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NYT: Cracks Starting to Appear in Public Pensions' Armor.

First in Detroit, then in Stockton, Calif., and now in New Jersey, judges and other top officials are challenging the widespread belief that public pensions are untouchable.

Gov. Chris Christie of New Jersey delivered the latest blow on Tuesday, when he proposed to freeze that state's public pension plans and move workers into new ones intended not to overwhelm future budgets or impose open-ended demands on taxpayers.

The first crack came in Detroit, where a judge ruled that public pensions could, in fact, be reduced, at least in bankruptcy. Then, just a few weeks ago, an opinion by the bankruptcy judge for Stockton, which emerged from Chapter 9 on Wednesday, called California's mighty public pension system, Calpers, a bully for insisting in court that pension cuts were wholly out of the question.

Such dogma "encourages dysfunctional strategies," wrote the judge, Christopher Klein, chief judge of the United States Bankruptcy Court for the Eastern District of California. He said Calpers's legal arguments were invalid, and he concluded that it lacked standing to dominate the courtroom discussion the way it had. Stockton did not even seek permission to freeze its pension plans, but the judge nevertheless wrote that it was entitled to do so and went on to cite steps that struggling cities in general should take to trim their pension costs legally.

For starters, he recommended negotiating with their unions.

It may be sheer coincidence, but New Jersey seems have taken Judge Klein's instructions to heart, even though states cannot file for bankruptcy and thus lack that particular leverage. For months, a pension commission formed by Governor Christie has been working quietly with the New Jersey Education Association, normally one of the state's most litigious pension adversaries. By talking to each other instead of battling in court again, the two groups managed to find enough common ground to issue what they called a "road map" toward solving New Jersey's daunting pension problems.

Many details remain in flux, and the union took pains on Tuesday to say it was not endorsing Mr. Christie's full proposal and might never do so. But the road map identifies certain issues that are so important to New Jersey's teachers that the union is willing to consider a pension freeze if that is what it takes to fully protect its members from the state's looming pension collapse.

To appreciate how unusual it is for a state to propose a pension freeze, it helps to understand the "vested rights doctrine," the legal argument that public pension plans cannot be frozen or reduced. Most states uphold some form of this doctrine, though in some it is a matter of statute, in others it is enshrined in the constitution and in still others it stems from court precedent. Often, the provisions have been in place for decades and attracted little notice until recently, when baby boomers began to retire in large numbers, placing unexpected pressure on public pension funds and the state and local budgets that support them.

People have sometimes suggested freezing public pension plans to keep the hole from getting deeper. But officials usually say that is impossible, and few want to mount a costly test of the doctrine, especially because the judges who would decide such a case usually participate in public pension systems themselves.

Companies, by contrast, can legally freeze their pension plans and have been doing so for years. Since 1974, companies with pension plans have been governed by a single federal law, the Employee Retirement Income Security Act, or Erisa, which details how freezes must take place to pass legal muster. One basic requirement is that workers midway through their careers are entitled to keep whatever portion of a pension they managed to earn until the date of the freeze.

The states have long argued that because they are legal sovereigns, federal pension law does not apply to them. When states, cities and other local governments try to rein in pension costs, they often create new “tiers” of much smaller benefits for workers they expect to hire in the future, and call it a reform. But there is no freeze for existing workers, who keep accruing the same benefits as before.

In some places, it is increasingly clear that reducing benefits only for future hires does not save enough money to preserve overstretched pension plans, especially in places where retirees outnumber current workers.

The clearest solution is to curb benefit accruals, but that runs directly into the vested rights doctrine. Seeing no other way out, officials often resort to issuing bonds to obtain cash for their pension funds, a risky strategy that has failed in Detroit, Stockton and other places.

Detroit issued such debt in 2005, responding to what seemed a particularly strong rule against tampering with public pension plans: an explicit constitutional provision to that effect.

But Detroit’s bankruptcy judge, Steven W. Rhodes, ruled that the state constitutional protection was not in force while the city sought a fresh start under Chapter 9 of the bankruptcy code. In addition to cutting part of the retirees’ pensions, Detroit froze its existing pension plan and shifted its workers into a new plan that is supposed to have limited ability to tap taxpayers for any investment losses.

Judge Rhodes’s ruling was groundbreaking and so unnerved Calpers over 2,000 miles away that it immediately issued a statement that it had no bearing in California. Unlike Detroit, which operated its own pension fund, many cities and other local governments in California participate in big pooled pension systems, the largest of which is Calpers. Once they join, Calpers makes it extremely difficult to withdraw, demanding a huge termination payment. It also claims to have an enforceable lien it would use to seize the assets of any city that tried to leave without paying.

In his legal analysis in the Stockton case, Judge Klein dissected Calpers’s lien and found that it was flawed and unenforceable in any municipal bankruptcy.

“The bully may have an iron fist, but it also turns out to have a glass jaw,” he wrote.

His opinion seems likely to play a role in other fiscal hot spots. Already, two creditors have referred to it in the continuing bankruptcy case of San Bernardino, Calif. The creditors, a European bank known as E.E.P.K. and the bond insurer Ambac Assurance, are arguing that the city is playing favorites, something not allowed in bankruptcy, where sacrifices are supposed to be roughly equal. Specifically, San Bernardino has been paying its bills to Calpers while leaving E.E.P.K. and Ambac in the lurch.

And while bankruptcy is limited to cities, the ruling may also inform a pension battle in Illinois, where in November a county judge found that a state-led effort to restructure its ailing pension system was illegal because of a constitutional provision that says: “Membership in any pension or retirement system of the state” or its instrumentalities “shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.”

The state’s attorney general, Lisa Madigan, is appealing that decision, arguing in essence that public pensions can in fact be reduced in Illinois, despite what the constitution says, if that is what it takes “to protect the general public welfare.”

“This is one of those things where there’s a learning curve,” said Karol K. Denniston, a bankruptcy lawyer with Squire Patton Boggs in San Francisco who represented a local taxpayer group in Stockton’s case. “People will try things that don’t work quite right at first, then build on them. We’ve added to the municipalities’ tool kit.”

THE NEW YORK TIMES

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FEB. 25, 2015