plan of adjustment. If agreement cannot be reached between the parties, the court ultimately would decide on the plan of recovery for the government employer and pension fund with such modifications and adjustments to the plan as required by the court.

The use of prepackaged plan of debt adjustment (as described above) would be incorporated so that the bankruptcy plan for the pension fund could be confirmed in 45 to 90 days and be a good last resort that is efficient and more affordable. State authorization would be necessary for state and local government pension funds to file before the Public Pension Fund


60 The state or local government as the government employer would be consenting to the court’s ruling on the proposed plan including the sufficiency of taxes levied, the need for adjustment to pension contributions, pension benefits as such relate to the revenues, property and political affairs of the government. The state, in specifically authorizing the use of the Public Pension Fund Bankruptcy Court will be waiving any sovereignty and jurisdictional issues related to the federal court ruling on such matters. This is intended to avoid tenth amendment issues as was the problem facing the drafters of the municipal bankruptcy provisions to comply with the constitutional tests set forth in Ashton v. Cameron Cnty. Water Imp. Dist. No. 1, 298 U.S. 513 (1936) and U.S. v. Bekins, 304 U.S. 27 (1938).
Bankruptcy Court since states cannot file for Chapter 9 bankruptcy and municipalities need to be authorized by their state to file for a Chapter 9 proceeding. The Public Pension Fund Bankruptcy Court would allow financially troubled state and local government pension funds that also need a last resort to have one if so authorized by the state. Also, a Public Pension Fund Bankruptcy Court is a means of avoiding a prepackaged Chapter 9 bankruptcy of the municipality itself when the only or significant obligation that needs to be addressed is the public pension cost that cannot be controlled or fully funded. The focus is where pension obligations are the issue, and other relationships of the governmental body do not need to be disrupted or adversely affected. Further, the exclusive jurisdiction of Public Pension Fund Bankruptcy Court over the insolvent public pension fund should successfully cure the California situation as in Vallejo, Stockton and San Bernardino where threats by CalPERS of penalties for terminating the original pension plan or reducing payment from the full original pension benefit liabilities unadjusted by bankruptcy court and plan of recovery results in re-evaluation of pension fund assets at an unfavorable discount rate (as noted above). This result can be avoided by the Public Pension Fund Bankruptcy Court ordering adjusted pension payments that would be binding on all parties. This court would determine what obligation the government employer and pension fund must pay to the pension administration entity as an obligation of the government employer and the payments to be received by the debtor pension fund in bankruptcy and upon confirmation of the plan of debt adjustment as well as the appropriate valuation of pension assets. Such a determination, based on traditional bankruptcy case law, would be binding on the pension fund administrator, such as CalPERS, just as any prepetition obligation of the debtor pension fund to pay or to perform could be modified by the confirmed plan and binding on the parties in interest.

C. Government Oversight, Refinance and Debt Adjustment Commission to Assist Where Public Pension Reform Is Otherwise Legally or Practically Impossible

A variation on the two approaches above, a prepackaged Chapter 9 and the Federal Public Pension Fund Bankruptcy Court, is the creation by state legislation of a state commission that would help facilitate voluntary agreement but would have the ability to bind all parties to an affordable and sustainable recovery plan through a prepackaged Chapter 9 filing. GORDAC would be composed of a panel of at least three commissioners and a professional staff with experience in finance, government, accounting, employee benefits and financial restructuring.
The commission would be independent of the government. GORDAC would be created by state legislation as a quasi-judicial commission initiated through either voluntary petition by affected parties (municipalities, pension funds or requisite percentage of taxpayers, creditors or employees) or through the use of triggering criteria requiring mandatory review of financially troubled situations.61

The first phase of the process is mediation and consensual agreement by the municipality and the affected creditor constituencies. The negotiations and discussions of positions as part of the GORDAC process should be confidential. Accordingly, the state law establishing the commission should contain an exception to the state’s open meeting and freedom of information laws to allow for open discussion of any sensitive and confidential topics. If the consensual agreement requests additional tax revenues, loans or grants from the state, the commission will make recommendations to the state and determine the prudence and feasibility of such actions.

If the voluntary process is not successful, a second phase of the process may be requested or may be mandatory if the commission so requires. At this stage, the commission functions as a quasi-judicial panel. The municipality sets forth the actions proposed to be taken to address the specific financial problems (recovery plan) for the commission’s approval. GORDAC will bring its expertise to bear on the proposed recovery plan. GORDAC would determine, after hearing and input from all parties, the projected future revenues, the cost of essential governmental services and infrastructure, what pension obligations are sustainable and affordable for the municipality and whether the recovery plan should be approved or modified.

The first determination is whether the specific situation involves an ability to pay problem or willingness to pay issue? Should taxes be increased to fund pensions if it is a willingness problem? Should a referendum be sought? Should an adjustment to wages or pension benefits be necessary in order to ensure essential governmental services will be provided at an acceptable level? This independent objective expert commission will determine from the input of the parties the realistic projection of revenues compared to the amount of dollars required to pay for essential governmental services and necessary infrastructure improvements with the

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61 For a more detailed description of GORDAC, how it would operate, and why it addresses the deficiencies in other governmental debt adjustment mechanisms, see MUNICIPALITIES IN DISTRESS, pp. 102-112.
remaining funds available to pay wages and pensions benefits and whether taxes should be raised or debt, including for pension obligations, should be refinanced or restructured.

However, simply raising taxes to pay pension benefits is unwise at certain times when the raising of taxes and the lowering of services (reducing expenditures) bring about an exit of both business and individual taxpayers, which reduces tax revenues and frustrates the ability to pay workers and pensions and also to provide essential governmental services. Pension underfunding is adverse to young workers and transforms pension benefits into a game of musical chairs. GORDAC will take such factors into consideration as it determines what unfunded pension obligations can be paid and are affordable and what are not versus what funds are needed to provide essential governmental services and infrastructure and must be funded. GORDAC will determine the elements of a recovery plan. If, following this quasi-judicial process, needed pension reform is possible voluntarily, this approach would include a sustainable and affordable pension benefit obligation as part of a recovery plan. If, however, a voluntary and binding resolution on all parties is not possible on a consensual basis, then the parties will be bound by the recovery plan approved by GORDAC (with such modifications and adjustments to the recovery plan as GORDAC determines necessary for its approval). The approved recovery plan would be enforced by having the municipality file a prepackaged Chapter 9 using the recovery plan, vote of creditors and the proceeding before GORDAC as the basis for the Bankruptcy Court’s confirmation of the recovery plan as a Prepackaged Plan in a Chapter 9 (“Prepackaged Plan Option”).

Further, as part of GORDAC or as a separate entity, there could be established by the state, an agency to foster best practices in pension fund management, to police against fraud, abuse and waste in any pension system within the state and to determine for any new proposed pension benefit, whether it is in good faith, consistent with fair dealing and affordable (“Pension Policing”). This state agency would be charged with looking into recommended best practices as well as any instances of fraud, waste and abuse in the granting and administration of pensions. While governments should pay their contractual obligations to the fullest degree possible, pension underfunding due to losses attributed to fraud, waste and abuse by investment advisors or others uninvolved in pension administration should not be tolerated. The purpose of this agency is to provide an objective, independent entity to police against such practices as
(a) pension spiking in the last years of employment by significant raises in the pensionable salary, which creates unjustifiable increases in pension benefits, (b) unjustified disability findings and awards, (c) failure to work a full day for a full day’s pay, (d) politically connected or otherwise incompetent financial advisors where significant losses are suffered and (e) other wrongful, abusive or wasteful actions. This approach recognizes there is a *quid pro quo* for every contract, as most state laws describe the relationship between the public worker and the government as contractual. Failure to perform in good faith on the part of a public worker should lead to an adjustment or elimination of pension benefits. Failure by the pension fund to properly administer or collect pension benefit payments in the appropriate amount can be reviewed and corrective administrative efforts can be instituted so that as much as possible can be collected by such policy and review. Failure to raise taxes or contributions can be reviewed and determined when additional tax revenues or contributions by the government employer are necessary and appropriate. Having such an agency on the books may be the best deterrent to prevent fraud, abuse and waste and to encourage best practices and full funding of public pension obligations.

**D. Model Guidelines for a Constitutional Amendment or Legislative Public Pension Funding Policy Where State Constitutional and Statutory Provisions and Court Rulings Appear to Prohibit or Impair Needed Pension Reform**

As previously noted, some states have constitutional provisions that appear to prohibit the state from reducing pension benefits. While each state constitution has varying requirements for amending its terms, given the mounting crisis caused by unaffordable, unsustainable pensions and the demands of cities for increased funding for governmental services and infrastructure, consideration may be given to providing some relief from inflexible interpretation of constitutional or statutory restrictions on modification and reduction of benefits. Instead, a more balanced approach of specific legislative findings is to be made by the government as to the necessity and extent of any adjustments of pension benefits before modification or adjustment to pension benefits could be made. If the health, safety and welfare of citizens mandate funding of services or needed infrastructure improvements at an acceptable level, required pension obligation funding should not and must not crowd out the funding of Governmental Services, as

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defined below. Obviously, unalterable pension benefits for unaffordable and unsustainable pension benefits can create an intolerable situation for citizens, taxpayers, workers, retirees and the business community where everyone fails to obtain what they should receive. A safety valve is needed to resolve the conflict if there is too little revenue and too many demands for payment. Accordingly, there is need for either an amendment to constitutions or statutory provisions that solve this funding gridlock or a legislative policy for the least drastic and appropriate adjustment of pension benefits for the higher public purpose of the health, safety and welfare of citizens and for the ultimate benefit of all concerned.

1. **Proposed Model Guidelines for Pension Protection Provisions in State Constitution or Statue**

   It is possible to develop an amendment to a state constitution or statute containing a pension protection clause ("Pension Protection Clause") that protects the general welfare of citizens while funding to the fullest extent possible the public pension obligations. Any such amendment should include balancing tests and conditions the United States Supreme Court has articulated that would justify modifications and reductions of contractual benefits previously granted. While the actual language of a constitutional or statutory amendment may vary, as well as the language of legislation for public pension funding policy, the following guidelines should be the tonic for any constitutional amendment or legislative funding policy appropriately amending state statutes to prevent a public pension crisis ("Model Guidelines"):  

   **MODEL GUIDELINES FOR A CONSTITUTIONAL AMENDMENT OR LEGISLATIVE FUNDING POLICY TO PREVENT A PUBLIC PENSION CRISIS**
   
   1. **Balanced Budget.** Balanced Operating Budget for Governmental Entity for the fiscal year where all expenses and liabilities that are due and payable do not exceed anticipated revenues of the Governmental Entity ("Balanced Budget").
   
   2. **Pay Annually the ADC.** The Governmental Entity shall pay in each and every fiscal year the actuarially determined contribution ("ADC") it is liable for under its pension or retirement system ("Pension Benefits") for that fiscal year provided the effect of any modification or reduction of
pension benefits required by these Model Guidelines or determined by its legislative body are included in such calculations. The state may from time to time enact standards and accepted reasonable assumptions to be used in calculating the ADC.

3. **Reasonable and Necessary Modification Permitted.** Reasonable modification and reduction of Pension Benefits of the Governmental Entity shall be permitted that are necessary for a higher important public purpose of fully funding and providing for the essential governmental services at an acceptable level including needed infrastructure and capital improvements ("Governmental Services") as determined in good faith by the Governmental Entity’s legislative body or its equivalent ("Legislative Body"). Again, the states may from time to time enact standards or further Model Guidelines for what is a sustainable, affordable, and acceptable level of Governmental Services.

4. **Fully Funding of Governmental Services at Acceptable Level.** The Governmental Entity’s Legislative Body shall in good faith determine the amount of full funding of Governmental Services at the acceptable level required for the welfare of its citizens and the appropriate operation of its government.

5. **Reasonableness of Modification of Public Pension Benefits in Relation to Governmental Entity’s Ability to Fully Fund and Afford Governmental Services and Pension Benefits.** The Governmental Entity’s Legislative Body shall make a good faith determination of the reasonableness of any modification or reduction of Pension Benefits in relation to the Governmental Entity’s ability to fully fund and provide Governmental Services and afford and fund actuarially determined Pension Benefits as well as maintain a Balanced Budget for the current fiscal year and the foreseeable future. The inability to do so requires the reasonable modification or reduction of Pension Benefits to that which is affordable and sustainable in the good faith determination of the Legislative Body consistent with these Model Guidelines.

6. **Priority of Public Pension Modifications So That to the Extent Possible Any Modification Will Be Made First to Unearned Future Benefits and Any Impairment of Vested**
Rights Would Be Subject to a Court Validation Process. Any required modification or reduction of Public Pension Benefits may be for Pension Benefits to be earned prior to or after the effective date of the modification or reduction with the priority that any modification or reduction first be made to the extent reasonable possible to Pension Benefits to be earned in the future. Any modification or reduction of Pension Benefits earned shall be effective only after a court validation proceeding that confirms the need for the modification or reduction of Pension Benefits in accordance with the Model Guidelines and permitted impairment of contractual rights for a higher public purpose. The Government Entity may also seek a court validation of any reduction or modification of Pension Benefits including Pension Benefits to be earned in the future. This court validation process would follow a statutory procedure similar to bond validation proceedings where the court will validate the reduction or modification after a petition by the Governmental Entity; a hearing with notice to affected parties who have an opportunity to appear determining the modifications and reductions are permitted for a higher public purpose pursuant to these Model Guidelines and all required action and legislative findings thereunder have been made.

7. Public Pension Benefits Should Be Affordable and Sustainable by the Governmental Entity. Public Pension Benefits granted or to be granted by a Governmental Entity should be affordable and sustainable by the Governmental Entity and should specifically state such benefits are subject to reasonable modification or reduction as necessary to accomplish affordability and sustainability as determined by the exercise of the good faith judgment of the Legislative Body.

8. Additional Legislative Findings for Any Modification of Pension Benefits. (These legislative findings, in addition to those legislative findings and determination as noted above, would generally consist of: (1) existence of government function emergency requiring modification of Pension Benefits (“Governmental Emergency”), (2) modification necessary for provision of Governmental Services at an acceptable level, reasonable in relation to the Governmental Emergency, and that pays public Pension Benefits to fullest extent possible consistent with these Model Guidelines, (3) the balancing of harm caused to beneficiaries is
outweighed by the harm to the public and (4) the
modification of Pension Benefits is necessary for the
financial stability of the Governmental Entity and is the
least drastic. A further explanation of these findings to be
made in the legislation or pension reform.) In addition to
the Legislative Body’s determination and findings noted
above, the Legislative Body for the Governmental Entity
shall make the following findings in connection with any
modification or reduction of Pension Benefits found to be
reasonable and necessary under these Model Guidelines:

(A) **Existence of Governmental Emergency.** A
Governmental Emergency exists or will occur in the
foreseeable future that will adversely affect the
health, safety and welfare of its citizens and the
Governmental Entity’s ability to fully fund and
provide Governmental Services. Any further
increase in taxes and any further reduction in
expenditures are in the good faith judgment of the
Legislative Body unreasonable and contrary to the
interest of citizens and taxpayers as well as contrary
to financially responsible government.

(B) **Modifications Are Mandated for the Public Good.**
Any modification or reduction of Pension Benefits
by the Legislative Body are required in the exercise
of its governmental powers in order for the
Governmental Entity to be able to fund and provide
Governmental Services for the other higher public
purpose of the health, safety and welfare of its
citizens.

(C) **Any Modification Is Reasonable in Relation to the
Governmental Emergency and Extent of Any
Impairment with Pension Benefits Paid to the
Fullest Extent Possible.** A modification or
reduction of Pension Benefits is appropriate and
reasonable both (1) in relation to the Governmental
Emergency and adverse effects set forth in the
legislative finding under sub-paragraph (A) above
and (2) the extent of any impairment of Pension
Benefits. Pension Benefits should be funded to the
fullest extent possible and paid without
modification or reduction so long as no
Governmental Emergency exists and there is full
funding of and provision for Governmental Services
as mandated by the enactment of the Model Guidelines.

(D) The Harm to Pension Beneficiaries Due to a Modification Is Outweighed by the Harm Suffered by the Governmental Entity and the Citizens. The harm caused by any modification or reduction of Pension Benefits to the beneficiaries pursuant to these Model Guidelines are, in the reasonable judgment of the Legislative Body, the least required under the requirements of these Model Guidelines and is outweighed by the harm to be suffered by the Governmental Entity and its citizens if such modification and reduction of Pension Benefits required hereunder are not made to address the Governmental Emergency and the lack of funding for providing Governmental Services to its citizens.

(E) The Financial Creditability of the Governmental Entity Preserved. In the reasonable judgment of the Legislative Body, its financial credibility and access to the credit markets are encouraged by any Legislative Body’s action hereunder and are not adversely affected or limited by any modification and reduction to such Pension Benefits required hereunder.

9. Any Modification or Reduction of Pension Benefits Pursuant to These Principles Is Not Considered an Impairment or Diminishment. Any modification or reduction of Pension Benefits in compliance with these Model Guidelines hereunder shall not be considered under applicable state constitution, statutes and court rulings to be an impairment or diminishment of the contractual right to Pension Benefits because such Pension Benefits could not realistically be paid by the Governmental Entity due to limited financial resources and the Governmental Entity could not at the same time pay the Pension Benefits without such modification or reduction and fulfill its primary mission of fully funding provisions for Governmental Services along with its financial survival.
2. Discussion of Justification and Balancing of Interest for the Proposed Model Guidelines for Constitutional Amendment and Legislation for Public Pension Funding

   a. **Existence of a Governmental Emergency**

   Any legislative action for reduction or modification of Pension Benefits under the Amendment should provide that there is determination of a Governmental Emergency caused by the cost of Pension Benefits without modification or reduction that crowds out funding and provision of essential Governmental Services and necessary infrastructure improvements at an acceptable level thereby adversely affecting the health, safety and welfare of the government’s citizens. A Governmental Emergency exists when funding for governmental services at an acceptable level is insufficient and the ability to raise taxes is practically or legally impossible as determined in good faith by the Legislative Body and any further reduction of services and costs would be hazardous to the proper function of government. Waiting until infrastructure collapses or significant percentage of taxpayers and businesses have exited is too late and the threat of a death spiral too great. Further, the Legislative Body should in good faith determine that there is no further reduction of expenses or services that can be justified without impairing the health, safety and welfare of its citizens. Accordingly, all that can be done to address the Governmental Emergency practically has been done before modification and reduction of pension benefits.

   b. **The Amendment Is Required for an Important Public Purpose of Continued Governmental Services at an Acceptable Level When Current Pension Obligations Are Not Sustainable and Affordable**

   The essential purpose of government is to provide for the health, safety and welfare of its citizens. Given the significant and increasing percentage of revenues needed for fully funding the actuarially required contribution (“ARC”) / actuarially determination contribution (“ADC”), many state and many local governments are facing a funding crisis where funding of essential services and needed infrastructure improvements are either deferred or services reduced to permit larger contributions for unfunded pension obligations which, based on ability to pay, are generally unaffordable and unsustainable. This again is due to the fact that revenues have decreased to a level to be insufficient to pay now and in the foreseeable future all obligations due
on time and further tax increases and projected increased revenues are practically or legally impossible and further reduction of costs is not possible and prudent.

The above Model Guidelines for a constitutional amendment or legislation funding policy for public pensions addresses the important public purpose of ensuring essential Governmental Services at an acceptable level (including needed infrastructure and capital improvements) are fully funded and provided for and that obligations for Pension Benefits are funded to the fullest extent possible given the cost of Governmental Services so that Pension Benefits are affordable and sustainable. The Governmental Entity is required to have balanced financial budgets providing full funding of Governmental Services at an acceptable level with the only modifications or reduction of Pension Benefits due to that which is required by the Governmental Entity’s Legislative Body in a good faith determination to balance the financial budget for each fiscal year for the foreseeable future. The Legislative Body for the Governmental Entity in determining whether any reduction or modification of such Pension Benefits is reasonably necessary should take into consideration that: (A) such Pension Benefits should, to the fullest extent possible, be funded and paid without modification or reduction so long as there is full funding of and provision for Governmental Services (including raising taxes to the extent feasible, legal and practicable and reducing expenses to the extent possible and prudent) and (B) the credit markets’ perception of the financial credibility of the Governmental Entity as indicated by access to the credit markets and actual borrowing costs are encouraged by the Legislative Body’s actions and not adversely affected or limited by the failure to make modification and reduction to such Pension Benefits.

Any modifications or reductions in Pension Benefits pursuant to these Model Guidelines would serve the legitimate and important public purpose of preventing the crowding out of the funding of Governmental Services by unaffordable and unsustainable Pension Benefits. While such reductions and modifications are to be reasonably determined by the Legislative Body in good faith for the public good and welfare of the citizens of the Governmental Entity, it should not be considered an impairment or diminishment of the Pension Benefits since the limited resources of the Governmental Entity realistically are not sufficient to pay such. The payment of the amounts that are the subject of the modification or reduction are costs which threaten and impair the welfare of the citizens and which cannot, given the limited resources of government,
be paid in reality. The payment of such unaffordable and unsustainable Pension Benefits leads not only to impairment of the health, safety and welfare of citizens but also, in the long term, to the death spiral of the Government Entity where everyone receives less.

The examples of Detroit, Bridgeport, Connecticut, and other financially distressed governments have demonstrated that if the government raises taxes and reduces services to pay for unaffordable and unsustainable costs, the result will be that individual and corporate taxpayers will leave and less revenues actually will be collected to the detriment of all. In effect, there are no issues of impairment of Pension Benefits or inappropriate reductions or modifications of Pension Benefits since all that realistically can be paid will be paid and that which cannot be paid without harm to all is not paid and cannot be paid. Accordingly, there is no impairment of contract or inappropriate diminishment of Pension Benefits.

c. **Any Modification or Reduction of Pension Benefits Must Be Appropriate to Preventing the Harm to Public Health, Safety and Welfare**

The Model Guidelines are focused only on reasonable modifications or reductions of Pension Benefits to the extent necessary to avoid a Governmental Emergency due to the failure to fully fund and provide Governmental Services. This requires the respective Legislative Body

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63 Similarly, although the Fifth Amendment provides that “private property [shall not] be taken for public use, without just compensation, the right to compensation does not extend to the loss of property as the result of necessary exercises of the police power. A state’s discretionary decision to take private land to build a road requires compensation; but taking private property in response to an emergency—even seizing or destroying property or rendering it completely valueless—does not. For example, a state’s action to prevent a public nuisance is categorically never a taking requiring compensation. David A. Dana & Thomas W. Merrill, PROPERTY: TAKINGS 111 (2002). Nor, more broadly, is a state’s destruction of private property “to forestall ***grave threats to the lives and property of others.” Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1029 n. 16 (1992). The test is whether there is an “actual necessity” for the state to take property to forestall threats to its citizens. Id. Examples of public necessity include “to prevent the spreading of a fire” (Boulditch v. City of Boston, 101 U.S. 16, 18-19 (1880)); preventing the spread of disease (Juragua Iron Co. v. U.S., 212 U.S. 297, 308-309 (1909)); or preventing property falling into the hands of an enemy. U.S. v. Caltex, Inc., 344 U.S. 149, 155-156 (1952).

One more example. The public trust doctrine generally forbids states from alienating trust property to the prejudice of the general public. Illinois Cent. R.R. Co., 146 U.S. at 453-454. Indeed, the U.S. Supreme Court has specifically analogized the public trust to reserved sovereign police powers in holding that a State may alienate neither. See Id. at 453 (“The state can no more abdicate its trust over property in which the whole people are interested, like navigable waters and soils under them, so as to leave them entirely under the use and control of private parties ***than it can abdicate its police powers in the administration of government and the preservation of the peace”).
to determine in good faith the necessity of any reduction or modification of Pension Benefits and only to the extent necessary to ensure a balanced financial budget and the operation of government for the general welfare of its citizens. The Legislative Body, as the representative of the people’s will, makes those determination within the parameters of the Model Guidelines. If proposed modifications or reductions of Pension Benefits are too much or too little to balance the budget and provide Governmental Services at an acceptable level, the modification or reductions would not meet the required test of the Model Guidelines. There must be a good faith determination of what is necessary for the funding of such Pension Benefits to the fullest extent possible while not crowding out Governmental Services needed for the welfare and survival of the government and its people. The Model Guidelines are intended to address the Governmental Emergency through the necessary modification or reduction of Pension Benefits for the welfare of citizens and appropriate operation of government.

d. **Under the Model Guidelines, Any Modification or Reduction of Pension Benefits Must Be Reasonable, Appropriate and Balance the Welfare of Citizens with any Harm to Pension Beneficiaries**

As noted above, the Model Guidelines deal with modifications and reductions to Pension Benefits only to the degree necessary to allow appropriate operation of the government for the health, safety and welfare of its citizens. The crowding out of funding of vital Governmental Services by unaffordable and unsustainable Pension Benefits is to be avoided. As part of a determination of a modification or reduction in Pension Benefits, the Model Guidelines require the Legislative Body to fund such Pension Benefits to the fullest extent possible so long as the fiscal year budget is balanced and Governmental Services are fully funded and provided for at an acceptable level (as determined by the Legislative Body). The Model Guidelines leave to the Legislative Body the determination of what specific modifications or reductions should be made.

Modification or reduction of Pension Benefits of a prospective nature as of the effective date as opposed to those already earned, in the exercise of good faith should be considered first. The unaffordability and unsustainability of the Pension Benefits may be so great that full funding of essential Governmental Services and appropriate operation of government may require Pension Benefits for past services earned to be modified or reduced so the government can continue to survive and fund the remaining Pension Benefits rather than face a financial
meltdown providing less for all concerned. Further, the Model Guidelines provide for a validation process of any modification or reduction in earned Pension Benefits that are vested contractual rights. This process would be similar to a bond validation procedure where the Governmental Body, pursuant to a state statute, petitions a court to validate that the proposed modification or reduction in Pension Benefits meets the requirements of the Model Guidelines and all required actions and legislative findings thereunder have been made so that, under applicable case law, any impairment of contractual rights is permitted for a higher public purpose. The process would provide for a public hearing with notice to all affected parties and an opportunity for them to be heard on an expedited basis with direct appeal to the highest court of the state and, if necessary, to the U.S. Supreme Court based on the civil rights of citizens under U.S. Constitution to have their health, safety and welfare protected by state and local governments and the Guarantee Clause of the U.S. Constitution relating to a Republican Form of Government.  

(i) **Defaulting on Public Debt Has a Price Paid by All**

Further, the simple answer of not paying public debt and defaulting on those obligations is not only short sighted but more likely long term fatal to the financial future of the government. Defaulting on public debt securities brings not only a financial stigma but increased costs for borrowings necessary for needed infrastructure improvements as well as providing liquidity to governments given uneven and sometimes delayed tax payments. Being a weak credit due to unaffordable and unsustainable debt such as Pension Benefits (even without a default on public debt) can bring low credit ratings and high borrowing costs of an additional 2 to 3% additional interest cost per year. An additional 200 basis points (2%) annual interest cost on a twenty-year

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64 See Preamble to U.S. Constitution, 42 U.S.C. § 1983, Article IV, Section 4 (Guarantee Clause) of the Constitution and footnotes 70-71 infra.

65 Traditionally the spread in the municipal market between strong credits (top investment grade) and significantly weak credits (lower non-investment grade) was 200-300 basis points (See e.g., approximate 200 basis point trading spread between Detroit sewer and water with and without Chapter 9 threat and Chicago sale tax securitization approximate 275 basis point lower than similar Chicago maturities. https://fixedincome.fidelity.com/ftgw/fi/FINewsArticle?id=201801251903SM_____BNDBYER_00000161-2a4f-dad2-a779-ff4fc963_110.1 Even if weaker credit or past defaulters suffer only a 200 to 300 basis point rise in annual interest expense, that is 60% to 90% more payment of principal over 30-year period. (Spread between AAA and BBB can vary 100 to 150 basis points. Baird Fixed Income Study, 4/7/14, p. 8.) February 28, 2018, S&P Municipal Bond Index AAA (average duration 4.9 years) to B (average duration 6.08 years) on average 230 basis point yield difference. Bloomberg Barclay BVAL scale 10 years AAA.
borrowing with a bullet maturity at 5% discount rate equals a present value additional cost of borrowing of about 25% of the principal amount borrowed (namely on a $1 billion principal borrowing, the additional present value cost is about $250,000,000). Certainly, this additional, significant cost could be better used to pay Pension Benefits or other governmental costs. For this reason, the Model Guidelines encourage financial credibility by the Governmental Entity.

(ii) Mandated Annual Payment of the Actuarially Determined Contributions

The Model Guidelines are intended to balance the needs of an important public purpose (the general welfare of its citizens) with the least harm possible to beneficiaries of public pension funds recognizing, if there are not funds sufficient to fund fully all reasonable costs, adjustments must be made. After exhausting tax increases and expenditure reduction, the Legislative Body balances the harm to the general health safety and welfare of citizens due to lack of funds to pay for necessary and needed governmental services against the harm suffered by pension beneficiaries due to implementation of proposed reduction or modification of Pension Benefits under the Model Guidelines. Further, the Model Guidelines as part of this balancing of the interests, provides that the annual actuarially determined contribution (ADC) will be funded and paid by the Government Entity subject to such modification and reduction of Pension Benefits as provided for by the Legislative Body pursuant to the Model Guidelines.

The Model Guidelines do not allow Governmental Entities and Legislative Bodies to fail to make necessary modifications and reductions of Pension Benefits and still avoid the pain of unaffordable and unsustainable grants of Pension Benefits by requiring the payment of ADC each and every year. The difficult and troubling questions and possible litigation regarding whether unaffordable and unattainable grants of Pension Benefits were ultra vires and voidable acts by government officials (contrary to various balanced budget mandates contained in state constitutions and statutes)66 that can be avoided by the enactment of the Model Guidelines.

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66 According to a study done by The National Conference of State Legislatures – All states but one (Vermont) have constitutional provisions or state statutes generally dealing with balance budget requirements. There

rated bond to BBB rated bond, a difference of 97 basis points in yield (March 21, 2018). That additional cost could have been used to reduce taxes, pay for needed infrastructure or services or pay unfunded pension obligations. In the near term spread may widen thereby increasing the cost of borrowing for weaker credits.
Under the Model Guidelines, modification and reduction should be enacted by the Legislative Body promptly in good faith. Any unaffordable obligation that remains will be subject to clear pain of full funding of the ADC each year and the requirement of a balanced budget. Pursuant to the Model Guidelines, the Legislative Body is required to make specific legislative findings that justify the need for such modifications and reductions of Benefits under the police power for a higher public good.67

(iii) Deference to Legislative Findings

Indeed, where the legislature has made an express determination that a statute is constitutional in the face of arguments that it is not, the statute should be upheld “unless it is clear beyond reasonable doubt that it is violative of the fundamental law.” *Ala. State Fed’n of Labor v. McAdory*, 18 So.2d 810, 815 (Ala. 1944), *cert. dismissed*, 325 U.S. 450 (1945); see also *Huber v. Colorado Mining Ass’n*, 264 P.3d 884, 889 (Colo. 2011) (“We presume legislative enactments *** to be constitutional. Overcoming this presumption requires a showing of unconstitutionality beyond reasonable doubt”); *Nelson*, 170 F.3d at 651 (under Michigan law “a statute should not be declared unconstitutional unless the conflict between the Constitution and the statute is palpable and free from reasonable doubt”) (emphasis original); *State v. Muhammad*, 678 A.2d 164, 173 (N.J. 1996) (“whenever a challenge is raised to the constitutionality of a statute, there is a strong presumption that the statute is constitutional. *** Thus, any act of the Legislature will not be ruled void unless its repugnancy to the Constitution is clear beyond a reasonable doubt”); *Sch. Dists’ Alliance for Adequate Funding of Special Educ. v. State*, 244 P.3d 1, 5 (Wash. 2010) (“the legislature is entitled to great deference and *** a party

are 44 states that require the governor must submit a balanced budget, 41 states the legislature must pass a balanced budget and 38 states the state cannot carryover a deficit to the next fiscal year. See https://www.ncsl.org/documents/fiscal/StateBalancedBudgetProvisions2010.pdf

challenging a statute’s constitutionality must therefore prove the statute unconstitutional beyond a reasonable doubt”); *Chappy v. Labor & Indus. Review Comm’n*, 401 N.W.2d 568, 573-574 (Wis. 1987) (“there is a strong presumption that a legislative enactment is constitutional. **[T]he party challenging the statute carries a heavy burden of persuasion [and] must prove beyond a reasonable doubt that the act is unconstitutional**”). In this context, “beyond a reasonable doubt” does not refer to an evidentiary standard, but rather emphasizes the court’s “respect for the legislature” and the importance of conducting a “searching legal analysis” before determining that a statute violates the constitution. *Sch. Dists’ Alliance*, 244 P.3d at 5. Courts have held that this deferential standard of review is prudent because “declaring a statute **to be unconstitutional is one of the gravest duties impressed upon the courts,” *Huber*, 264 P.3d at 889, and because courts “do not act as a super-legislature.” *Muhammad*, 678 A.2d at 173.

3. **If No Constitutional Amendment Pursuant to the Model Guidelines to the Pension Protection Clause Is Possible or Required Then the Proposed Model Guidelines Can Be Adopted by Governmental Entities as a Legislative Statement of Public Pension Funding Policy and Enforced Through Litigation, If Necessary**

If the political obstacles to enacting a constitutional amendment pursuant to the Model Guidelines are insurmountable or are not necessary as there is no state constitution pension protection clause, then the alternative approach is adopting the Model Guidelines as a legislative pronouncement of the Governmental Entity’s public pension funding policy. Such legislative enactment may well draw significant litigation by representatives of current public employees and retirees. The response may be to take objections to public pension reforms head on based on the important public purpose of the government to first and foremost provide for the health, safety and welfare of its citizens by fully funding governmental services and preventing anything, including Pension Benefits, from crowding out the fully funding of essential and needed services necessary for the general welfare of citizens. Such litigation of the exercise by the legislature of the public pension funding policy as pronounced in the Model Guidelines could lead to a test case. If such a test case is properly presented to the court, it could ease the way for pension reform to be enacted and implemented or the legislative public pension funding policy to be followed by the state and local governmental bodies.
The legislative enactment should be supported by factual analysis and finding of the Governmental Emergency and the crowding out of fully funding of needed Governmental Services by unaffordable and unsustainable Pension Benefits. In addition, public education and support of civic groups, taxpayers, workers, retirees, and citizens is essential and the information developed in that effort should also be considered for inclusion in legislative findings. In addition, the Governmental Entity may proceed after public education efforts by referendum or survey of its citizens to determine the support for the public pension funding policy as set forth in the proposed Model Guidelines, which is to be incorporated into a legislative enactment. This developed record of the critical need and public support for the public pension funding policy contained in the Model Guidelines will provide the evidentiary and legislative support combined with the expression of the will of the people. As noted above, the balancing of interests of the beneficiaries of Pension Benefits with the mission of government and the welfare of citizens is embodied in the Model Guidelines and public pension funding policy to be adopted by Governmental Entities.

To say that the government and the welfare of its citizens should fail or go lacking so that unaffordable Pension Benefits imprudently granted can be paid in full only leads to the failure and demise of government. As a result, the beneficiaries of Pension Benefits receive far less than that provided by the Model Guidelines and the legislative public pension funding policy related thereto.

V. THE LEGAL JUSTIFICATION FOR THE MODEL GUIDELINES’ PERMITTED IMPAIRMENT OF CONTRACTUAL PUBLIC PENSION RIGHTS FOR A HIGHER PUBLIC PURPOSE: STATES AND LOCAL GOVERNMENT CANNOT ABDICATE THEIR INALIENABLE GOVERNMENTAL POWER TO PROVIDE ESSENTIAL GOVERNMENTAL SERVICES

A. The Contract Clause of the United States Constitution Does Not Prevent the Exercise of Police Power

The mandate of state government and its reason for being is to provide essential governmental services at an acceptable level for the health, safety and welfare of citizens so the state and its citizens may prosper and grow. See PAUL BAIROCH, CITIES AND ECONOMIC DEVELOPMENT (1998); BRENDAN O’FLAHERTY, CITY ECONOMICS (2005). Legally, the assessment of a state’s ability to adjust pension benefits begins with the Contract Clause in the United States Constitution and the mission of the state to provide mandated public services at an
acceptable level. Currently, it is widely accepted that public pensions are in the nature of a contract and therefore entitled to the protection of the Contract Clause. Amy B. Monahan, *Public Pension Plan Reform: The Legal Framework*, 5 EDUC. FIN. & POL’Y 617 (2010) (“Monahan”). Public pension protection is generally classified as a contractual right whether the “right” is attributable to a constitution provision, a state statute or judicially created by court ruling.68

B. **In a Government Contractual Relationship, the Government Does Not Surrender Essential Governmental Powers**

The Contract Clause of the United States Constitution provides that “no State shall pass any Law impairing the Obligation of Contracts." Article I, Section 10, Clause 1 (the “Contract Clause”). The question raised is whether public pension obligations must be observed to the financial ruin of the state or local government or whether the obligations can be adjusted, modified or reduced so that the government can fulfill its duty of providing essential public services at an acceptable level for its citizens.

For nearly 200 years, courts have held that legislatures lack the power to “surrend[e]r an essential attribute of [their] sovereignty” or “bargain away the police power of a State” *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 23 (1977) (quoting *Stone v. Mississippi*, 101 U.S. 814, 817 (1880)). As the U.S. Supreme Court explained in *Butchers’ Union Slaughter-House & Live-Stock Landing Co. v. Crescent City Live-Stock Landing & Slaughter-House Co.*, 111 U.S. 746, 751 (1884), “[t]he preservation of [the public health and morals] is so necessary to the best interests of social organization, that a wise policy forbids the legislative body to divest itself of the power to enact laws for the preservation of health and the repression of crime.” See also *Home Bldg. & Loan Ass’n v. Blaisdell*, 290 U.S. 398, 436-437 (1934) (collecting Supreme Court authority). This has been generally referred to as the exercise of police powers for a higher public purpose.

An early case holding that the United States Contract Clause does not require a state to adhere to a contract that surrenders an essential governmental power was *Stone v. Mississippi*, 101 U.S. 814 (1879). In that case, the state had granted a charter to a lottery company for twenty-five years but subsequently adopted a constitutional provision banning lotteries. In upholding the

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68 See, Monahan at pp. 3-10; Munnell at pp. 1-3; WILLAMETTE.
constitutional ban, the court noted that supervision by the state of this issue needed to be dealt with “as the special exigencies of the moment require.” *Id.* at 819. This limitation on the Contract Clause thus found its source in the police power, *i.e.*, in the capacity of the states to regulate behavior and enforce order within their territory in the interest of the health, safety, morals, and general welfare of the inhabitants.

**The Police Power Is Paramount to any Contractual Rights and the Implied Reservation of the Rights of Government.** This principle that a State may not alienate the basic police power that “is one of the great purposes for which the State government was brought into existence” has been generally recognized by state courts. As these authorities demonstrate, the “national Constitution[al]” problem with alienating police power is that such power is an “essential”—indeed the “inherent” and defining—characteristic of a sovereign state. Cooley, *TREATISE* at 283. The very “maintenance of a government” *at all* requires that a State “retai[n] adequate authority to secure the peace and good order of society”: the “necessary residuum of state power” is that “the state * * * continues to possess authority to safeguard the vital interests of its people.” *Home Bldg. & Loan Ass’n*, 290 U.S. 398, 434-435 (1934). And those vital interests extend to the economic well-being of the state as well as to public order and safety. As the Supreme Court has said, “[t]he economic interests of the state may justify the exercise of its continuing and dominant protective power * * *.” *Id.* at 437. The Nation’s federalist structure

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69 E.G., *Chicago, R. I. & P. Ry. Co. v. Taylor*, 192 P. 349,356 (Okla. 1920) (“As neither the state nor the municipality can surrender by contract the [police] power * * *, a contract purporting to do so is void ab initio, and, being void, it is impossible to speak of laws in conflict with its terms as impairing the obligations of a contract”); *Brick Presbyterian Church v. City of N.Y.*, 5 Cow. 538, 542 (N.Y. Sup. Ct. 1826). And it has been described in leading treatises. *E.g.*, Thomas M. Cooley, *A TREATISE ON THE CONSTITUTIONAL LIMITATIONS WHICH REST UPON THE LEGISLATIVE POWER OF THE STATES OF THE AMERICAN UNION* 283 (1868) (hereinafter “Cooley, *TREATISE*”) (“the prevailing opinion” is “that the State could not barter away, or in any manner abridge or weaken, any of those essential powers which are inherent in all governments” and “that any contracts to that end cannot be enforced under the provision of the national Constitution now under consideration”); Christopher G. Tiedman, *A TREATISE ON THE LIMITATIONS OF POLICE POWER IN THE UNITED STATES* 580-581 (1886) (it has “been often decided, in the American courts, Federal and State, that the State cannot * * * in any way curtail its exercise of any of those powers, which are essential attributes of sovereignty, and particularly the police power”).

depends on “every State in this Union” in fact governing, exercising its police powers so as to maintain the conditions for commerce, prevent the need for the United States to make good on its Article IV § 4 “guarantee” to backstop a failure to govern with federal power.\footnote{71}

In another early case, parties who had contracted with the state for clear passage through a creek objected to subsequent legislation providing for the installation of a dam across it. \textit{Manigault v. Springs}, 199 U.S. 473, 473 (1905). The United States Supreme Court noted that police power is \textit{paramount} to any contractual right and the principle against the impairment of contracts does not prevent the state from exercising such powers as are vested in it for the promotion of the common good. \textit{Id.} at 480.

Similarly, in \textit{Chicago and Alton Railroad Company v. Tranbarger}, the plaintiff argued that subsequent legislation requiring railroads to construct ditches and drains interfered with its operation. \textit{Chicago & Alton R.R. Co. v. Tranbarger}, 238 U.S. 67, 74 (1915). The Supreme Court found that no person has a vested right in any policy of legislation entitling him to insist that it shall remain unchanged nor is such right implied in any express contract. \textit{Id.} at 76. There is an implied reservation of rights that cannot be abrogated, surrendered or bargained away by contractual provisions. In an extension of this view, the Supreme Court in \textit{Stephenson v. Binford} rejected the complaint of private carriers to provisions of highway legislation; it noted that

\begin{itemize}
\item and to prevent offices against the State, but also to establish for the intercourse of citizen with citizen those rules of good manners and good neighborhood which are calculated to prevent a conflict of rights, and to insure to each the uninterrupted enjoyment of his own, so far as is reasonably consistent with a like enjoyment of rights by others\textsuperscript{37};
\item Day-Brite Lighting Inc. v. Missouri, 342 U.S. 421, 424 (1952) (the police power “extends * * * to all the great public needs”).
\end{itemize}

\footnote{71} In light of all these considerations, though the United States Constitution does not say in so many words that a state may not alienate its core police powers necessary to the economic and social functioning of the state and its citizens, that is “an inference from structure and relation” in the constitutional scheme “just as sure as any constitutional inference could be.” \textit{Black, Structure and Relationship} 40. See \textit{The Federalist No. 45 at 313} (Jacob E. Cooke ed., 1961) (“The powers reserved to the several States * * * concern the lives, liberties, and properties of the people; and the internal order, improvement, and prosperity of the State”); \textit{City of New Orleans v. Bd. of Comm’rs of Orleans Levee Dist.}, 640 S.2d 237, 249 (La. 1994) (“The principle of constitutional law that a state cannot surrender, abdicate, or abridge its police power has been recognized without exception by the state and federal courts. Because the police power is inherent in the sovereignty of each state, the power is not dependent for its existence or inalienability upon the written constitution or positive law”); \textit{State ex rel. City of Minot v. Gronna}, 59 N.W.2d 514, 531 (N.D. 1953) (“The police power is an attribute of sovereignty inherent in the states of the American union, and exists without any reservation in the constitution, being founded on the duty of the state to protect its citizens and provide for the safety and good order of society”) (internal quotation marks omitted).
contracts are to be regarded as having been made subject to the future exercise of the
classical police power of the state. See Phillips Petroleum Co. v. Jenkins, 297 U.S. 629
(1936).

There is no doubt that the principles described above prohibit a State by contract
conferring special immunities from its power to advance the public welfare. As Justice Holmes
explained, “[o]ne whose rights are subject to state restriction, cannot remove them from the
power of the state by making a contract about them. The contract will carry with it the infirmity
Allowing alienation of the police power would permit states to delegate too much authority to
private person, who may not act for the best interests of the community. Courts have adopted two
rules to implement this prohibition. First, where a contract is silent on alienating the State’s
reserved powers, the contract will be understood as reserving them to the State. Home Bldg. &
Loan Ass’n, 290 U.S. at 435 (”the reservation of essential attributes of sovereign power is read into contracts as a postulate of the legal order”). Second clear and express contractual
promises to alienate the State’s reserved power are void and unenforceable. Butchers’ Union
Slaughter-House & Live-Stock Landing Co. v. Crescent City Live-Stock Landing & Slaughter-
House Co., 111 U.S. 746 at 751 (1884); Stone v. Mississippi, 101 U.S. 814 at 817-819 (1880).72

B. The United States Supreme Court Recognizes Balancing of Interests as
Applied to the Contract Clause

Over time, the Supreme Court’s stated reasoning in determining the propriety of alleged
impairment of contract rights has become more nuanced. In Homebuilding & Loan Ass’n v.
Blaisdell, the Minnesota Mortgage Moratorium Law (which provided that, during a declared
emergency, relief could be had with respect to mortgage foreclosures and execution sales) was

72 Of a State’s reserved powers, the police power is not unique in its inalienability. The U.S. Supreme Court
has refused to allow states to alienate other great powers as well. As early as 1848, the Court held that
states could not surrender the power of eminent domain by contract. West River Bridge Co. v. Dix, 47 U.S.
(6 How.) 507 (1848); see also Backus v. Lebanon, 11 N.H. 19, 24 (1840). Likewise, the Supreme Court has
prevented states, under the public trust doctrine, from abridging the public’s reasonable use of the
waterways by granting title to submerged lands. Illinois Cent. R.R. Co. v. Illinois, 146 U.S. 387, 460 (1892)
(“There can be no irrepealable contract in a conveyance of property by a grantor in disregard of a public
trust, under which he was bound to hold and manage it”). The only core state powers that clearly are
alienable are the taxation and spending powers. U.S. Trust Co., 431 U.S. at 24; New Jersey v. Wilson, 11
U.S. (7 Cranch) 164 (1812).
challenged as being repugnant to the Contract Clause. *Homebuilding & Loan Ass’n v. Blaisdell*, 290 U.S. 398 (1934) ("Blaisdell"). The United States Supreme Court upheld the statute as a valid exercise of the police power, noting that the constitutional protection against the abrogation of contracts was qualified by the authority the state possesses to safeguard the vital interests of its people and that the legislature cannot bargain away the public health or the public morals. Further, the economic interests of the state may justify the exercise of its continuing and dominant protective power notwithstanding any interference with contracts. Importantly for this analysis, the Blaisdell court noted that there needs to be a rational compromise between individual rights and the public welfare. It articulated the conditions that justify interference with contractual rights, including: (1) an emergency is present, (2) the legislation is addressed to a legitimate end, (3) the relief afforded is of a character appropriate to the emergency and (4) the conditions do not appear to be unreasonable. *Id.* at 444.

**Contractual Rights Are Not Absolute.** The United States Supreme Court applied these principles in an instance of governmental distress. In *Asbury Park*, the Supreme Court upheld a challenge by the unsecured bondholders of Asbury Park to a New Jersey law that provided for plan of adjustment in which they received refunding bonds that represented a haircut from their original securities. The Supreme Court specifically rejected the bondholders’ claims that the original bonds “constituted contracts, the obligation of which was impaired by the denial of their right to recovery thereon and by the transmutation without their consent into the securities authorized by the plan of adjustment.” *316 U.S.* 502, 509. The Supreme Court also rejected the view that the Contract Clause barred “the only proven way for sure payment of unsecured municipal obligations.” *Id.* at 512-13. According to the Asbury Park court, the state retains police power for the maintenance of its political subdivisions and for the protection of all citizens. *Id.* at 513-14. The court specifically noted that its holding did not apply to secured claims, claims secured by property (revenues) dedicated or pledged for the obligation by statute or contract such as revenue bonds. *Id.* at 516. Further, the court commented that, in view of the slump of the collections from the exercise of the city’s taxing power, the original bonds had little value. *Id.* at 513. The Asbury Park court noted that, under the circumstances, the modification of contract obligations was not an impairment, but a recognition of limited resources and the paper rights of
the contract did not alter the duties of government to provide essential services.73 The court in *El Paso v. Simmons*, 379 U.S. 497 (1965) cited these cases when summarizing that not every modification of a contractual promise impairs the obligation of a contract under the Contract Clause. The Court cited *Blaisdell* for the proposition that the prohibition against impairment of contract “is not … absolute … and is not to be read with literal exactness like a mathematical formula.” *Id.* at 509.

Many view the *U.S. Trust* decision as the case in which the Supreme Court refined its analysis of the ability to impair public contracts. The trustee and holder of port authority bonds brought suit claiming that a New Jersey statute impaired the obligations of the state’s contract with bondholders in violation of the Contract Clause. 431 U.S. 1, 3. Citing *Blaisdell*, the Supreme Court confirmed that the Contract Clause was not absolute. *Id.* at 21. However, the Court noted that the New Jersey statute, in fact, *totally eliminated* an important security provision for the bonds. *Id.* at 19. The Court specified that, when a state impairs the obligations of its own contract, the “reserved-powers doctrine has a different basis.” *Id.* at 23. Impairment may be constitutional if it is reasonable and necessary to serve an important public purpose. *Id.* The court found that the extent of impairment is a relevant factor in determining its reasonableness. *Id.* at 27.

The following year, in *Allied Structural Steel Co. v. Spannaus* ("Spannaus"), the Supreme Court quoted *U.S. Trust* for the proposition that the Contract Clause does not obliterate the police power of the state but does impose some limits upon the power of the state to abridge existing contractual relationships. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978). Legislation adjusting the rights and responsibilities of contracting parties must be based upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption. See *Id.* at 242.

The wisdom of the above-cited United States Supreme Court cases should reinforce the appropriate interpretation of the Model Guidelines that unaffordable pension benefits whose

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73 In fact, the Court noted that state and local governments in financial distress may lack the ability to collect sufficient funds to pay certain unsecured obligations and therefore there was no impairment or diminishment in the adjustment of those unsecured obligations to what can be paid.
funding would interfere with the appropriate funding of governmental services and infrastructure must be reasonably adjusted for the sake of all concerned.\textsuperscript{74}

VI. CONCLUSION

If financially mandated pension reform efforts under current state law have failed and state constitutional and statutory provisions are obstacles to any needed pension reform efforts, the answer should not and cannot be that the government reduces funding for essential governmental services, services decline to unacceptable levels, the government melts financially and corporate and individual taxpayers leave. As horrific and unacceptable that result, it is the probable reality states and local governments face if needed pension reform is not capable of being implemented. This is not the case of unwillingness to pay, which never is an acceptable excuse for not funding public pension obligations. Rather, this is the financial and practical inability to pay and still provide the services that are mandated by the vital mission of government. This paper provides four possible alternatives to prevent the financial ruin of the government and the resulting human suffering of its citizens, taxpayers, workers and retirees.

First, effect restructuring of obligations and priorities through an expedited and efficient prepackaged Chapter 9 plan of municipal debt adjustment that is negotiated and agreed upon before jumping into a Chapter 9 proceeding.

Second, the creation of a new federal bankruptcy court for public pension funds that find themselves insolvent. The government employer and pension fund, with the help of a specialized court designed to balance the best interest of the workers and retirees, and the best interest of taxpayers, citizens and local business interests, resolve the insolvency and government function emergency. The goal will be to pay as much as can be paid on pension obligations while assuring full funding of essential governmental services at an acceptable level. Again, the purpose of the new federal bankruptcy court is to provide a fair and just resolution of the pension fund insolvency with an objective independent determination of: (a) what is sustainable and affordable, (b) whether there should be an increase in contributions or taxes or both, if necessary,\textsuperscript{74}

\textsuperscript{74} See Jack M. Beermann, \textit{The Public Crisis}, 70 WASH & LEE L. REV 3, 47-48 (2013).
and (c) what is the best method of adjusting pension obligations to a level that is feasible and affordable for the benefit of all.

Third, the use of GORDAC as supervisor and overseer of the government to facilitate consensual resolution and, if necessary, determine what can be paid and what cannot. The local government would propose a recovery plan with the ability to comment or object by interested parties, including workers and retirees, followed by a hearing before GORDAC. If agreement on the recovery plan is not reached, then GORDAC would rule on the recovery plan and enforce it, thereby using the approved recovery plan (possibly modified by GORDAC) as a prepackaged Chapter 9 plan of debt adjustment.

Fourth, if none of the above alternatives is possible or desirable, there can be a resort to a constitutional amendment or statutory public pension funding policy that follows the Model Guidelines and U.S. Supreme Court precedent for modification or adjustment of contractual rights for a higher public purpose to protect the health, safety and welfare of citizens. This constitutional amendment or legislative policy would provide for legislative findings to support the need and justification for the modification or adjustment of pension benefits, consistent with the Model Guidelines, developed case law and the purported rights of workers and retirees, while assuring taxpayers, citizens and business interests that governmental services will be fully funded and provided at an acceptable level. The public pension obligation, as mandated by the amendment and public policy, would be paid to the fullest extent possible without crowding out full funding for needed essential services and infrastructure. Also, the actuarially determined contribution for the annual pension fund payment would be calculated and mandated to be paid each year to assure the public workers and retirees past underfunding practices will not be the repeated and appropriate funding will be made.

These alternatives are conceptual proposals to be further refined and developed by the constructive dialogue of interested parties. While voluntary resolution of unfunded pension problems is the preferred and most appropriate approach, when all else fails, these four methods provide a realistic and practical way of resolving pension underfunding and preventing a government service and financial meltdown. The answer should never be that the needed public pension reforms have failed or appear impossible so the government itself fails and all parties suffer the worst outcome possible.