

RETROACTIVE PENSION
BENEFITS ARE
UNCONSTITUTIONAL

Supervisor John M.W. Moorlach

Second District

July 31, 2007

Basic Facts

- In 2001, the AOCDS (Deputy Sheriffs' union) reopened an existing contract solely to ask for an increase in pension benefits from 2% at 50 to 3% at 50.
- In December, 2001, the County granted the increase, not only going forward from the June 28, 2002 effective date, but *retroactively*. Except for a very short period applied only to the going forward portion, the County agreed to pay for 100% of the benefit from its General Fund.

Basic Facts (ctd.)

- **As an example, a 50-year old deputy sheriff who, on June 27, 2002, had worked for 25 years, had earned 50% of his or her final year's compensation as an annual pension. On June 28, 2002, that same deputy sheriff was *given* an additional 1% per year for the past 25 years, and now had 75% of the final year's compensation as an annual pension, 1/3 of which (25% of the 75%) was given to them *without working for it or paying for it.***

The Law

- **The retroactive portion of the pension increase violates the California Constitution in *three different ways*: (A) it violates the debt limitation (Article XVI, Section 18); (B) it is a “gift of public funds” (Article XVI, Section 6; and (C) it is “extra compensation” for work already performed (Article XI, Section 10).**

Debt Limitation

- **Article XVI, Section 18: “No county ... shall incur any indebtedness or liability ... for any purpose exceeding in any year the income and revenue provided for such year, without the assent of two-thirds of the voters ...” This is a “pay as you go” principle—government cannot contract to pay what it cannot allocate based on revenue in a single year.**

Debt Limitation (ctd.)

- **Before the 3% at 50 retroactive portion was adopted, the County pension was over 103% funded. Afterward, it dropped below 70% funding. The unfunded liability exceeded at least \$100 million, and, given the actual number of retirees, may exceed \$300 million.**

Debt Limitation (ctd.)

- **Pension obligations are a liability—and they can violate the constitutional debt limitation provisions. *State ex rel. Pension Obligation Bond Committee v. All Persons Interested, etc.* (July 3, 2007) (pensions are not obligations imposed by law).**

Debt Limitation (ctd.)

- **The liability is measured at the inception, and for its full amount. Therefore, here we are talking about \$100-\$300 million.**
- **“Income and revenue” means unappropriated revenue for the current fiscal year in which the liability is created. In FY 2001-02, this was \$29 million-\$48 million. Since the unappropriated income and revenue in that year was less than the liability created, the retroactive increase violated the debt limitation.**

Debt Limitation (ctd.)

- **None of the exceptions to the debt limitation apply: (A) this is not a contingent installment obligation, like a lease; (B) the pension obligations are not paid for from a “special fund,” because the County pays the entire amount from the General Fund, and the deputies pay nothing; and (C) as noted in the July 2007 POB case, pensions (unlike salaries) are not obligations imposed by law**

Retroactive benefits are not vested

- Pension rights acquired by public employees become vested as to each employee on the happening of the contingency upon which the pension becomes payable—when the employee earns it by working for it.
- Thus, only when pension benefits are earned by the performance of services, are they deemed “vested,” and cannot be reduced.
- Retroactive benefits are not earned by working—they were “given” to the employees—and thus they were never vested. If they are not vested, they are not constitutionally guaranteed.

Gift of Public Funds

- **Article XVI, Section 6: “The Legislature shall have no power to make any gift or authorize the making of any gift, of any public money or thing of value to any individual, municipal or other corporation whatever ...”**

Gift of Public Funds (ctd.)

- **“A pension is a gratuity when it is granted for services previously rendered and which at the time they were rendered gave rise to no legal obligation ...” *Lamb v. Board of County Peace Officers Retirement Commission of Los Angeles County* (1938).**
- **Here, the pension increase was granted for work done in the years before June 28, 2002, and the work done in those years only gave rise to an obligation to pay no more than 2% per year in pension benefits. Thus, when the work was done by the deputy sheriffs, there was no legal obligation to pay them another 1% per year in pension benefits.**

Gift of Public Funds (ctd.)

- **Therefore, the 1% retroactive increase was a “gratuity”—a gift—of public funds to individuals.**
- **Every retroactive increase in compensation where the employee worked under a definitive contract for a specified compensation has been stricken down as an illegal gift of public funds.**

Extra Compensation

- **Article IV, Section 17: “The Legislature has no power to grant, or to authorize a ... county ... to grant, extra compensation or extra allowance to a public officer, public employee, or contractor after service has been rendered or a contract has been entered into and performed in whole or in part ...”**
- **Article XI, Section 10: “[A] local government body may not grant extra compensation or extra allowance to a public officer, public employee, or contractor after service has been rendered or a contract has been entered into and performed in whole or in part ...”**

Extra Compensation (ctd.)

- **This is even more specific than the constitutional prohibition against a gift of public funds. The County of Orange is a “local government body.” The 1% per year retroactive portion was “extra compensation,” because it was additional to the 2% per year that the deputy sheriffs already earned for the same work. The extra compensation was granted after the services were rendered, since it was explicitly retroactive. It was also granted after the contracts were performed, since the retroactivity covered numerous prior contracts, and was arrived at in the middle of the then-current contract.**

Extra Compensation (ctd.)

- **Thus, the plain language of Article XI, Section 10 prohibits the retroactive pension benefit increase.**
- **The Legislature, in passing Government Code Section 31678.2 in 2000, which purported to authorize retroactivity, acted unconstitutionally under Article IV, Section 17 to the extent it permitted, but did not require, that employees pay for the benefits.**

Has this theory been checked?

- **The County retained outside counsel who studied the matter for several months and concurred in this analysis.**
- **Dean John Eastman of Chapman Law School concurs in these findings.**

Can we avoid litigation?

- If the employees agree to pay for all of the retroactive benefit, as is contemplated in Govt. Code Section 31678.2(b), this will create a “special fund” to pay the benefits, and will not constitute either a gift or extra compensation because the employees, and not the County, will be paying for the benefit.

What Next?

- **Supervisor Moorlach recommends the following:**
- **That the BOS indicate its intention to *rescind* the illegal, unconstitutional retroactive portion, and to employ legal counsel to go to court to obtain a declaratory judgment as to the unconstitutionality and an injunction against further payments of the 1% retroactive portion, once staff returns on September 11, 2007 with a recommendation on the method for effecting rescission and a recommendation of whom to employ as outside legal counsel; and**
- **That the BOS direct staff to determine, in consultation with OCERS, the cost of having the active safety employees pay for the retroactive benefit and consult with AOCDS over a proposed contract modification providing for the deputies to agree to make such payments.**

Is rescission of the retroactive benefit fair to retirees?

- **Is it fair to someone who retired relying on the agreement? This solution will hurt a few, BUT: (A) those deputies never earned this retroactive amount—it was a gift; (B) they won't have to give back what they have already been paid over the last five years—they just cannot collect the additional 1% per year for their pre-2002 service in the future; (C) far more people will be hurt if the County cannot pay the huge unfunded liability due to flattening property tax revenue or declining investment returns, because the County will have to cut services in a wide number of areas—health care; aid to the homeless; parks; roads; and social services. Those items are not guaranteed—pension benefits are.**

Courts have held that the harm to those who will have to give up the illegal gift in the future is outweighed by the harm of continuing the illegality in the future.

What might be the fiscal effect of rescission?

- **While the exact savings from rescinding the retroactive portion are not precisely calculable, even assuming only a \$100 million unfunded liability as created in December, 2001, the overall savings in the remaining 24.5 years of amortization of the liability would amount to, conservatively, \$183,750,000.**
- **If, in fact, the unfunded liability, due to actual retirement patterns, is \$300 million, the savings may well approach \$550,000,000.**

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