When a Promise Is Not a Promise: Chicago-Style Pensions

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ABSTRACT

Cities and states around the country have promised their workers—most often teachers, police officers, and firefighters—retirement benefits, but have in many cases failed to set aside adequate assets to fund those benefits. Several of these pension plans are predicted to become insolvent within the next decade and innumerable additional plans appear headed for insolvency in the decade that follows. Once insolvency occurs, pension benefits due to retirees will either have to be paid out of the government's cash on hand, or simply not be paid at all. Based on their current financial positions, most jurisdictions appear unable to fund pension benefits while maintaining essential governmental services, unless taxes are raised significantly. This Article is the first to examine whether and to what extent retirees will have effective legal recourse to secure the payment of their pensions in the event of retirement plan insolvency—a critical issue not only for pensioners, but also for taxpayers. It concludes that law is unlikely to provide effective recourse for retirees due to the inability of courts to force legislatures to appropriate funds, raise taxes, or incur debt. As a result, even in cities and states with apparently iron-clad legal protection for pension benefits, pension fund insolvency leaves payment of benefits in doubt, with any solution resting solely with the legislative branch. Understanding that it is politics, not law, that will play the primary role in solving the public pension problem is critical knowledge for all interested parties as they work toward a fair solution.

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INTRODUCTION

> The contracts between a nation and individuals are only binding on the conscience of the sovereign, and have no pretensions to a compulsive force.
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> —Alexander Hamilton, *The Federalist No. 81*[1]

Over twenty-seven million Americans are creditors of state and local governments,[2] and for many of these individuals there is only a slim chance that their debt will be fully repaid. These individuals are not sophisticated investors who knowingly took on risk in lending money to state and local governments. Instead, they are firefighters, teachers, police officers, and other public employees who simply accepted employment that included a right to pension benefits at retirement. These pension benefits ostensibly entitle public employees to guaranteed payments beginning at retirement and continuing for as long as the employee lives. The amount of unfunded pension benefits currently owed to such workers tops $1 trillion.[3]

While unfunded pension liability is a nationwide issue, it is becoming an acute crisis in a handful of cities and states. In 2013, each household in the city of Chicago would have needed to contribute between $28,472 and $66,900 in order to fully fund the city's pension plans.[4] The city of Chicago's teacher pension plan "stands at risk of collapse."[5] Mayor Rahm Emanuel recently stated that Chicago's pension debt "is a big dark cloud that hangs over the rest of our city's finances."[6] He warned that if taxes are not sharply increased, pension debt will require the city to "lay[] off thousands of police officers and firefighters, end[] rat-

1. THE FEDERALIST NO. 81, at 488 (Alexander Hamilton) (Clinton Rossiter ed., 1961).
2. U.S. GOV'T ACCOUNTABILITY OFF., GAO-12-322, STATE AND LOCAL GOVERNMENT PENSION PLANS: ECONOMIC DOWNTURN SPURS EFFORTS TO ADDRESS COSTS AND SUSTAINABILITY 1 (2012), http://www.gao.gov/assets/590/589043.pdf.
3. ALICIA H. MUNNELL & JEAN-PIERRE AUBRY, CTR. FOR RET. RES. AT BOS. COLL., THE FUNDING OF STATE AND LOCAL PENSIONS: 2014–2018 4 (2015) http://crr.bc.edu/wp-content/uploads/2015/06/SLP45.pdf (reporting unfunded liabilities of $1.1 trillion using a 7.6 percent discount rate; the unfunded liability grows to $3.9 trillion if a 4 percent discount rate is used).
4. Joshua D. Rauh, *Why City Pensions Have Not Improved, and a Roadmap Forward* 16, 26 (Hoover Inst., Economics Working Paper No. 15101).
5. Monica Davey & Mary Williams Walsh, *Chicago Sees Pension Crisis Drawing Near*, N.Y. TIMES (Aug. 5, 2013), http://www.nytimes.com/2013/08/06/us/chicago-sees-pension-crisis-drawing-near.html [https://perma.cc/P73H-LRMJ].
6. Mary Williams Walsh, *Rhode Island Averts Pension Disaster Without Raising Taxes*, N.Y. TIMES (Sept. 25, 2015), http://www.nytimes.com/2015/09/26/business/dealbook/rhode-island-averts-pension-disaster-without-raising-taxes.html [https://perma.cc/63ST-P97L].

control programs and let[] street repairs lapse," among other cuts.[7] Put simply, Chicago "would become unlivable."[8] And Chicago is not alone. New Jersey's pension plan for state employees is expected to run out of funds in less than ten years, with its pension plan for K–12 teachers following close behind.[9] In Pennsylvania, nearly half of the state's municipal pension plans are considered "distressed,"[10] with the city of Philadelphia's plan labeled as "[s]everely [d]istressed" with over $5.3 billion in unfunded liabilities.[11] And Kentucky's largest statewide pension plan has assets on hand to pay only 21 percent of already-earned benefits.[12]

Traditional pension plans are by far the most common form of retirement benefits for public employees.[13] Funding these plans is much more complicated than funding 401(k) plans, which have become the norm in the private sector.[14] Funding a traditional pension plan involves relying on assumptions about life expectancy, wage growth, inflation, employee tenure, rates of disability, and investment returns.[15] It becomes even more complicated in the public sector, where funding relies on politicians agreeing to the necessary annual appropriations.[16] Given scarce budgetary dollars and many competing needs, it is easy to see why politicians who seek to be reelected would rationally choose to

7. *Id.*
8. *Id.*
9. N.J. PENSION & HEALTH BENEFIT STUDY COMM'N, A ROADMAP TO RESOLUTION 4 (2015), http://www.state.nj.us/treasury/pdf/FinalFebruaryCommissionReport.pdf.
10. PA. DEP'T OF THE AUDITOR GEN., REPORT ON MUNICIPAL PENSION FUNDS 2 (2015), http://www.paauditor.gov/Media/Default/Reports/Updated%20Municipal%20pension%20special%20report_01142015_FINAL.pdf.
11. *Id.* at 4, 13.
12. KY. RET. SYS., COMPREHENSIVE ANNUAL FINANCIAL REPORT: BUILDING A BETTER FUTURE FOR KENTUCKIANS 8, 131 (2014), https://kyret.ky.gov/Investments%20Annual%20Reports/2014-cafr.pdf.
13. *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-08-223, STATE AND LOCAL GOVERNMENT RETIREE BENEFITS: CURRENT FUNDED STATUS OF PENSION AND HEALTH BENEFITS 4 (2008), http://www.gao.gov/assets/280/271576.pdf.
14. A majority of Americans who participate in an employer-sponsored retirement plan are covered only by a 401(k) plan. *See* Craig Copeland, *Retirement Plan Participation and Asset Allocation, 2010*, 34 EBRI NOTES 9, 11–12 (2013), http://www.ebri.org/pdf/notespdf/EBRI_Notes_04_Apr-13_CDHPs-RetPart1.pdf (finding that among working heads of household who participated in an employer-sponsored retirement plan, 18.9 percent participated only in a defined benefit plan, 65 percent participated only in a defined contribution plan, and 16.1 percent participated in both). Such 401(k) plans are easy to fund because they involve simply implementing a participant's election to contribute a certain amount of her salary to the plan. *See* Amy B. Monahan, *Addressing the Problem of Impatients, Impulsives and Other Imperfect Actors in 401(k) Plans*, 23 VA. TAX REV. 471, 475–76 (2004).
15. Jonathan Barry Forman, *Funding Public Pension Plans*, 42 J. MARSHALL L. REV. 837, 843 (2009).
16. Amy B. Monahan, *State Fiscal Constitutions and the Law and Politics of Public Pensions*, 2015 U. ILL. L. REV. 117, 128 (2015).

shortchange annual pension contributions in favor of spending that is more visible to constituents.[17] While the causes of today's pension underfunding are complicated, it is clear that part of the problem lies in the systemic underfunding of such plans by politicians.

Regardless of why this massive pension debt has accrued, difficult choices will need to be made to address such debt—at least in the most poorly funded jurisdictions. These poorly funded jurisdictions are often, but not always, experiencing fiscal distress that is much broader than pension debt. In highly distressed jurisdictions, budget contractions have already led to "a generation of urban, high-poverty governments focused on little more than the control of fire and violent crime."[18] It is often within this context that state and local governments must embrace some combination of raising taxes, reducing the level of government services, or cutting pensioners' benefits in order to address their pension debt. The stakes involved are high, not only for pensioners, but also for taxpayers. There are no easy solutions for debt of this magnitude. If pension benefits must be paid in full, essential governmental services may be severely impaired—potentially leading to a breakdown in the jurisdiction's revenue base, as affluent households move away to avoid the debt burden.[19] And if pension benefits are not paid, the retirement security of millions may be endangered.

Yet, for the most part, participants in these plans are not panicked about the possibility of benefit nonpayment. In many cases, this lack of panic is due to court rulings that have found pensioners to have strong legal rights to their earned pension benefits. For example, the Illinois Supreme Court recently held that public employees' pension rights could not be reduced or impaired under any circumstances, regardless of any financial distress of the relevant public entity.[20]

Pensioners should not, however, feel comforted by such rulings. Based on current projections, the pension funds of several cities and states will deplete their assets within a decade.[21] This Article offers the first detailed analysis of what legal options are available to pensioners in the event that a pension plan no longer holds sufficient assets to pay benefits. The answer, as the introductory quote to this Article suggests, is that pensioners will have no effective remedy against a state or city to force pension payments in the event the pension fund's assets are depleted, even where there is a legal right to the benefit. Pensioners

17. *See infra* Part I.C.
18. Michelle Wilde Anderson, *The New Minimal Cities*, 123 YALE L.J. 1118, 1126 (2014).
19. For a discussion of this issue, see D. Roderick Kiewiet & Mathew D. McCubbins, *Erosion of the Foundations of Municipal Finance*, *in* PUBLIC PENSIONS AND CITY SOLVENCY 64, 64–84 (Susan M. Wachter ed., 2016).
20. *In re* Pension Reform Litig., 32 N.E.3d. 1, 18–20 (Ill. 2015).
21. *See infra* Part I.C.

must instead depend on politicians to voluntarily make the necessary appropriations to pay benefits out of current cash flow, or to borrow funds to accomplish the same outcome.

This Article begins in Part I with an overview of the current state of public pensions, examining how they are funded, the extent of current underfunding, and reasons behind the current funding crisis. It also provides a quick look at the tools available to cities and states to address underfunding. Part II then explores the critical issue of whether plan participants will have effective legal recourse in the event that pension fund assets are insufficient to pay benefits. Even if the hurdle of sovereign immunity can be overcome so that a court will hear a claim against the state or city, courts have generally held that they lack power to order an appropriation—a power considered to lie exclusively with the legislative branch. Related limitations on the judiciary's ability to raise taxes or incur debt may similarly prevent courts from raising the revenue necessary to pay pension benefits. While conventional legal relief appears out of reach for pensioners, Part II also explores whether courts might be able to craft creative remedies, within their judicial power, that might lead to politicians making the necessary appropriations or otherwise raising the necessary revenue. These nontraditional remedies, such as the sequestration of other public appropriations, offer pensioners some small degree of hope that a court might be able to place enough pressure on legislators to force legislative action to either appropriate or borrow the necessary pension funds.

Given the highly undesirable outcome for pensioners that can result if pension funds are depleted, Part III examines whether law can be used proactively to force politicians to make required annual contributions to pension funds, in order to avoid the scenario in which the pension fund's assets are depleted and pensioners have no legal recourse to secure benefits owed to them. Here, too, the conclusion is disappointing for pensioners seeking reassurance that their earned benefits will be paid. State balanced budget requirements and debt limitations do nothing to ensure adequate pension funding, in many cases even appearing to contribute to politicians' inclination to underfund such plans.[22] Even where politicians have attempted to precommit themselves to adequate pension funding by enacting statutes requiring appropriate funding, such laws have been held unenforceable. One state supreme court has even held that the legislature "cannot constitutionally create a legally binding, enforceable [pension funding] obligation on the State."[23] The Article concludes by examining what this legal

22. *See infra* Part III.A.
23. *See* Burgos v. State, 118 A.3d 270, 296 (N.J. 2015); s*ee also infra* Part III.B.

analysis means for pensioners, taxpayers, and politicians in distressed jurisdictions.

The systemic failure of many states and cities to adequately fund their pension plans has put public workers in the discomforting position of being long-term creditors of these governments. This, of course, is a precarious position for workers, given that states and cities may in fact be judgment proof and workers must instead depend on political goodwill in order to be paid. When commercial creditors take this risk we are relatively unconcerned. Bond market investors know the risks of nonpayment; they can price the risk accordingly, and can rely in part on the fact that most governments need access to credit markets and are therefore likely to repay their debt even in difficult circumstances (despite any questions about whether such debt is in fact legally enforceable).[24] It is hard to imagine that most public workers take on this same risk with full knowledge, particularly in light of workers' well-publicized rights to their pension benefits. The legal analysis in this Article obviously paints a bleak picture for pensioners in highly distressed cities and states. But understanding that the responsibility for solving the public pension problem rests primarily with the legislative branch, rather than the judicial, is critical knowledge for all stakeholders.

I. THE CURRENT STATE OF PUBLIC PENSIONS

Pension plans for state and local employees (public pensions) are complicated political and financial entities. They are often difficult to fund accurately and adequately, and many plans are currently struggling with significant funding shortfalls. This Part provides a brief overview of pension funding theory and the public plan funding process, before detailing the current extent of public plan underfunding. It concludes with an examination of the political economy of annual funding decisions for public plans, as well as an overview of strategies that state and local governments can use to address funding shortfalls.

A. The Difficulties of Funding Pensions

Public pension plans currently cover over twenty-seven million individuals.[25] These plans are traditional, defined benefit pension plans that pay each eligible participant a guaranteed amount at retirement, for as long as the

24. *See* Emily D. Johnson & Ernest A. Young, *The Constitutional Law of State Debt*, 7 DUKE J. CONST. L. & PUB. POL'Y 117, 125 (2012) (contrasting the risk of sovereign debt with corporate debt).
25. U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 2.

participant lives. While the specifics vary from plan to plan, a plan's benefits are generally based on a participant's years of service with the state or locality and the participant's final average salary.[26] Unlike pension plans in the private sector, these plans are generally funded by both employers and employees.[27] Employers, however, bear all of the investment risk associated with such plans. If the plan has insufficient assets to pay benefits, it is the employer that is obligated to make up the shortfall. About a quarter of all participants in public pension plans do not participate in the federal Social Security program because their governmental employers have opted out under applicable law.[28] For these participants, their public pension benefits are critical to their retirement security, as they likely have no other form of guaranteed income at retirement.

Traditional defined benefit plans of the type commonly seen in the public sector are lauded for their ability to help participants enjoy financial security in retirement.[29] Because participants face no investment risk in such plans, and because benefits paid out in retirement are set by formula and guaranteed for as long as the participant lives, these plans provide much better financial security than is typically enjoyed in the more common 401(k) plan.[30] Funding such plans is, however, much more complicated than funding a 401(k) plan.

Because pension plans guarantee a specific payout in retirement for as long as a participant lives, funding methodologies for such plans are necessarily inexact. While plans generally have significant freedom under state law to determine funding strategy, the basic premise of actuarially based funding standards is to make annual contributions that cover the cost of benefits earned during the year in issue, so as to spread pension costs over employees' working years.[31] Determining how to fund a pension plan throughout an employee's working years is not necessarily easy. Because the benefit is not payable until some years in the future, and its amount depends on many factors such as the age at which the participant retires, how long the participant lives, the participant's final salary, and the rate of investment return from the time of contribution until payout, the contribution amount is necessarily an estimate.

The fact that the amount contributed to cover the benefits earned in a given year is an estimate means that the amount contributed can be more or less than

26. Edward A. Zelinsky, *The Cash Balance Controversy*, 19 VA. TAX REV. 683, 687 (2000).
27. In the private sector, employees are not permitted to contribute to defined benefit pension plans. Funding must come solely from the employer.
28. U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 2, at 5.
29. *See, e.g.*, Edward A. Zelinsky, *The Defined Contribution Paradigm*, 114 YALE L.J. 451, 458–69 (2004).
30. *See id.*
31. Forman, *supra* note 15, at 869.

necessary. For example, if a plan calculates contribution amounts assuming an 8 percent rate of return on investments, but the plan earns only 5 percent, the plan will have a funding shortfall—referred to as an unfunded liability. As a result, in addition to funding benefits earned in a given year, plans must also make up any funding shortfalls from previous years by paying down any unfunded liability. Unfunded liabilities are usually paid down over a period of not more than thirty years, thereby preventing large financial shocks to the employer.[32]

Pension funding becomes even more complicated when politics enter the picture. Pension plans for state and local employees take many different forms, but they are often established by state legislation that specifies the terms of the benefit, establishes a trust to hold funds, and provides for a board of trustees to administer the trust and pay out benefits. Pension benefits are sometimes bargained over as part of labor negotiations, but this typically only happens at the municipal level, and even then is relatively uncommon. While each state often has one or more large, state-level plans to cover state employees, plans are also organized at the county, city, and a variety of municipal levels.

Regardless of the level of government at which a public pension plan is established, funding is dependent on political budget appropriations. For state-level plans, this means that the legislature must allocate an appropriate amount of funds each year, and similar processes must generally take place at the local level for those plans that are established by municipalities. Funding needs are typically determined by actuaries who have been hired by a plan's board of trustees, but politicians can and do deviate from such funding recommendations.[33] There are, however, some exceptions to this political model of pension funding. Some states require municipalities to participate in state-level pension plans and to fully fund such plans. In the event that the municipality contributes less than the required amount, the state withholds the shortfall from any state transfers to the municipality and uses the withheld funds to fund the pension plan.[34]

32. THE NAT'L ASS'N OF STATE BUDGET OFFICERS, GASB ENACTS PENSION ACCOUNTING REFORMS REGARDING THE USE OF DISCOUNT RATES 1 & n.1 (2012), https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/Issue%20Briefs%20/GASB%20Enacts%20Pension%20Accounting%20Reforms%20Regarding%20the%20Use%20of%20Discount%20Rates.pdf.

33. Thomas J. Fitzpatrick IV & Amy B. Monahan, *Who's Afraid of Good Governance? State Fiscal Crises, Public Pension Underfunding, and the Resistance to Governance Reform*, 66 FLA. L. REV. 1317, 1324–25 (2014).

34. Natalya Shnitser, *Funding Discipline for U.S. Public Pension Plans: An Empirical Analysis of Institutional Design*, 100 IOWA L. REV. 663, 685–86 (2015).

Given the inherently political nature of most public pension funding methods, it is unsurprising that funding methodology is sometimes manipulated to lower required contributions. State and local governments are not subject to any funding requirements other than those imposed by their own laws, and are therefore free to use any methodology they choose. Actuarial methods can be relatively easily manipulated to lower current contribution amounts, pushing higher required contributions into future years.[35] In addition, some plans do not pay off unfunded liabilities over the thirty-year period mentioned above. Some plans, for example, use a thirty-year "open" amortization period, meaning that one-thirtieth of the unfunded liability in year one is paid off in year one, but is then refinanced over a new thirty-year period in year two.[36] One does not need to be an actuary to see that open amortization can result in unfunded liability never being significantly paid down. Finally, some plans do not use actuarial methodology to determine contribution rates at all, but rather specify in statute that contributions will be equal to a set percentage of payroll each year. Not surprisingly, using fixed statutory contribution rates is negatively associated with funding status.[37]

The funding process for public plans differs significantly from that seen in the private sector. Private employers that sponsor defined benefit pension plans are regulated by the federal government pursuant to the Employee Retirement Income Security Act of 1974 (ERISA), rather than the states.[38] ERISA's requirements are specific and detailed, and include federal funding requirements[39] and a federal program to insure private pensions against insolvency, run by the Pension Benefit Guarantee Corporation.[40] The end result is that participants in private pension plans are likely better protected against both underfunding and insolvency than their public plan counterparts. While Congress did consider subjecting public plans to federal regulation under ERISA, it was found to be unnecessary in part because state and local governments' power to tax was thought to be an effective safeguard against plan underfunding and insolvency.[41]

35. Monahan, *supra* note 16, at 141–46.
36. *Id.* at 144.
37. Shnitser, *supra* note 34, at 698.
38. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974).
39. 29 U.S.C. § 1082 (2012).
40. 29 U.S.C. § 1301 (2012).
41. S. REP. NO. 93-383 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4890, 4965; H.R. REP. NO. 93-807 (1974), *reprinted in* 1974 U.S.C.C.A.N 4670, 4756–57; Agullard v. Principal Life Ins. Co., 685 F. Supp. 2d 947, 955 (D. Ariz. 2010).

B. How Underfunded Are They?

While there is much debate about the correct measures to use to calculate the extent of public pension underfunding,[42] nearly all measures illustrate that the problem is significant. State pension plans are estimated to be underfunded by nearly $1 trillion, an amount that is equal to roughly 8 percent of gross domestic product.[43] City pension plans add another $99 billion to that number.[44] If more conservative discount rates are used, state liability rises to over $2.5 trillion, with city liabilities coming in at $574 billion.[45] On average, employers' required contributions to such plans were almost 19 percent of total payroll in 2014.[46]

What these national numbers do not reflect is that the burden varies tremendously among different cities and states. There are many plans that enjoy a healthy funding level,[47] and therefore raise little concern about the impact of pension debt on essential government services. At the opposite end of the spectrum are cities and states that appear to be headed toward fund insolvency or the devastating crowd-out of basic governmental services. One study estimated that Illinois's pension funds would be depleted by 2018, with Connecticut, Indiana, and New Jersey following close behind in 2019.[48] In order to prevent default, "state revenues might have to increase by twenty percent in Indiana and by thirty-five percent in Illinois and New Jersey."[49] In Colorado, which may deplete its pension funds by 2022, tax revenues would need to increase by over 50 percent in order to pay benefits when due.[50] In Chicago, per household pension debt in the city was over $28,000 in 2013, and this number was calculated using the system's own investment return assumptions.[51] If more conservative

42. *See, e.g.*, Jeffrey R. Brown & David W. Wilcox, *Discounting State and Local Pension Liabilities*, 99 AM. ECON. REV. 538 (2009); *see also* Robert Novy-Marx & Joshua Rauh, *Public Pension Promises: How Big Are They and What Are They Worth?*, 66 J. FIN. 1211, 1211–16 (2011).
43. THE PEW CHARITABLE TRS., THE STATE PENSIONS FUNDING GAP: CHALLENGES PERSIST 8 (2015), http://www.pewtrusts.org/~/media/assets/2015/07/pewstates_statepensiondebtbrief_final.pdf.
44. THE PEW CHARITABLE TRS., A WIDENING GAP IN CITIES: SHORTFALLS IN FUNDING FOR PENSIONS AND RETIREE HEALTH CARE 3 (2013).
45. Rauh, *supra* note 4, at 2.
46. MUNNELL & AUBRY, *supra* note 3, at 3.
47. *See id.* (finding that for fiscal year 2014, 6 percent of public plans had funded ratios of 100 percent or more, and 31.3 percent of public plans had funded ratios between 80 and 99 percent).
48. Joshua D. Rauh, *Are State Public Pensions Sustainable? Why the Federal Government Should Worry About State Pension Liabilities*, 63 NAT'L TAX J. 585, 586 (2010).
49. Terrance O'Reilly, *A Public Pensions Bailout: Economics and Law*, 48 U. MICH. J.L. REFORM 183, 186 (2014).
50. *Id.*
51. Rauh, *supra* note 4, at 16.

assumptions are used, per household debt in Chicago rises to over $66,000.[52] The total amount of Chicago's unfunded pension liability is equivalent to ten years' worth of general revenue.[53] Chicago's pension plans are paying out 14 percent of trust assets per year,[54] a rate that appears unsustainable. And if the pension funds were to run dry, Chicago would need to devote nearly half of all of its revenues to pay currently due benefits.[55]

Pension debt is so significant in some cities and states that credit markets are taking notice. States that have seen a negative effect on their credit rating because of pension debt include California,[56] Connecticut,[57] Kentucky,[58] Illinois,[59] New Jersey,[60] and Pennsylvania.[61] Chicago's bond rating has recently been "super downgrade[d]" to junk status.[62] As a result of these credit downgrades, distressed cities and states face higher borrowing costs, further reducing their financial capacity.[63]

52. *Id.* at 26.
53. *Id.* at 23.
54. *Id.* at 24.
55. *Id.*
56. James Nash, *California Pensions Upgraded by Moody's on Funding Plan*, BLOOMBERG (July 7, 2014, 5:33 PM), http://www.bloomberg.com/news/articles/2014-07-08/california-pensions-upgraded-by-moody-s-on-funding-plan [https://perma.cc/X4V7-DNRR] (noting that California had been downgraded in December 2009 in part due to pension liabilities, but has since received a higher rating because of the state's improved fiscal position).
57. MOODY'S INV'RS SERV., *Rating Action Affects Approximately $14.6 Billion in Outstanding G.O. Debt*, MOODY'S (Jan. 20, 2012), https://www.moodys.com/research/MOODYS-DOWNGRADES-STATE-OF-CONNECTICUT-GENERAL-OBLIGATION-BONDS-TO-Aa3--PR_235771 (noting, among other causes, "pension funded ratios that are among the lowest in the country and likely to remain well below average").
58. Tom Loftus, *Pension Debt Lowers Kentucky Credit Rating*, COURIER-J. (Sept. 4, 2015, 6:21 PM), http://www.courier-journal.com/story/news/politics/2015/09/03/kentucky-credit-rating-downgraded/71668062 [https://perma.cc/JR3L-VB3U].
59. David McKinney & David Roeder, *Downgrade for State's Credit Due to Pension Woes*, CHI. SUN-TIMES, Aug. 30, 2012, at 62.
60. Matt Friedman, *Citing Christie's Pension Cuts and Budget Issues, S&P Downgrades N.J. Debt Rating*, NJ.COM (Sept. 10, 2014, 1:53 PM), http://www.nj.com/politics/index.ssf/2014/09/citing_christies_pension_payment_cuts_and_budget_problems_sp_downgrades_nj_debt_rating.html [https://perma.cc/XE3T-MJ4N].
61. Paul Burton, *S&P Becomes Latest to Downgrade Pennsylvania*, BOND BUYER (Sept. 26, 2014), http://www.bondbuyer.com/news/regionalnews/s-and-p-becomes-latest-to-downgrade-pennsylvania-1066488-1.html.
62. Davey & Walsh, *supra* note 5; Heather Gillers, *New Emphasis on Pension Debt at Moody's Helped Chicago Fall to Junk Status*, CHI. TRIB. (May 26, 2015, 5:07 AM), http://www.chicagotribune.com/news/local/politics/ct-chicago-ratings-moodys-met-20150525-story.html [https://perma.cc/ZN9Y-FFEN].
63. *See, e.g.*, Gillers, *supra* note 62 (noting that the interest rates on some of Chicago's debt increased by 3.5 percent as a result of its credit downgrade).

Because public pension underfunding began to garner attention around the time of the financial crisis that began in 2007, many have wondered whether the underfunding problem might actually be a short-term one, brought on by the decline in equity markets. Evidence suggests, however, that this hypothesis is not true.[64] Rather, states are facing long-term financial burdens and debt overhang.[65] Absent significant and sustained revenue growth, it seems unlikely that the most distressed states will be able to continue their operations without in some way addressing these long-term liabilities.[66]

C. Why Are They Underfunded?

Many factors combine to result in systemic underfunding of public pension plans. Perhaps the most important factor is that public plan funding depends on annual appropriations made through the city's or state's legislative budgeting process, an exercise that is inherently political.[67] The budgeting process generally takes place in a balanced budget environment in which legislators may only make appropriations equal to the amount of projected or actual revenue for the year, leading to significant constraints on appropriations, including those to pension plans.[68]

In addition to facing the same spending constraints that all budget appropriations face, pension plans are likely shortchanged because they involve setting aside money now to benefit individuals in the future. There are two distinct problems that arise because of the delayed benefit inherent in pension funding. First, it is well established that individuals (including politicians) are likely to engage in hyperbolic discounting, irrationally favoring current needs over future needs.[69] All other things being equal, then, we would expect pension

64. *See* Rauh, *supra* note 4, at 5–9 (summarizing findings that city pension liabilities increased during the strong market return period of 2009–2013).
65. *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-11-495SP, STATE AND LOCAL GOVERNMENTS' FISCAL OUTLOOK: APRIL 2011 UPDATE 1–2 (2011), http://www.gao.gov/new.items/d11495sp.pdf; STATE BUDGET CRISIS TASK FORCE, FINAL REPORT 8, 10 (2014); *see also* O'Reilly, *supra* note 49, at 186 (noting that the revenue demands caused by public pension debt "would not be temporary").
66. Johnson & Young, *supra* note 24, at 123–24.
67. Monahan, *supra* note 16, at 128.
68. *See id.*
69. *See, e.g.*, R.H. Strotz, *Myopia and Inconsistency in Dynamic Utility Maximization*, 23 REV. ECON. STUD. 165, 180 (1955–56); Richard Thaler, *Some Empirical Evidence on Dynamic Inconsistency*, 8 ECON. LETTERS 201, 202 (1981); *see also* George Loewenstein, *The Fall and Rise of Psychological Explanations in the Economics of Intertemporal Choice*, *in* CHOICE OVER TIME 3–32 (George Loewenstein & Jon Elster eds., 1992) (providing an historical overview of hyperbolic discounting scholarship).

contributions to be given a lower priority than spending that has an immediate benefit. Second, politicians generally operate within the context of the election cycle—meaning that they make decisions based on a desire to be reelected.[70] It is easy to see how voting to immediately increase education spending is much more valuable to a politician's reelection efforts than a decision to keep education spending flat while responsibly funding the pension plan so that it can continue to pay benefits thirty years in the future.

Suboptimal political decisionmaking is of course not a new phenomenon, nor is it limited to public pensions. But what is unique about political decisionmaking in the pension context is that there is no effective counterpressure to politicians' incentives to underfund such plans.[71] There are three potential sources of counterpressure to the political pressure to underfund: workers, credit markets, and taxpayers. To date, none have appeared to successfully counteract pension underfunding. Workers generally have not been active lobbyists in favor of full funding, likely in part because most plans are not in danger of immediately running out of funds to pay benefits. And even where plans are severely distressed, workers may assume that because state law guarantees their benefits they will be able to collect against the city or state even in the absence of funds in the pension trust. Perhaps most importantly, workers actually benefit from disguising the true costs of pension benefits.[72] If workers pushed hard for adequate pension funding, there would be less money available for other forms of compensation. If contributions are kept artificially low, workers may be able to secure higher overall levels of compensation and benefits.

Credit markets have also been ineffective in ensuring adequate pension funding. While credit rating agencies can and do downgrade cities and states based on pension debt, they do so only once pension debt has become so large that it potentially endangers the repayment of bonds.[73] As a result, credit markets do not exert pressure until pension funding is already highly distressed and difficult to correct.

And finally, taxpayers have shown little interest in lobbying for responsible pension funding. This is not surprising, given pension funding's lack of salience for the typical voter, along with the fact that the most serious ill effects

70. *See* JAMES M. BUCHANAN & RICHARD E. WAGNER, DEMOCRACY IN DEFICIT: THE POLITICAL LEGACY OF LORD KEYNES 159 (1977).

71. Monahan, *supra* note 16, at 129.

72. *See* Sarah F. Anzia & Terry M. Moe, *The Politics of Pensions* 5 (Inst. for Research on Labor and Emp't, Working Paper No. 108–14, 2013), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2300640 (observing that, with respect to public pensions, all of the organized interest groups were "pushing in the same direction—a classic formula for political capture").

73. Monahan, *supra* note 16, at 155.

of irresponsible funding are often not felt for decades. Given the propensity for individuals to discount the future, along with uncertainty regarding whether they will still be taxpayers in the jurisdiction when the problem arises, it is understandable why taxpayers have not become involved in any meaningful way in most jurisdictions.

Compounding each of these factors is the fact that pension contribution needs tend to be countercyclical. When the economy is doing well and revenues are high, pension funds usually enjoy strong investment returns and thus have relatively low contribution needs. When the economy is doing poorly, and revenues are down and social needs greatest, pension funds often experience market losses, and therefore require relatively larger contributions. In other words, pension funds often need the most money at the exact time that states are under the greatest fiscal stress.

D. What Can Distressed Cities and States Do to Address Pension Underfunding?

There are not many obvious solutions to the public pension problem. Many states and cities have reduced the generosity of pension benefits for new hires, but such actions generally do nothing to address existing debt.[74] States and cities have also pursued reforms that provide some combination of lower benefits for existing employees and higher contributions from either employers or employees, but these reforms are often limited or prohibited entirely by laws protecting pension benefits and accruals from reduction.[75] And of course a handful of large cities have resorted to municipal bankruptcy to address their debt overhang.[76]

But if accrued (and in some cases, future) pension benefits cannot be reduced, there are few other options for states, in particular, to get out from under pension debt. The available options include: (1) raising taxes, (2) shifting government resources away from current allocations to fund pensions, (3) hoping for economic growth that results in higher revenues at current tax rates, and (4) hoping that pension assets grow at rates exceeding investment return

74. In some cases, changes for new employees essentially require those employees to contribute greater amounts for lower benefits, in that way requiring new employees to help subsidize older workers.

75. *See generally* Amy B. Monahan, *Public Pension Plan Reform: The Legal Framework*, 5 EDUC. FIN. & POL'Y 617 (2010) (providing an overview of the legal protections that apply to public pension benefits).

76. Clayton P. Gillette & David A. Skeel, Jr., *Governance Reform and the Judicial Role in Municipal Bankruptcy*, 125 YALE L.J. 1150, 1152 (2016) (noting recent municipal bankruptcies in Vallejo, San Bernardino, and Stockton, California; Jefferson County, Alabama; and Detroit, Michigan).

assumptions. The first and second options remain unattractive in the current fiscal and political climate. States and cities are generally wary of tax increases, given concerns about the effect of increased taxes on economic growth, and also the potential for taxpayers to move outside of the jurisdiction in response to either higher taxes or reduced government services.[77] The third and fourth options are the most palatable, but also the hardest to control and predict.[78] The fourth option is also inherently risky. Where the only hope for the pension fund is to produce blockbuster investment returns, pension funds may take on risk well above the optimal level. And finally, even if the third and fourth options were to work, they require time that several pension funds simply do not have.

II. WHEN THE MONEY RUNS OUT: LEGAL ENFORCEMENT OF SOVEREIGN PROMISES

For a state or city in fiscal distress with large unfunded pension liabilities, the ultimate question is what will happen if there are insufficient funds available in the pension trust to pay earned, legally protected pension benefits. This issue arises only when the pension trust itself runs out of money. Funds contributed to a public pension plan are held in trust for the exclusive benefit of plan participants.[79] As a result, those funds cannot be diverted for other purposes without violating both the terms of the trust and the requirements of the Internal Revenue Code governing pension plans.[80] Once a participant has earned the right to a pension benefit, he or she has the right to receive payment from the trust.

As long as there are sufficient funds in the trust to pay currently due benefits, it is clear that participants can relatively easily ensure they receive the benefits due to them. The harder question arises when the trust no longer holds sufficient

77. Raising taxes and reducing government services can lead to a situation where taxpayers are paying more to get less and less. Where this occurs, the fiscal distress that already exists can snowball, as those who can will migrate out of the jurisdiction, further decreasing the tax base. Kiewiet & McCubbins, *supra* note 19, at 77. Illinois, for example, is already losing taxpayers at one of the fastest rates in the country. *SOI Tax Stats-Migration Data*, INTERNAL REVENUE SERVICE, https://www.irs.gov/uac/SOI-Tax-Stats-Migration-Data [https://perma.cc/34EP-6TRS] (reporting under the Migration Data for 2012–2013 and 2013–2014 that Illinois lost 68,943 residents from 2012–2013 and 82,881 residents from 2013–2014); *see also IRS 2012–2013 State Migration Data-NY Down Big, TX & FL Shine*, CLEAN SLATE TAX (Aug. 20, 2015), http://cleanslatetax.com/blog/irs-state-migration-data [https://perma.cc/77W4-WMTM] (finding that Illinois had the second-largest loss of taxpayers among the states from 2012 to 2013).

78. *See* Johnson & Young, *supra* note 24, at 123–24 (noting that some cities and states are likely to be unable to satisfy their pension debt even if strong economic growth occurs).

79. 26 U.S.C. § 401(a) (2014).

80. *Id.*

assets.[81] In many states, such a scenario is relatively unforeseeable, but the same is not true in a handful of highly distressed states and cities. New Jersey's general employee pension plan is projected to run out of funds in 2024, with the state teacher's plan following close behind in 2027.[82] In Illinois, the state Teachers' Retirement System declares in its own financial report that it faces a "calamity" in less than twenty-five years if funding practices do not change.[83] Kentucky did not disclose a depletion date in its most recent annual report, but referred to its funding levels as "alarmingly low" at 21 percent funded.[84] Each of Chicago's four pension plans is projected to be insolvent by 2026 or earlier.[85]

Where a pension trust is depleted, a participant can have a legal right to her benefit but not be able to effectively enforce that right absent the cooperation of the legislature in agreeing to the necessary appropriation. And keep in mind that by the time a pension trust runs dry, the annual appropriation needed to pay out current benefits may be an enormous share of the overall state or city budget. For example, in the 2014 fiscal year, the Illinois Teachers' Retirement System paid out over $5.2 billion in benefits—an amount that was more than half of what it paid in salary to all active teachers in 2014.[86] In Kentucky, the amount of benefits paid out to participants in its nonhazardous employee plan was over $889 million, an amount that is equal to 56 percent of its covered payroll.[87] In 2013, the city of Philadelphia paid out over $676 million in benefits, an amount equal

81. One of the reforms enacted by ERISA was to prohibit an employer from limiting pension liability to trust assets. *See* JOHN H. LANGBEIN ET AL., PENSION AND EMPLOYEE BENEFIT LAW 82, 220–21 (5th ed. 2010). ERISA does not, however, apply to public plans. 29 U.S.C. § 1003 (2012).

82. N.J. PENSION & HEALTH BENEFIT STUDY COMM'N, A ROADMAP TO RESOLUTION 4 (2015), http://www.state.nj.us/treasury/pdf/FinalFebruaryCommissionReport.pdf.

83. TEACHERS' RET. SYS. OF THE STATE OF ILL., COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR THE FISCAL YEAR ENDED JUNE 30, 2014 7 (2015), http://trs.illinois.gov/pubs/cafr/FY2014/fy14.pdf.

84. KY. RET. SYS., COMPREHENSIVE ANNUAL FINANCIAL REPORT: BUILDING A BETTER FUTURE FOR KENTUCKIANS 8 (2014), https://kyret.ky.gov/Investments%20Annual%20Reports/2014-cafr.pdf (referencing, among other statistics, a 21 percent funded level in the Kentucky Retirement System nonhazardous plan).

85. COMM'N TO STRENGTHEN CHICAGO'S PENSION FUNDS, FINAL REPORT VOL. 1: REPORT & RECOMMENDATIONS 21–22 (2010), http://www.chipabf.org/ChicagoPolicePension/PDF/Financials/pension_commission/CSCP_Final_Report_Vol.1_4.30.2010.pdf (the latest insolvency date of 2026 assumes the plans earn a 6 percent average rate of return; the insolvency date occurs earlier if the plans fail to achieve that rate of return, or later if the plans beat a 6 percent return. Even if each plan achieves 8 percent annualized returns, all are projected to be insolvent by 2030).

86. TEACHERS' RET. SYS. OF THE STATE OF ILL., *supra* note 83, at 9.

87. KY. RET. SYS., *supra* note 84, at 58, 164 (percentage computed by author).

to 47 percent of the total salaries it paid out in that year to employees.[88] While these historic figures do not necessarily tell us what the financial burden will be in the future, they do illustrate that, if pension funds are depleted, several cities and states could expect to see their payroll expenses increase by more than 50 percent.

The stakes involved in sorting through the legal responsibility for such debt are incredibly high, for both affected workers and taxpayers. As the Subparts below will explore, there are two primary hurdles that must be overcome in order for workers to successfully collect pension debt: sovereign immunity and limitations on judicial remedies.[89] Because states and cities are treated differently for purposes of sovereign immunity and remedies, each will be examined separately.

A. Enforcement of State Promises

1. Sovereign Immunity in State Courts

In order to have any hope of collecting unfunded pension debt, plan participants must be able to bring suit against the state. An initial hurdle for such potential plaintiffs is the doctrine of sovereign immunity, which operates to prevent a government from being sued in its own courts without consent.[90] As the Subpart below will explain, the fact that pension benefits are considered contractual in nature should be sufficient to overcome sovereign immunity and allow a participant to successfully bring an action against the state for nonpayment of pension benefits.

State governments are sovereign, and as such enjoy broadly recognized sovereign immunity from many different types of legal actions. While the Eleventh Amendment specifically grants sovereign immunity to a state being sued by citizens of another state, the U.S. Supreme Court has explained that immunity is in fact much broader than the text of the amendment.[91] Hamilton stated in Federalist 81 that, "[i]t is inherent in the nature of sovereignty not to be amenable to the suit of an individual *without its consent*."[92] Sovereign immunity has its origins in English common law.[93] It is premised on the principle that "there can be

88. CITY OF PHILA. BD. OF PENSIONS & RET., ANNUAL REPORT: FISCAL YEAR ENDING JUNE 30, 2013 21 (2013), http://www.phila.gov/pensions/PDF/2013%20Philly%20Annual%20Report.pdf (percentage computed by author).

89. *See* Johnson & Young, *supra* note 24, at 125 ("It is unclear what, if any, enforceable remedies a stakeholder has against a state.").

90. *Sovereign Immunity*, BLACK'S LAW DICTIONARY (10th ed. 2014).

91. Hans v. Louisiana, 134 U.S. 1, 10–12, 16 (1890).

92. THE FEDERALIST NO. 81, at 487 (Alexander Hamilton) (Clinton Rossiter ed., 1961).

93. *See* Kawananakoa v. Polyblank, 205 U.S. 349, 353 (1907).

no legal right as against the authority that makes the law on which the right depends."[94] In the United States, sovereign immunity has been justified as a rule that protects the state from interference in its performance of the functions of government and preserves its control over state coffers.[95]

State sovereign immunity also has been characterized as an explicit mechanism to protect the public fisc by preventing damages from being imposed against a state during periods of financial distress.[96] While suffering a legal wrong without a remedy is inherently troublesome, sovereign immunity is thought necessary to protect public assets where a monetary award might destroy the ability of governments to provide essential services.[97] As Professor Young explains:

> When a private plaintiff recovers a large damage award against a state government, the money inevitably comes out of funds that otherwise would be available for public use. It is one thing to compensate a plaintiff for grievous injuries; it is quite another to take money from the K–12 education budget to do so.[98]

Sovereign immunity is also related to the remedial issues discussed in Subpart 4, below. While sovereign immunity functions to prevent a legal cause of action from being heard against a government, it also conveniently avoids the difficulty of enforcing a monetary judgment against a noncooperating sovereign.[99]

The doctrine of sovereign immunity is therefore problematic for public pension plan participants seeking to enforce their legal rights to benefits in the event that the pension trust lacks sufficient funds. Absent explicit consent by the state to suit, sovereign immunity would appear to bar participant lawsuits filed in state court.

In order for pension participants to seek pension benefits in state court, pensioners must establish that the state has waived its sovereign immunity. States often explicitly waive retirement board immunity,[100] but this is unhelpful to pensioners once the trust fund has been depleted, as there would be no remedy

94. *Id.*
95. *See* Joseph D. Block, *Suits Against Government Officers and the Sovereign Immunity Doctrine*, 59 HARV. L. REV. 1060, 1061 (1946).
96. *See generally* Ernest A. Young, *Its Hour Come Round at Last? State Sovereign Immunity and the Great State Debt Crisis of the Early Twenty-First Century*, 35 HARV. J.L. & PUB. POL'Y 593 (2012). The author states, for example, that "[s]overeign immunity is one of the Constitution's austerity mechanisms." *Id.* at 595.
97. *See id.* at 597.
98. *Id.*
99. *See, e.g.*, *id.* at 599.
100. *See, e.g.*, N.J. STAT. ANN. § 43:13-37.2 (West 2015).

against a fundless retirement board. Many states, however, explicitly waive sovereign immunity with respect to contracts entered into with the state.[101] It is easy to see the practical necessity of such action, as otherwise it might be difficult for a state to induce others to enter into contracts with it. This is good news for pensioners, because most states consider pensioners' claims to be contractual in nature. Some states' laws (notably, Illinois and Kentucky) specifically label membership in a public retirement system as contractual in nature.[102] In other states, courts have specifically ruled that pension benefits represent a contract between the state (or city) and its employees.[103] While not all states' laws clearly label pension rights as contractual, it is highly likely that all state courts would consider the right to a pension contractual once the employee has retired and become eligible to receive benefits. It is clear, after all, that a bargain was made between the state (as employer) and the employee. The state promised the employee certain benefits (including cash salary, a pension at retirement, and other benefits) in exchange for the employee performing work for the state. As the employee performs that work, she accepts the contractual offer through performance. Once an employee has done everything necessary to be owed a pension under the law—which typically involves working a minimum number of years and attaining a minimum age—the employee has fully completed her side of the bargain and the state is contractually obligated to pay the benefit due. Even states that find no contract to exist prior to an employee's eligibility for retirement should have no trouble concluding that a contract exists once an employee has fulfilled all conditions under state law to receive a pension.[104] It therefore seems likely that in most states, an eligible retiree should be able to successfully bring an action to enforce her pension rights against a state. A current employee not yet eligible to retire may have more difficulty bringing a similar suit, as she may not have any contractual rights under state law; but given this Article's focus on situations in which the pension trust has run out of money, the primary concern is with those currently due benefits.[105]

101. *See, e.g.*, 62 PA. CONS. STAT. §§ 1702, 1712.1 (2007).

102. ILL. CONST. art. XIII, § 5; KY. REV. STAT. ANN. § 61.692 (LexisNexis 2015).

103. See Monahan, *supra* note 75, for an overview of the relevant case law.

104. This position is based, in part, on a U.S. Supreme Court holding that public employees are contractually entitled to compensation earned by services performed. Mississippi *ex rel.* Robertson v. Miller, 276 U.S. 174, 178–79 (1928). Once an employee has completed her side of the pension deal, the government becomes contractually obligated to pay the pension earned.

105. For employees not yet eligible to retire when the trust fund runs out of money, sovereign immunity may, in states that find no contract to exist prior to retirement, bar lawsuits until the participant is actually eligible for retirement, thereby delaying but not entirely barring such lawsuits.

2. Examples of the Contract Exception to Sovereign Immunity in State Courts

The Commonwealth of Kentucky provides a good example of how the contractual waiver of sovereign immunity may play out in pension cases. Kentucky has statutorily waived sovereign immunity with respect to "lawfully authorized written contract[s] with the Commonwealth . . . ."[106] This statutory waiver is likely to apply to attempts to sue the commonwealth to enforce pension rights, depending on how the court interprets "*written* contracts." Effective in 2013, the Kentucky Legislature amended the pension statute to provide that, for individuals who participated in the retirement system prior to January 1, 2014, the pension statute shall constitute an "inviolable contract of the Commonwealth."[107] In applying the "lawfully authorized written contract" exception to sovereign immunity to these facts, it is clear that any contract created by the pension statutes has been "lawfully authorized," as it was adopted by the legislature and signed by the Governor. The only potential issue would be whether the contract is "written." The statute establishing that public pensions are contractual does not take the form of a traditional contract, but it clearly has been reduced to writing and is not, for example, an oral contract. The sovereign immunity exception could, however, also be interpreted as covering only formal, traditional contracts. As a result, it is unclear whether pension plan participants in Kentucky would be able to sue the Commonwealth in state court in the event that pension benefits are unpaid.[108]

In some states the answer is likely to be clearer. For example, New Jersey has statutorily waived sovereign immunity with respect to certain contract actions.[109] New Jersey's waiver is, however, significantly broader than Kentucky's, applying to both express and implied contracts.[110] The one significant limitation on the waiver, for our purposes, is that there is no waiver for contracts implied in law.[111] New Jersey pension statutes have, however, been interpreted to create contractual rights and, as a result, potential plaintiffs should not need to make a

106. KY. REV. STAT. ANN. § 45A.245 (LexisNexis 2007).
107. KY. REV. STAT. ANN. § 61.692 (LexisNexis 2015).
108. The Kentucky Supreme Court has ruled that legal actions seeking declaratory relief are permitted against the Commonwealth, as such actions do not implicate the traditional sovereign immunity concern of protecting the public fisc. Commonwealth v. Ky. Ret. Sys., 396 S.W.3d 833, 838–40 (Ky. 2013).
109. N.J. STAT. ANN. § 59:13-3 (West 2006).
110. *Id.*
111. *Id.*

claim based on a contract implied in law.[112] Assuming New Jersey plan participants comply with the other requirements of the New Jersey Contractual Liability Act,[113] they should be able to successfully assert a contract-based claim against the state in the event of benefit nonpayment.

While the above examples look like good news for pensioners, some states add an additional wrinkle to pursuing contract claims against a state. Some states (notably Illinois and Pennsylvania) do not allow contract claims against the state to proceed through the state's court system, instead establishing a quasi-judicial tribunal to hear such claims. In Illinois, this body is named the "Court of Claims,"[114] while in Pennsylvania it is labeled the "Board of Claims."[115] The Pennsylvania Board is authorized to hear all contract-based claims against the Commonwealth, including quasi-contractual actions.[116] In Illinois, the Court of Claims is authorized to hear a variety of claims against the state, including "[a]ll claims against the State founded upon any contract entered into with the State of Illinois."[117] In both states, there are significant differences between cases brought in these quasi-judicial tribunals and those brought in state court. Both tribunals are comprised of individuals appointed by the Governor with the advice and consent of the Senate.[118] In Illinois, seven attorneys serve on the Court,[119] while in Pennsylvania, one attorney, one civil engineer, and one citizen comprise the Board.[120] In Illinois, claimants have no right to appeal a decision of the court,[121] while in Pennsylvania the Board's final decisions are subject to a highly deferential standard of review on appeal.[122] There are also significant limitations on the tribunals' ability to make awards, a topic that will be addressed in Subpart 4 below.

112. A contract implied in law is a quasi contract where the law imposes an obligation based on a special relationship between the parties or to avoid unjust enrichment. *Implied-in-Law Contract*, BLACK'S LAW DICTIONARY (10th ed. 2014); *see, e.g.*, Allen v. Fauver, 742 A.2d 594, 598 (N.J. Super. Ct. App. Div. 1999) (finding no waiver of sovereign immunity based on federal Fair Labor Standards Act as contractual in nature).
113. For example, plaintiffs must notify the state of their claim for breach of contract within ninety days of the accrual of the claim. N.J. STAT. ANN. § 59:13-5 (West 2006).
114. 705 ILL. COMP. STAT. 505/1 (2015).
115. 62 PA. CONS. STAT. § 1721 (2007).
116. *See* Dep't of Envtl. Res. v. Winn, 597 A.2d 281, 284 (Pa. Commw. Ct. 1991). The board cannot, however, hear claims arising from the terms of collective bargaining agreements. Kapil v. Ass'n of Pa. State Coll. & Univ. Faculties, 470 A.2d 482, 486 (Pa. 1983).
117. 705 ILL. COMP. STAT. 505/8(b) (2015).
118. 705 ILL. COMP. STAT. 505/1 (2015); 62 PA. CONS. STAT. § 1721 (2007).
119. 705 ILL. COMP. STAT. 505/1 (2015).
120. 62 PA. CONS. STAT. § 1721 (2007).
121. 705 ILL. COMP. STAT. 505/17 (2015).
122. 62 PA. CONS. STAT. § 1725 (2007); Three-O-One Mkt., Inc. v. Dep't of Pub. Welfare, 439 A.2d 909, 910 (Pa. Commw. Ct. 1982).

Despite the various differences among the states, it appears that in most states plaintiffs could successfully file some form of action against the state seeking redress for the nonpayment of pension benefits. Note, however, that if a state court or tribunal finds that sovereign immunity applies to bar a lawsuit, Congress would be powerless to change the result through legislation, as it lacks the authority to abrogate a state's sovereign immunity in its own courts.[123]

3. Sovereign Immunity in Federal Courts

A state public pension plan participant who is deprived of her pension benefits due to a lack of funds in the applicable pension trust would likely be able to state a federal cause of action related to the denial of those benefits, but would nevertheless be barred from proceeding in federal court by sovereign immunity. The U.S. Constitution provides in its Contracts Clause that a state shall not impair the obligation of contracts.[124] And the failure of a state to pay vested pension benefits may be an action by the state that does just that. Yet the U.S. Supreme Court has made it clear that, although a federal cause of action can be stated, a state cannot be sued by one of its citizens in federal court[125]—despite the fact that the Eleventh Amendment to the Constitution only appears to bar suits by citizens of one state against another state. The Supreme Court has consistently recognized that state sovereign immunity is in fact much broader than the terms of the Eleventh Amendment.[126]

One potential method of changing the usual sovereign immunity result in federal court would be to have Congress pass a statute authorizing suits by public pension participants against a state in federal court. There might be political and practical reasons why Congress would wish to do so, but the Supreme Court has significantly limited Congress's power to abrogate a state's immunity. In order to do so, Congress must (1) "unequivocally express[] its intent to abrogate the [states'] immunity" and (2) act "pursuant to a valid exercise of power."[127] The first clause of the test is relatively easy to satisfy; Congress must simply make it clear that the statute seeks to abrogate state immunity with respect to public pension

123. *See* Alden v. Maine, 527 U.S. 706, 733 (1999).
124. U.S. CONST. art. I, § 10.
125. *See* Hans v. Louisiana, 134 U.S. 1 (1890). In some cases, however, the terms of a bond will explicitly waive sovereign immunity in order to allow a federal court lawsuit to proceed. *See* Johnson & Young, *supra* note 24, at 150–51.
126. *See, e.g.*, *Alden*, 527 U.S. at 713 (observing that "Eleventh Amendment Immunity" is "something of a misnomer, for the sovereign immunity of the States neither derives from, nor is limited by, the terms of the Eleventh Amendment").
127. Seminole Tribe of Fla. v. Florida, 517 U.S. 44, 55 (1996) (quoting Green v. Mansour, 474 U.S. 64, 68 (1985)).

claims. It is the second prong that is problematic. The Supreme Court has held that Congress abrogated state immunity pursuant to a valid exercise of power only twice: once on the basis of Congress's power under section 5 of the Fourteenth Amendment, and once on the basis of the power granted by the Commerce Clause.[128] The Court, however, subsequently overruled the holding based on Commerce Clause power.[129] It now appears relatively settled that Congress cannot make a state amenable to suit in federal court without the state's consent.[130] The end result is that state pension plan participants will only have recourse in state court in the event of benefit nonpayment.

While it is sometimes possible to do an end run around sovereign immunity by suing a state official (rather than the state itself) in federal court, this is only true where the state official has acted outside her statutory or constitutional authority.[131] This strategy tends to work in federal civil rights actions, but not in contract-based disputes.[132] One alternative for pension participants would be to make a takings claim under the Fifth Amendment, but federal courts have expressed significant skepticism that such claims could ever be successful.[133] As a result, it seems unlikely that suing a state official in federal court will provide participants with their desired relief.[134] For even where state officials are sued in federal court on civil rights grounds, the Supreme Court has made clear that the only remedy available is prospective injunctive relief.[135] And even if pension participants state their desired remedy in terms of prospective injunctive relief (that is, requiring state officials to pay pension benefits going forward), federal

128. *Id.* at 59.
129. *Id.* at 66.
130. *Id.* at 75–76. *But see* Young, *supra* note 96, at 621 (suggesting that it may be possible to reach a contrary result by arguing either that "the history of the Contracts Clause indicates a desire to suppress state fiscal imprudence," or by converting contract claims into takings claims, thereby allowing Congress "to abrogate state immunity pursuant to its Section Five power").
131. Larson v. Domestic & Foreign Commerce Corp., 337 U.S. 682, 701–02 (1949).
132. *See* Johnson & Young, *supra* note 24, at 135.
133. *See* Adams v. United States, 391 F.3d 1212, 1225 (Fed. Cir. 2004) ("[N]o statutory obligation to pay money . . . can create a property interest within the meaning of the Takings Clause."); Pittman v. Chi. Bd. of Educ., 64 F.3d 1098, 1104 (7th Cir. 1995) (finding that the Takings Clause does not extend to contract rights); Puckett v. Lexington-Fayette Urban Cty. Gov't, 60 F. Supp. 3d 772, 779 (E.D. Ky. 2014) (holding that a statutory entitlement is not property for purposes of a takings claim); Adams v. United States, No. 00-447 C, 2003 WL 22339164, at *8 (Fed. Cl. Aug. 11, 2003) (stating that "even if an obligation to pay money can be considered property" for purposes of the Takings Clause, there can be no takings claim where the property was not seized for public use because nothing was "taken," the proceeds simply were not paid).
134. *See Adams*, 2003 WL 22339164, at *12 (agreeing with the conclusion that pensioners are unlikely to be able to bring a Contracts Clause claim in federal court).
135. *See* Edelman v. Jordan, 415 U.S. 651, 677 (1974).

courts may instead view the requested relief as nothing other than money damages against the state, which are clearly unavailable in federal court.[136]

Not only does existing precedent strongly suggest that participants will be unable to overcome sovereign immunity in federal court, it also seems unlikely that federal judges would be inclined to stretch to reach a different result, even with the sympathetic case that participants might be able to present. It is simply hard to imagine that federal judges would want to wade into these sensitive state political and fiscal issues given the very significant federalism concerns such action would raise.

4. Remedies Against the State

The Subparts above have concluded that pension participants are likely to be able to successfully overcome sovereign immunity in state court, but are unlikely to be able to do so in federal court. Yet in order for participants to be ultimately successful, regardless of which court hears the claims, the remedy sought must be one that is within the court's power to grant. As a result, this Subpart analyzes whether these courts or tribunals actually have both the power and inclination to provide the desired relief—payment of earned pension benefits. In some instances, statutory limitations may effectively curtail any attempt to pursue such payment, but that is likely to be the exception rather than the rule. Instead, most plaintiffs will struggle with convincing a court or tribunal that it should do one of three things: (1) order the legislature to make the necessary appropriation to the trust so that it can pay benefits due; (2) raise revenue, either through judicially imposed taxes or asset sales, or through borrowing, in order to provide the trust with the necessary funds; or (3) craft a creative solution such as sequestering further spending until the legislature crafts a plan to provide the necessary funds to the trust. Pension participants are obviously sympathetic plaintiffs, raising the distinct possibility that a court would go out of its way to grant relief. Yet the desired remedies intrude so deeply into the core legislative functions of spending and taxation that it seems unlikely that courts would be willing to grant any of them, potentially leaving plan participants without any legal recourse against the state.

136. *See* Ford Motor Co. v. Dep't of Treasury, 323 U.S. 459, 464 (1945), *overruled on other grounds by* Lapides v. Bd. of Regents of Univ. Sys., 535 U.S. 613 (2002). While the Supreme Court has permitted prospective injunctive relief that requires expenditures of state funds, the funds were a necessary part of implementing a prospective fix to a federal constitutional violation rather than a direct payment to individuals. *See* Milliken v. Bradley, 433 U.S. 267, 289–90 (1977).

Of course, an interesting question arises in this situation: Why is it insufficient for the court to simply declare the lack of benefit payments unconstitutional and direct the legislature to enact the remedy? Why is it that legislators do not simply follow court orders and uphold the law? The simplest explanation for the failure of legislators to comply with court orders is a very practical one—it is that courts have little power to force them to comply.[137] But aside from this fact, why might legislators—who take oaths to uphold the law—disregard the judiciary? While a thorough unpacking of this issue is beyond the scope of this Article, there are likely two primary motivations behind such apparently noncompliant actions. First, prior to a state supreme court ruling on the topic, a legislator might have a well-reasoned position that supports her actions as legal. Under mainstream conceptions of the rule of law, however, once a state supreme court has ruled legislative action illegal, such positions should fall away out of respect for the supreme court's role as ultimate arbiter of state law. Nevertheless, legislators might dispute the supreme court ruling on the basis that the court was incorrect, or might rely on the common lay criticism of judges as being "activist" rather than impartially interpreting the law. A second motivation, and a more charitable one, is that legislators might simply believe that acting in opposition to the supreme court ruling is what the public good requires.[138] This last argument is likely to be particularly salient in the case of pension nonpayment. Where a state has depleted its pension fund assets, it has likely reached a point of severe financial distress. Even if paying pension benefits in full is required under the rule of law, a legislator may believe that serving the public good requires preserving other forms of government spending over pension benefits. For example, if the payment in full of pension benefits would decimate a state's educational system or enforcement of public safety, it may be understandable why a legislator would be unswayed by a court opinion. The Subparts below will examine in more detail the potential remedies available to state courts in the event of pension nonpayment, beginning first with limitations on judicial remedies that are imposed by statute.

a. Statutory Limitations

Before delving into the more difficult issue of judicially awarded remedies, it is important to note that there are some instances in which state law

137. Adam Shinar, *Dissenting From Within: Why and How Public Officials Resist the Law*, 40 FLA. ST. U. L. REV. 601, 615 (2013).

138. *See id.* at 619 (arguing that legislators might resist the law to further a public goal that may not necessarily be consistent with the rule of law).

will effectively foreclose legal remedies for plan participants. First, some state statutes explicitly provide that a participant's only recourse is against trust fund assets, and that no recourse is available against the state.[139] For example, an Illinois statute provides:

> Any pension payable under [state statute] shall not be construed to be a legal obligation or debt of the State, or of any county, city, town, municipal corporation or body politic and corporate located in the State, other than the pension fund concerned, but shall be held to be solely an obligation of such pension fund, unless otherwise specifically provided in the law creating such fund.[140]

Where such statutory provisions are in place, it is highly unlikely that a court will ignore that language and hold the state liable.[141]

Another type of statutory limitation applies in those states that do not allow contract claims against the state to proceed through the state court system, but instead require claimants to utilize a quasi-judicial tribunal. The statutes establishing those systems typically limit, to a significant degree, the power of the tribunal to make awards. In most cases, the tribunals are explicitly dependent on the legislature voluntarily appropriating the necessary amount to satisfy an award, and they have no independent authority to order the transfer of funds.[142] Pension claimants who find themselves in this situation will not receive their owed benefits absent a cooperative legislature.

b. Ordering Appropriations

At the core of any pension claim is a desire for the full payment of earned benefits. In the context of a judicial challenge, the most direct relief would be for the court to order the payment of benefits. Yet as this Subpart will explore, courts do not hold the power of the purse, and are therefore unable to directly order the payment of benefits. At best, a court could order the legislature to appropriate

139. *See, e.g.*, 40 ILL. COMP. STAT. 5/22-403 (2015).
140. *Id.* As part of 2013 pension reform, Illinois included a change to this language that explicitly made pensions an obligation of the state. That reform was held unconstitutional by the Illinois Supreme Court on other grounds, but was deemed unseverable and therefore struck down in its entirety. *In re* Pension Reform Litig., 32 N.E.3d. 1, 29–30 (Ill. 2015).
141. *But see* Jones v. Mun. Emps. Annuity & Benefit Fund, No. 14 CH 20027, 2015 WL 4662009, at *23–24 (Ill. Cir. Ct. July 24, 2015) (emphasis omitted) (suggesting that the state's constitutional protection of public pension benefits against diminishment or impairment would require the payment of benefits in all circumstances, while also acknowledging that the constitution leaves the "politically sensitive area" of funding benefits to other branches of government), *aff'd*, 50 N.E.3d 596 (Ill. 2016).
142. *See, e.g.*, 705 ILL. COMP. STAT. 505/24 (2015); 62 PA. CONS. STAT. § 1726 (2007).

the necessary funds and then seek contempt sanctions in the event of noncompliance.[143] In general, problems that require appropriations to solve are problems that courts are ill-equipped to handle.[144] A legislature could, of course, always voluntarily comply with a court order regarding pension appropriations, but in severely distressed states such voluntary actions are likely to be the exception rather than the rule. Presumably if the legislature were inclined to voluntarily pay pension benefits it would have done so absent a court ruling, although a court ruling could perhaps provide the political cover necessary for legislators to take such action.

The first barrier to court-ordered payment of benefits is that state constitutions typically specify that the power and authority to appropriate funds lie exclusively with the legislative branch.[145] Even in the absence of an explicit limitation on the appropriation power, separation of powers principles compel the same conclusion.[146] Allocating funds is a quintessential political and legislative task.[147] As one court explained, "[b]ecause 'the power and authority to appropriate funds lie solely and exclusively with the legislative branch of government, [t]here can be no redress in the courts to overcome either the Legislature's action or refusal to take action pursuant to its constitutional power over state appropriations.'"[148] This is true even where the legislature violates state law.[149] Elected legislators determine the government's spending priorities and are held accountable by the electorate for their choices.[150] It is not proper to litigate "the propriety of

143. *See* Jeffrey W. Stempel, *A More Complete Look at Complexity*, 40 ARIZ. L. REV. 781, 832 (1998) (noting that, where courts seek to impose remedies on other political branches, courts will eventually "hit a metaphorical 'wall' in their ability to get results").

144. *See, e.g.*, Erwin Chemerinsky, *The Essential but Inherently Limited Role of the Courts in Prison Reform*, 13 BERKELEY J. CRIM. L. 307, 307 (2008) (noting that courts are ill-equipped to address prisoners' constitutional claims, given that such claims arise because of "too little money to pay for the needs of too many inmates").

145. *See, e.g.*, KY. CONST. § 230 ("No money shall be drawn from the State Treasury, except in pursuance of appropriations made by law . . . ."); N.J. CONST. art. VIII, § 2, para. 2.

146. *See, e.g.*, State, Dep't of Health and Rehab. v. Brooke, 573 So. 2d 363, 371 (Fla. Dist. Ct. App. 1991); State *ex rel.* Marshall v. Blaeuer, 709 S.W.2d 111, 112 (Mo. 1986) (en banc).

147. *See* Burgos v. State, 118 A.3d 270, 275 (N.J. 2015).

148. *Id.* at 290 (alteration in original) (citations omitted) (quoting City of Camden v. Byrne, 411 A.2d 462, 469–70 (N.J. 1980)); *see also* Commonwealth *ex rel.* Armstrong v. Collins, 709 S.W.2d 437, 441 (Ky. 1986) ("It is clear that the power of the dollar—the raising and expenditure of the money necessary to operate state government—is one which is within the authority of the legislative branch of government.").

149. Berry v. Crawford, 990 N.E.2d 410, 414 (Ind. 2013).

150. *See Burgos*, 118 A.3d at 298 (noting that legislators can be held accountable for their spending decisions in a way that the judiciary typically cannot).

the budget priorities of the Legislature and Executive . . . ."[151] Allowing the judicial branch to step into this process undermines the core of the political process and as a result is an almost unheard-of remedy.[152] As the Supreme Court has explained:

> The legislative department of a State represents its polity and its will, and is called upon by the highest demands of natural and political law to preserve justice and judgment, and to hold inviolate the public obligations. Any departure from this rule, except for reasons most cogent, (of which the legislature, and not the courts, is the judge,) never fails in the end to incur the odium of the world, and to bring lasting injury upon the State itself. But to deprive the legislature of the power of judging what the honor and safety of the State may require, even at the expense of a temporary failure to discharge the public debts, would be attended with greater evils than such failure can cause.[153]

In addition to the significant separation of powers issues that accompany attempts by the judiciary to influence or order appropriations, there are also very practical difficulties that arise. States have highly constrained budget processes. Appropriations are generally made in a single bill, either once a year or once every two years. And all or nearly all estimated revenues for the budgetary period are allocated, with the result that a court attempting to force an allocation would essentially have no choice but to wait for the next budget cycle—which could be as far off as two years. Even after waiting for the next budget cycle, any allocation would be constrained by balanced budget requirements and debt limitations.[154] As a result, it seems highly unlikely that a court would attempt to directly order

151. *Id.* at 297; *see also* Janice C. Griffith, *Judicial Funding and Taxation Mandates: Will* Missouri v. Jenkins *Survive Under the New Federalism Restraints?*, 61 OHIO ST. L.J. 483, 572 (2000) (noting that state courts are hesitant to interfere in the state legislative process).

152. *See, e.g.*, Rose v. Council for Better Educ., Inc., 790 S.W.2d 186, 213–15 (Ky. 1989); McCleary v. State of Washington, No. 84362-7, at *7–8 (Wash. Aug. 13, 2015) (database); Kirk Johnson, *Washington State Faces $100,000-a-Day Fine Until Schools Plan Is Reached*, N.Y. TIMES (Aug. 13, 2015), http://www.nytimes.com/2015/08/14/us/washington-state-faces-dollar100000-a-day-fine-until-schools-plan-is-reached.html [https://perma.cc/XQ8G-27MD]; *see also* Griffith, *supra* note 151, at 574 ("State courts have ruled steadfastly that under no circumstances may the judiciary direct the legislative branch to appropriate funds to rectify an adjudicated duty."). *But see* 46th Circuit Trial Ct. v. Cty. of Crawford, 719 N.W.2d 553, 562–63 (Mich. 2006) (appearing willing to order an appropriation where necessary to preserve the independence of the state's judicial branch); Dadisman v. Moore, 384 S.E.2d 816, 832 (W. Va. 1988) (ordering the West Virginia legislature to allocate, in the next budget year, the full pension contributions required by law).

153. Hans v. Louisiana, 134 U.S. 1, 21 (1890).

154. *See, e.g.*, Isabel Rodriguez-Tejedo & John Joseph Wallis, *Fiscal Institutions and Fiscal Crises*, *in* WHEN STATES GO BROKE: THE ORIGINS, CONTEXT, AND SOLUTIONS FOR THE AMERICAN STATES IN FISCAL CRISIS 9, 19 (Peter Conti-Brown & David A. Skeel, Jr., eds., 2012).

an appropriation even if it could overcome separation of powers concerns or constitutional limitations.[155] And even if the legislature desires to voluntarily comply with a court-ordered appropriation, these budget timeframes and limitations may make timely relief for pensioners practically unavailable.

The challenges (and frustrations) for courts attempting to sanction unlawful government behavior that requires revenue allocations to remedy is not unique to pensions. Other examples include attempts to enforce federal fair housing requirements, constitutional education requirements,[156] as well as the rights of prisoners[157] and those receiving public assistance. Courts are understandably frustrated by their inability to remedy certain types of illegal government action. It is not uncommon for a court to declare an act of the legislature to be unconstitutional, yet acknowledge that it lacks the power to order the appropriation to remedy the wrong, hoping that the legislature will take the holding seriously and voluntarily seek to remedy the wrong.[158] In fact, seeking only a declaratory judgment is sometimes part of a litigation strategy that seeks to avoid separation of powers issues.[159] This "name and shame" approach is thought to have worked in at least one school finance case.[160] Not only do legislators have a duty to uphold state law (which should by itself spur legislation in the face of a state supreme court ruling), but a court ruling holding a certain action unconstitutional may give legislators political cover to undertake what would otherwise be a politically unpopular action.[161] It is not clear that the same pressure would exist in the case of pension debt. The dollar amounts may, in some states, simply be too large for most legislators to voluntarily fund, given the potentially disastrous effects on essential government services and the economy of the state. The "pension envy" that exists in the general population,[162] along with the political unpopularity of

155. Where federal law requires an appropriation, at least one state court has held that the federal law trumps state law limits on appropriations under principles of conflict preemption. Council 13, Am. Fed'n of State, Cty. & Mun. Emps., AFL-CIO *ex rel.* Fillman v. Rendell, 986 A.2d 63, 82 (Pa. 2009). In the case of public pensions, however, state courts are unlikely to be able to utilize the same reasoning to overcome the appropriations limitation.

156. *See, e.g.*, Myron Orfield, *The Region and Taxation: School Finance, Cities, and the Hope for Regional Reform*, 55 BUFF. L. REV. 91, 104–06 (2007).

157. For an overview of the challenges involved in court-ordered prison reform, see generally Chemerinsky, *supra* note 144.

158. *See* Griffith, *supra* note 151, at 575–79 (stating that "no other practical remedy exists unless the legislature willingly appropriates funds for payment of the obligation").

159. Orfield, *supra* note 156, at 123.

160. *Id.*

161. *See id.* at 123–24 (explaining that a state court ruling holding the state's educational system unconstitutional provided political cover to the governor and legislature to undertake what would otherwise have been a difficult-to-pass tax increase).

162. Forman, *supra* note 15, at 857.

public workers in some states,[163] are both likely to hamper judicial efforts to get legislators to voluntarily shift vast amounts of public funds to pay benefits to retired workers.

But in other circumstances, courts are unwilling to simply declare themselves powerless. While it is well established that courts cannot appropriate funds themselves, it is also well established that courts have the power, through the contempt sanction, to enforce their orders. The strongest form of contempt sanction in the context of nonpayment of pension benefits would be to either impose monetary fines on or imprison individual legislators who failed to make the required appropriation. Yet Supreme Court precedent suggests that neither of these sanctions is likely to be readily available to courts.

The Supreme Court explained in *Spallone v. United States*[164] that, although "courts have inherent power to enforce compliance with their lawful orders through civil contempt,"[165] they must use the "least possible power adequate to the end proposed."[166] In that case, the Court reviewed a contempt sanction that imposed monetary fines on individual council members in the city of Yonkers for failing to enact a public housing ordinance necessary for the city to comply with a consent decree in a civil rights lawsuit. In exploring why sanctions against the individual council members were not the least possible exercise of power, the Court explained why, in general, sanctions should first be imposed against the city itself, rather than individual legislators:

> The imposition of sanctions on individual legislators is designed to cause them to vote, not with a view to the interest of their constituents or of the city, but with a view solely to their own personal interests. . . . Such fines thus encourage legislators, in effect, to declare that they favor an ordinance not in order to avoid bankrupting the city for which they legislate, but in order to avoid bankrupting themselves.
>
> This sort of individual sanction effects a much greater perversion of the normal legislative process than does the imposition of sanctions on the city for the failure of these same legislators to enact an ordinance.[167]

163. *See, e.g.*, James Surowiecki, *State of the Unions*, NEW YORKER: FIN. PAGE (Jan. 17, 2011), http://www.newyorker.com/magazine/2011/01/17/state-of-the-unions [https://perma.cc/8XR7-8KWN].
164. 493 U.S. 265 (1990).
165. *Id.* at 276 (quoting Shillitani v. United States, 384 U.S. 364, 370 (1966)).
166. *Id.* (quoting United States v. Yonkers, 856 F.2d 444, 454 (2d Cir. 1988)).
167. *Id.* at 279–80.

The court further explained "that any restriction on a legislator's freedom undermines the 'public good' by interfering with the rights of the people to representation in the democratic process."[168]

While the *Spallone* decision involved federal court sanctions against local actors, its principles have been adopted by state courts as well. For example, when a trial court ordered township supervisors imprisoned for three to six months on contempt charges stemming from their failure to comply with an order from the state's department of environmental protection, the Pennsylvania Supreme Court overturned the sanction as too severe.[169]

The existing jurisprudence regarding contempt sanctions against legislators, along with the current composition of the Supreme Court, have led a leading constitutional scholar to conclude that it is "highly questionable whether a court could enforce an order requiring . . . expenditure of government funds."[170] In one recent and ongoing case in Washington state, the Washington Supreme Court, frustrated by the legislature's lack of progress in remedying an unconstitutional school finance system, recently imposed a $100,000 per day fine on the state, to continue in effect until a constitutional solution is reached.[171] Fining the state gets around existing precedent that strongly suggests contempt sanctions against individual legislators should be considered only as a last resort, yet for the same reason fining the state is legally permissible, it is likely to be ineffective. The fine is on the state itself, and therefore does not place much pressure on individual lawmakers. And a fine on the state may itself be unenforceable because it would require an appropriation. Even if the fine is a permissible contempt sanction, courts are likely to lack the power to enforce the payment of the fine. At best, a large daily fine may increase the attention paid to the issue by the media and the public, thereby perhaps creating political pressure for the legislature to act.[172]

While the picture is grim for public pension plan participants attempting to use the courts to force pension payments, the allocation issue is just as bad, if not worse, for those pension claimants who are forced to proceed through quasi-judicial bodies that hear contract cases against the state as discussed above for Illinois and Pennsylvania. In those states, the statute establishing the quasi-judicial forum usually specifies that any monetary awards depend on

168. *Id.* at 279.
169. Commonwealth, Dep't of Envtl. Prot. v. Cromwell Twp., 32 A.3d 639, 657 (Pa. 2011).
170. Chemerinsky, *supra* note 144, at 314.
171. McCleary v. State, No. 84362-7, at *9–10 (Wash. Aug. 13, 2015).
172. *See* Johnson, *supra* note 152.

corresponding legislative allocations,[173] and provides no method other than voluntary compliance to secure such appropriations.[174]

c. Raising Revenue

Another potential remedy would be for the court to order taxes raised in order to generate the funds necessary to pay earned benefits. On a practical level, this option is easier than an appropriation to implement because it does not depend on the current availability of funds or the budget cycle. Most states, however, have constitutional limits in place with respect to state taxes that will effectively prevent a court from pursuing this option,[175] as courts generally lack the power to impose a remedy that would raise taxation above the limits set by state law.[176]

In addition to limits on the amount and structure of state taxes, many state constitutions grant the legislature the exclusive power to tax.[177] Even where the constitution does not do so, state courts have had no trouble finding that the power to tax is one that resides exclusively with the legislature.[178] As with appropriations, it therefore seems highly unlikely that a court would directly order taxes to be increased,[179] again relying on voluntary compliance by the legislature to do so.

173. 705 ILL. COMP. STAT. 505/24 (2015); 62 PA. CONS. STAT. § 1726 (2007).

174. *See, e.g.*, 705 ILL. COMP. STAT. 505/9 (2015) (mentioning the availability of a contempt sanction only in the case of an individual's refusal to comply with a subpoena to testify).

175. For example, Illinois is constitutionally limited to a single tax on individual income, and it must be imposed at a flat rate, while maintaining a maximum spread between the individual and corporate income tax. ILL. CONST. art. 9, § 3(a). In addition, statewide ad valorem property taxes have been constitutionally abolished in Illinois. *Id.* § 5(b).

176. Griffith, *supra* note 151, at 580.

177. *See, e.g.*, ILL. CONST. art. 9, § 1; KY. CONST. § 171 (stating that an annual tax shall be provided "by law"); *id.* § 175 (declaring that the power to tax shall not be surrendered by contract); N.J. CONST. art. 4, § 6, para. 1 (stating that all revenue bills must originate in the General Assembly); *see also* People *ex rel.* Brittain v. Outwater, 196 N.E. 835, 836 (Ill. 1935) ("The power to . . . impose tax burdens and raise money may be exercised only by or under the authority of the Legislature."); Praxair Tech., Inc. v. Dir., Div. of Taxation, 988 A.2d 92, 100 (N.J. 2009) (referring to the New Jersey legislature's power to tax as "exclusive").

178. *See, e.g.*, Commonwealth v. Dauphin Cty., 6 A.2d 870, 871 (Pa. 1939) ("[T]he power to tax vests exclusively in the legislature."); Appeal of Harrisburg Sch. Dist., 417 A.2d 848, 850 (Pa. Commw. Ct. 1980) ("[T]he power of taxation lies solely with the General Assembly of the Commonwealth.").

179. *See* Chemerinsky, *supra* note 144, at 314–15 (noting that the author is "dubious" that courts could directly impose a tax increase to address unconstitutional legislative actions). Further, my own research in preparing this Article did not reveal a single case where a state court has ordered a tax increase.

The other method commonly used by state and local governments to raise revenue is through the issuance of debt. As a result, it may be possible for the court to order the state to issue bonds. In some respects, issuing debt may be an attractive solution to crippling pension debt, in that it allows the debt to be paid off over a potentially long time horizon, thereby avoiding financial shock to the government and the accompanying undesired consequences that would result from an order for immediate payment. But judicially ordered bond issuance is unlikely to occur. First and foremost, as with raising taxes, most state constitutions contain limitations on the ability to incur debt.[180] Generally speaking, debt that exceeds certain limits must be approved by public vote.[181] There are no reported cases where a court has circumvented this voting requirement with respect to bond issuance.[182] It may be possible, however, to structure a bond offering to avoid these constitutional debt limitations, for example by issuing an annual appropriation bond.[183] It remains unclear whether a court might avail itself of such options in order to incur debt without violating the state constitution.

Even if the public vote requirement could either be met or judicially ignored, however, there would need to be buyers for the debt at issue. While issuing pension obligation bonds would not change the underlying amount of debt,[184] a state or municipality that has completely depleted its pension funds may already suffer from a poor credit rating. Where that is the case, any bond issuance may entail very high credit costs—something a court may be unwilling to impose.

A final option to raise the money necessary to pay pension benefits is to use the approach commonly used by courts to provide relief to those owed money judgments—to execute on property held by the debtor. In the case of state debtors, however, it is highly unlikely that a court would seize or order the sale of government property.[185] Courts routinely hold that public policy

180. *See* D. Roderick Kiewiet & Kristin Szakaly, *Constitutional Limitations on Borrowing: An Analysis of State Bonded Indebtedness*, 12 J.L. ECON. & ORG. 62, 67 tbl.1 (1996) (finding only five states lacked some form of constitutional prohibition on debt).

181. *See id.*

182. Glenn E. Deegan, *Judicial Enforcement of State and Municipal Compliance With the Clean Water Act: Can the Courts Succeed?*, 19 B.C. ENVTL. AFF. L. REV. 765, 800 (1992).

183. For an overview of the types of bonds generally used to finance pension obligations and a discussion of whether they are subject to constitutional debt limitations, see ROGER L. DAVIS, AN INTRODUCTION TO PENSION OBLIGATION BONDS AND OTHER POST-EMPLOYMENT BENEFITS 11–12 (3d ed. 2006).

184. *See id.* at 13–14.

185. *See generally* 10 EUGENE MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 28:73 (3d ed. 2009).

forbids execution against public property.[186] As a result, public property will not likely be available to satisfy pension debt. A different result might be reached for property held by the government for quasi-private purposes,[187] but it is relatively unlikely that a state would hold sufficient amounts of property for quasi-private purposes to satisfy the relevant pension debt.

d. Getting Creative: The Sequestration Remedy

Courts do not appear to have many attractive options for assuring that pensioners are paid their earned benefits, given that the power to award relief is largely within the hands of the legislature. But frustrated state courts have been known to turn to creative approaches when necessary to uphold state law. The most commonly litigated scenario in which state courts attempt to force a legislature (against its will) to make appropriations is in the context of state constitutional rights to education. When brought in state court, these cases seeking to enforce the state constitutional right to a quality education face the same remedial challenges as those that apply to pension debt. The remedy involves money, which is very difficult to secure against contrary legislative will. The New Jersey Supreme Court tried to solve that problem through what is known as sequestration of other funds by enjoining all educational expenditures until the state came up with a solution that satisfied state constitutional requirements.[188] The idea behind sequestration is that it is a valid exercise of a court's equitable powers that does not violate separation of powers, in that it does not give the judiciary the legislative powers of appropriation or taxation but simply enjoins unconstitutional conduct by the legislature.[189] In the New Jersey case, the pressure this created—to either have no educational system or a compliant one—was enough to force the legislature's hand.[190] The Supreme Court of Kansas recently issued a similar ultimatum, which would have enjoined all educational spending if the legislature failed to appropriate educational funds in a manner consistent with the state

186. *See* Consol. Constr. Co. v. Malan Constr. Corp., 192 N.E.2d 263, 266 (Ill. App. Ct. 1963) ("Liens cannot be enforced against public buildings, improvements or property, as public policy forbids execution upon such property."); *see also* 17 EUGENE MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 49:45, at 445–46 (3d ed. 2014). *But see* City of Bradenton v. Fusillo, 184 So. 234, 236 (Fla. 1938) (providing that municipal property unconnected with any public purpose may be sold under execution).

187. *See* 10 MCQUILLIN § 28:73, *supra* note 185, at 292 (providing an example of a court executing on shares of stock held by a municipality, because such stock was not held for a public purpose).

188. *See* Robinson v. Cahill, 358 A.2d 457, 459 (N.J. 1976).

189. For a more detailed discussion of the court's authority to sequester funds, see Gannon v. State, 368 P.3d 1024, 1059–63 (Kan. 2016).

190. *See* Griffith, *supra* note 151, at 575–79.

constitution by the end of the current fiscal year on June 30, 2016.[191] The Kansas legislature then acted in special session to appropriate $38 million to address inequities between poorer and richer school districts in order to keep schools open for another year.[192] Similarly, a federal court upheld the sequestration of Pennsylvania's federal highway funds in response to the state's lack of compliance with the federal Clean Air Act.[193] Another court, however, denied sequestration where there was an insufficient connection between the sequestered funds and the legal violation.[194] In the case of pensions, it may be difficult to find funds sufficiently related to pensions to sequester that would not also bring about such severe collateral harm that a court would be unwilling to impose the sanction.[195] For example, salaries of current public employees might be considered sufficiently related to pension benefits to sequester, but courts may be unwilling to order the sanction given the significant harm that may result to current employees. The bottom line for pension participants in a state plan with a depleted trust fund is that, regardless of their rights to benefit payment, it may be difficult or impossible to use law to enforce such rights.

B. Enforcement of City Promises

While cities and other municipalities are considered political subdivisions of the state, there are important legal differences between cities and states that affect both the protections of sovereign immunity and the availability of remedies. The Subparts below investigate the extent to which cities are protected by sovereign immunity against pension nonpayment lawsuits and examine the availability of judicial remedies available against cities.

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191. *See* Gannon v. State, 368 P.3d 1024, 1061–62 (Kan. 2016); *see also* Gannon v. State, 372 P.3d 1181 (Kan. 2016) (holding that legislature's first attempt to comply with constitutional education requirements following the earlier Kansas Supreme Court ruling was insufficient, but allowing legislature until the end of the current fiscal year to pass a compliant appropriation before enjoining all educational spending).
192. Hunter Woodall, *Kansas Ends Fiscal Year With More Bad Budget News*, KAN. CITY STAR (July 1, 2016, 6:34 PM), http://www.kansascity.com/news/politics-government/article87282457.html [https://perma.cc/ME57-BPLS].
193. Delaware Valley Citizens' Council v. Pennsylvania, 678 F.2d 470, 479 (3d Cir. 1982).
194. Gautreaux v. Romney, 457 F.2d 124, 127 (7th Cir. 1972).
195. *See* Deegan, *supra* note 182, at 783–84 (suggesting that collateral harm of sequestration might prevent courts from ordering the sanction).

1. Sovereign Immunity in State Court

A city is a form of municipal corporation that derives its authority from the state.[196] Cities are typically found to be political subdivisions of the state,[197] yet they are not necessarily treated as substitutes for the state when it comes to immunity.[198]

In Illinois, while cities and other local governmental entities enjoy sovereign immunity related to "liability arising from the operation of government,"[199] such immunity does not extend to liability of a local government entity arising from contract.[200] Because the Illinois Constitution specifically treats pensions as contractual, it seems near certain that Illinois would allow pension lawsuits to proceed against cities.[201] Interestingly, while contract claims against the state may only be heard by the quasi-judicial Court of Claims, contract actions against cities may proceed through the Illinois state court system.[202]

In Kentucky, counties benefit from sovereign immunity,[203] but cities generally do not.[204] Cities, however, cannot be held liable for legislative or judicial functions.[205] Because pension claims are contractual in nature, it seems likely that no sovereign immunity defense would be available to Kentucky cities with respect to unpaid pension benefits. New Jersey also allows contract-based lawsuits against cities (as well as other public entities) to proceed.[206]

196. *See* Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law*, 90 COLUM. L. REV. 1, 73 (1990).
197. *See, e.g.*, City of Tucson v. Fleischman, 731 P.2d 634, 637 (Ariz. Ct. App. 1986); Boh Bros. Constr. Co., Inc. v. City of New Orleans, 499 So. 2d 385, 386 (La. Ct. App. 1986).
198. *See* Jack M. Beermann, *The Public Pension Crisis*, 70 WASH. & LEE L. REV. 3, 77 (2013).
199. 745 ILL. COMP. STAT. 10/1-101.1 (2015).
200. *See* 745 ILL. COMP. STAT. 10/2-101 (2015).
201. In the recent case involving changes to Chicago's pension plans, the plaintiffs sued the plan itself and the city intervened in the action. *See* Jones v. Mun. Emps. Annuity & Benefit Fund, No. 14 CH 20027, 2015 WL 4662009 (Ill. Cir. Ct. July 24, 2015).
202. While there are no rulings that specifically state that contract actions against a city are not considered contract actions against the state for purposes of Court of Claims jurisdiction, there are many cases on record where breach of contract actions have been pursued against Illinois cities where the city has not challenged circuit court jurisdiction. *See* Bernard v. City of Chicago, No. 1-13-0425, 2014 WL 1207801 (Ill. App. Ct. Mar. 21, 2014); United Airlines, Inc. v. City of Chicago, 954 N.E.2d 710 (Ill. App. Ct. 2011); Torres v. City of Chicago, 632 N.E.2d 54 (Ill. App. Ct. 1994); Papas v. City of Chicago, 554 N.E.2d 607 (Ill. App. Ct. 1990).
203. Lexington-Fayette Urban Cty. Gov't v. Smolcic, 142 S.W.3d 128, 132 (Ky. 2004).
204. Bolden v. City of Covington, 803 S.W.2d 577, 579 (Ky. 1991).
205. *Id.* at 580.
206. N.J. STAT. ANN. § 59:1–4 (West 2006); *see also* Christy v. City of Newark, 510 A.2d 22 (N.J. 1986).

In Pennsylvania, the legislature has the authority to determine the scope of municipal immunity,[207] but the governmental immunity statute is silent with respect to contract-based claims.[208] Nevertheless, Pennsylvania courts have held that sovereign immunity does not apply where a claim against a city is contract-based.[209] As a result, participants in Pennsylvania city pension plans are unlikely to have legal action related to the nonpayment of benefits barred by sovereign immunity. Like Illinois, breach of contract actions against Pennsylvania cities may be brought in the regular court system, and do not need to be heard by the quasi-judicial Board of Claims.[210]

City pension participants, like state plan participants, should therefore be able to have claims for unpaid pension benefits successfully heard in state court. In some states, city pension participants may even have greater judicial rights than state plan claimants, given that, in those states with courts of claim, city claimants are not subject to quasi-judicial tribunal jurisdiction but rather have full recourse to state courts.

2. Sovereign Immunity in Federal Courts

Unlike state plan participants, city pension plan participants will not be prevented by sovereign immunity from filing suit against the city in federal court. While cities are considered subdivisions of the state, the U.S. Supreme Court has always distinguished between the state and its subdivisions when it comes to sovereign immunity.[211] The relevant test for whether immunity applies is whether

207. *See* City of Phila., Police Dep't v. Gray, 633 A.2d. 1090, 1093 (Pa. 1993). This type of immunity is often referred to as governmental immunity.

208. *See* 42 PA. CONS. STAT. § 8541 (2011).

209. *See* McShea v. City of Philadelphia, 995 A.2d 334, 341 (Pa. 2010) (noting the clear legislative intent to "immunize political subdivisions from tort—not contract—liability"); Commonwealth Dep't of Transp. v. Mun. Auth., 919 A.2d 343, 347 (Pa. Commw. Ct. 2007). *But see* Davino v. Tyrone Twp., 50 Pa. D. & C.3d 115, 121 (1988) ("Nowhere in the statutory provisions for governmental immunity is there an exception for contract actions and nowhere does the statute state that its provisions were intended to deal strictly with tort claims.").

210. There are no reported rulings directly stating that cities are not considered instrumentalities of the Commonwealth for purposes of Board of Claims jurisdiction, but many breach of contract actions brought against Pennsylvania cities raise no jurisdictional issues. *See, e.g.*, A. Scott Enters., Inc. v. City of Allentown, 102 A.3d 1060 (Pa. Commw. Ct. 2014); Logan v. Borough of Dickson City, No. 1147 C.D.2012, 2013 WL 3973800 (Pa. Commw. Ct. Apr. 4, 2013); Holman v. City of Pittsburgh, No. 2149 C.D.2010, 2011 WL 10858114 (Pa. Commw. Ct. Aug. 5, 2011).

211. For a detailed history of the state subdivision distinction and its historical roots, see William A. Fletcher, *A Historical Interpretation of the Eleventh Amendment: A Narrow Construction of an Affirmative Grant of Jurisdiction Rather Than a Prohibition Against Jurisdiction*, 35 STAN. L. REV. 1033, 1099–1107 (1983).

the entity at issue is the state or an "arm of the state,"[212] and the Supreme Court has never found a municipality to be an "arm of the state" for purposes of sovereign immunity. As a result, cities do not enjoy immunity in federal court actions.[213]

But overcoming sovereign immunity is only the first hurdle for city pension participants suing in federal court. Such participants must also be able to state a federal cause of action. The only likely federal cause of action would be a claim that the city violated the Contracts Clause of the U.S. Constitution.[214] As discussed earlier, retired pension plan participants in all likelihood have a contractual right to their benefits. Nevertheless, for the claim to survive in federal court, they must allege that the city took legislative action that substantially impairs that contractual right, given that the Contracts Clause only prohibits states from passing a "law" that impairs the obligation of contracts.[215] Legislative actions have been defined as "[t]he process of making or enacting positive law in written form, according to some type of formal procedure, by a branch of government constituted to perform this process."[216] City actions relevant to nonpayment or underpayment of benefits are unlikely to be considered legislative in nature,[217] as they are unlikely to involve any affirmative action by the city, let alone action that constitutes a legislative action. And even where a federal court finds the action complained of to be legislative, it may still remand any state law issues to state court.[218] In the end, while sovereign immunity may not bar federal court lawsuits by city pension participants, the lack of a federal claim may prevent a federal court from deciding such claims.

212. N. Ins. Co. of N.Y. v. Chatham Cty., 547 U.S. 189, 194 (2006).
213. *See generally* Underwood v. City of Chicago, 779 F.3d 461, 463 (7th Cir. 2015); Taylor v. City of Gadsden, 767 F.3d 1124 (11th Cir. 2014); Cheek v. City of Greensboro, Nos. 1:12-CV-981, 1:12-CV-1110, 1:12-CV-1311, 1:12-CV-888, 2015 WL 4393067 (M.D.N.C. July 15, 2015).
214. Pension participants might also claim a violation of the Takings Clause of the Fifth Amendment, but federal courts appear unwilling to find a taking based on a failure to pay money due under a statutory entitlement. *See supra* note 133 and accompanying text.
215. *See Taylor*, 767 F.3d at 1132–33 (explaining why a city ordinance was not considered legislative for purposes of a Contracts Clause action); Cherry v. Mayor and City Council of Balt. City, 762 F.3d 366, 372 (4th Cir. 2014) (denying federal Contracts Clause action where action was merely a breach of contract and not a legislative impairment that took away state law remedies); Horwitz-Matthews, Inc. v. City of Chicago, 78 F.3d 1248, 1250 (7th Cir. 1996) (explaining that Contracts Clause actions only exist in specific instances of legislative action, and stating that "[i]t would be absurd to turn every breach of contract by a . . . municipality into a violation of the federal Constitution").
216. *Taylor*, 767 F.3d at 1132 (quoting *Legislation*, BLACK'S LAW DICTIONARY (9th ed. 2009)).
217. *Id.* at 1136 (explaining why a city ordinance was not considered legislative for purposes of a Contracts Clause action).
218. *See, e.g.*, Underwood v. City of Chicago, 779 F.3d 461, 463 (7th Cir. 2015) (remanding to state court the issue of which benefits were protected by alleged contract).

3. Remedies Against a City

Assuming that a city pension participant is able to bring a legal action regarding pension nonpayment, and succeeds on the merits of such claim, the next hurdle will be the availability of a meaningful judicial remedy. Attempting to impose remedies against a city involves many of the same difficulties present in the state context. City pensions may be subject to statutory provisions that limit recourse to the fund itself. And courts are unlikely to order city appropriations, given the same separation of powers concerns that are present in all judicially mandated appropriation attempts. It is commonly held, however, that money judgments against cities may be enforced if the city has available funds on hand, without any of the constitutional or practical issues that confront state creditors seeking appropriations.[219] But cities facing a depleted pension fund are unlikely to have sufficient funds on hand. As a result, in all likelihood, city pension creditors will face the same inability to secure payment of benefits directly through judicial order. Courts could, however, attempt to hold the city itself (and, eventually, its legislators) in contempt if it fails to voluntarily comply with a court ruling holding the nonpayment of pension benefits unconstitutional.

City pensioners will also face difficulty in seeking judicially ordered tax increases. Cities are often subject to the same or similar restrictions on tax increases that we see at the state level. In addition, the power of taxation is considered a legislative power, not a judicial one. Depending on the relevant facts and legal limitations, however, it is possible that a state court would order a city to levy a tax in order to satisfy pension debt, as state courts have done on multiple occasions to satisfy bond debt.[220] This result is not certain, however. In the case of bonds, the terms of the bonds often speak directly to the municipality's duty to levy taxes if necessary to retire the bond.[221] No such specification exists in the case of public pension debt, and it is unknown whether courts would nevertheless issue a writ of mandamus requiring the city to levy additional taxes.

Despite such restrictions on state and local taxation, the U.S. Supreme Court has upheld a federal district court order that required a city to raise its property taxes (even where doing so violated state law limiting taxation), although that decision involved enforcing federal civil rights law to remedy past

219. *See* 17 MCQUILLIN, *supra* note 186.
220. *Id.* § 51:41.
221. Even where the terms of the bond expressly authorize a tax levy, the remedy can be difficult to enforce. *See* O'Reilly, *supra* note 49, at 209 (noting that attempts to compel tax increases in order to cover bond defaults have not been particularly successful recently).

school segregation.[222] It is unlikely that, even if a federal court agreed to hear a public pension default case against a city, it would sanction such an extraordinary remedy.

The remaining remedies are as problematic for cities as they are for states. Courts are unlikely to be willing and able to order a city to issue bonds to cover pension payments, and will only execute on city assets that are not held for a public purpose. Sequestration remains an option, but only if a court can find city funds that are substantially related to pension benefits that will not cause undue harm if withheld.

4. A Potential Trump Card for Cities: The Bankruptcy Remedy

Cities have an important judicial tool available to them that states lack. Cities can, with the state's consent, declare Chapter 9 bankruptcy.[223] Currently, just over half of all states have statutes enabling municipalities to file for bankruptcy.[224] Municipal bankruptcy varies from corporate or individual bankruptcy in many ways, but a key distinguishing factor is that a court cannot force a bankruptcy plan on a municipality; the municipality itself must propose a plan. If there are creditors who object to the plan, it can nevertheless be approved by a court if at least one class of creditors accepts it and the court determines that it is fair, equitable, and in the best interest of the creditors.[225]

One open question in recent municipal bankruptcies was whether municipal pension liabilities were even subject to adjustment in bankruptcy. Thus far, however, courts have taken the position that pension contracts are no different from any other contracts for purposes of bankruptcy and are therefore subject to adjustment. In the Vallejo, California bankruptcy, arguably the first to consider the pension issue, the court held that collective bargaining agreements (in which pension benefits were negotiated) could be rejected in bankruptcy.[226] Until the Detroit, Michigan bankruptcy, however, there was not a direct, written opinion regarding public pension benefits in municipal bankruptcy. In that case, the court directly addressed this issue and held that pension rights, even those specifically protected in the state constitution, could be modified in bankruptcy.[227] The

222. *See* Missouri v. Jenkins, 495 U.S. 33 (1990).
223. *See generally* 11 U.S.C. § 901 (2012).
224. *See* Juliet M. Moringiello, *Goals and Governance in Municipal Bankruptcy*, 71 WASH. & LEE L. REV. 403, 461 (2014).
225. *See* 11 U.S.C. § 901 (2012) (incorporating the cramdown provisions of 11 U.S.C. §§ 1129(b)(1), 1129(b)(2)(A), and 1129(b)(2)(B)).
226. *In re* City of Vallejo, 432 B.R. 262, 275 (E.D. Cal. 2010).
227. *In re* City of Detroit, 504 B.R. 97, 149–54 (Bankr. E.D. Mich. 2013).

judge in the Stockton, California bankruptcy case reached the same conclusion.[228] As a result, it seems clear at this point that federal bankruptcy courts are amenable to modifying pension debt in bankruptcy.

These bankruptcy holdings deserve attention from public pension stakeholders. Although cities are in some ways easier to sue and easier to be sanctioned than states, cities have an available method to avoid pension debt entirely, thereby mooting the previous discussion regarding remedies and sovereign immunity—a distinction that should be of clear concern to public pensioners. But there are two factors that might somewhat temper that alarm. First, cities can only declare bankruptcy if they are insolvent and have been given the consent of the state.[229] A state might choose to protect pension participants by withholding that consent.[230] Second, in the major municipal bankruptcies cited above, cities have not, in the end, drastically reduced pension benefits. In each of the cases, the cities had sizable pension debt, and initial discussions or even proposed workouts called for significant cuts to pension benefits.[231] Nevertheless, as each bankruptcy was negotiated, pension benefits were largely protected, even in the face of challenges from other unsecured creditors.[232] In Detroit, the solution that was crafted to protect pensioners involved complex negotiations to sell the city-owned art museum to the nonprofit that was already running the museum, with the $816 million sale price earmarked to help fund pension benefits.[233] Several foundations, private donors, and the state of Michigan came together to fund the museum purchase.[234]

228. *In re* City of Stockton, 526 B.R. 35, 60 (Bankr. E.D. Cal. 2015).

229. 11 U.S.C. §109(c) (2012). As a result of the insolvency requirement, a city could not declare bankruptcy solely on the basis of an underfunded pension. Instead, the city must be able to establish that it is not paying its debts as they become due. *See* 11 U.S.C. § 101(32)(C) (2012).

230. Even where a state has an existing statute authorizing municipal bankruptcy, it can repeal that statute prior to a filing and thereby revoke the necessary consent.

231. Monica Davey, *Pension Deal Edges Detroit a Step Closer to Recovery*, N.Y. TIMES (Apr. 15, 2014), http://www.nytimes.com/2014/04/16/us/a-deal-on-pensions-lifts-hopes-in-detroit.html?_r=1 [https://perma.cc/8GNE-BLRA] (noting that an initial bankruptcy proposal would have cut pension benefits by 26 percent); Mary Williams Walsh, *Bankruptcy Judge in California Challenges Sanctity of Pensions*, N.Y. TIMES: DEALBOOK (Oct. 1, 2014, 9:15 PM), http://dealbook.nytimes.com/2014/10/01/judge-rules-that-bankruptcy-invalidates-calpers-lien-against-stockton-calif/?_r=0 [https://perma.cc/RX83-THR2] (noting that a Stockton creditor challenged the lack of pension cuts in Stockton, arguing that a bankruptcy plan that left pensions untouched would be unfair to creditors); Jonathan Weber, *For Vallejo, Bankruptcy Isn't Exactly a Fresh Start*, N.Y. TIMES (Jan. 22, 2011), http://www.nytimes.com/2011/01/23/us/23bcweber.html [https://perma.cc/4YBP-EE5T] (noting that despite large pension debt, the city of Vallejo chose not to adjust such debt as part of its bankruptcy plan).

232. *See supra* notes 226–228 and accompanying text.

233. Matthew Dolan, *In Detroit Bankruptcy, Art Was Key to the Deal*, WALL ST. J. (Nov. 7, 2014, 7:09 PM), http://www.wsj.com/articles/in-detroit-bankruptcy-art-was-key-to-the-deal-1415384308.

234. *Id.*

These bankruptcy cases illustrate that even though cities have the legal ability to shed pension debt, they may choose not to for political or practical reasons. For example, it may be politically unpopular to treat debts owed to public workers in the same manner as sophisticated commercial lenders, or it may be difficult to continue the essential work of the city if employees feel that their employer's promises cannot be trusted. What is unknown is whether this calculus will continue to hold for all severely distressed municipalities.

C. How Does Pension Debt Compare to Municipal Bond Debt?

The Subparts above have presented a rather bleak picture with respect to the likelihood that public pension participants will be able to successfully use courts to ensure their full benefits are paid. Given that states and cities routinely incur debt for both short-term cash flow needs and long-term capital investments, it is worth examining whether the lack of legal recourse is shared by other, nonpension creditors.

In general, all state and city creditors would be constrained by the courts' limited remedial powers. There are, however, some important differences between typical creditors and public employee creditors. First, the most common lending scenario involving state and local governments is through the issuance of bonds. Most state and local governments depend on a variety of bonds to both create necessary cash flow and to finance various capital-intensive projects. Because state and local governments are generally highly dependent on the bond market for their day-to-day functioning, they tend to voluntarily repay such debt, even if they could repudiate the debt without legal consequence.[235] If a state or local government were to default on a debt, they would find it both more difficult and more costly to borrow money through the bond market in the future. As a result, bond repayment rates are very high even without a threat of court-ordered repayment.[236] As an example of how much states care about the bond market, Rhode Island passed a law in 2011 giving general obligation bondholders a first lien on all municipal revenues in order to ensure that

235. *Cf.* Johnson & Young, *supra* note 24, at 124. *But see* William B. English, *Understanding the Costs of Sovereign Default: American State Debts in the 1840's*, 86 AM. ECON. REV. 259, 261 (1996) (noting two state court cases where states were ordered by courts to repay bonds, but where creditors were in the end unable to collect on the judgment).

236. MERXE TUDELA ET AL., MOODY'S INV. SERV., SPECIAL COMMENT: U.S. MUNICIPAL BOND DEFAULTS AND RECOVERIES, 1970–2011 2, 11 (2012), http://www.nhhefa.com/documents/moodysMunicipalDefaultStudy1970-2011.pdf (noting that municipal bonds had a lower default rate than global corporate issuers, with a cumulative default rate of 0.13 percent).

Rhode Island remained an attractive bond issuer in the face of the state's fiscal difficulties.[237]

Second, the terms of many bonds explicitly spell out the obligations of the governmental issuer in the event of default. For example, some municipal bonds will explicitly require the municipality to levy taxes if necessary for repayment. Courts generally uphold these types of contractually agreed remedies as applied to city bonds. Courts in several cases have ordered localities to levy taxes in order to retire bonds issued or guaranteed by them, and the U.S. Supreme Court has upheld this tax-based remedy.[238] In each of these cases, however, the terms of the bond required the locality to levy taxes if necessary to retire the bond; the court was therefore enforcing contractual terms rather than fashioning its own remedy.[239] In addition, in each of the bond cases, the taxation ordered by the court was authorized under state or local law.[240]

With respect to a pension debt default, the creditors adversely impacted are former workers. Viewed through this narrow lens, earning the distrust of former workers may not create a significant incentive to avoid default. States, however, are likely to also feel the effects of such a default in the distrust of current workers. A state worker who witnesses a pension default that affects other workers is unlikely to give much weight to the state's pension promise and, in return, is likely to either seek work elsewhere or demand higher wages to compensate for the perceived risk of default (just as capital markets demand risk premiums).[241] Counterpressure, however, is likely to come from the general public, at least to the extent pension debt threatens highly visible public services. As a result, it is unknown whether governments would voluntarily satisfy pension debt in the absence of legal compulsion.[242]

237. 12 R.I. GEN. LAWS § 45-12-1(a) (Supp. 2015). For a detailed discussion of Rhode Island's statutory provision, see David A. Skeel, Jr., *What Is a Lien? Lessons From Municipal Bankruptcy*, 2015 U. ILL. L. REV. 675, 687–92 (2015).

238. *See, e.g.*, Louisiana *ex rel.* Hubert v. City of New Orleans, 215 U.S. 170 (1909); Graham v. Folsom, 200 U.S. 248 (1906); Wolff v. City of New Orleans, 103 U.S. 358 (1880); United States v. City of New Orleans, 98 U.S. 381 (1878); City of Galena v. Amy, 72 U.S. (5 Wall.) 705 (1866); Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535 (1866); Bd. of Comm'rs v. Aspinwall, 65 U.S. (24 How.) 376 (1860).

239. Griffith, *supra* note 151, at 548.

240. *Id.* at 550–51, 551 n.362.

241. *See* Johnson & Young, *supra* note 24, at 124–25 (briefly discussing the likely repercussions of a pension default).

242. "It is not hard to imagine a scenario in which the states cannot meet their financial obligations, cannot raise revenue, and no bailout is forthcoming. . . . [I]t would be a mistake to dismiss the possibility of default entirely." *Id.* at 148–49.

D. The Possibility of a Bailout or Other Federal Interventions

Given that enforcing sovereign promises appears difficult, at best, in either state or federal court, there may be pressure on the federal government to bail out states or cities that have defaulted on their promises to workers. Nevertheless, there are many reasons to believe that the federal government will strongly resist any suggestion of a bailout. The federal government is likely to be concerned that a bailout will result in moral hazard—states taking less care with their fiscal health if they believe that a bailout will be forthcoming. Additionally, several scholars have made the argument that resisting federal government bailouts of subnational governments is critical to maintaining a federal system.[243]

But the federal government might take steps other than a bailout to help mitigate the effect of a pension default on workers. For example, the federal government might offer to lend money to defaulting states and cities on favorable terms, provided the funds are used to satisfy pension obligations. While this does not completely eliminate the moral hazard and federalism concerns that arise in the context of a traditional bailout, it may be more palatable to the federal government than an outright transfer of funds.

Second, the federal government might establish some type of state bankruptcy-like system for a distressed state to resolve its debts in an orderly manner.[244] Clearly, this is not an ideal solution from the perspective of the workers, but it may be preferable to address all state debt in a systematic manner, rather than an unstructured process that may result in both unsustainable actions and distributions that depend largely on the influence of the particular creditor. Bankruptcy and similar solutions, however, raise complicated legal issues that are outside the scope of this Article.[245]

If the federal government were to take any of these actions, it would likely do so in exchange for some type of concession by the state and local governments. For example, one could imagine the federal government imposing actual funding

243. *See* JONATHAN A. RODDEN, HAMILTON'S PARADOX: THE PROMISE AND PERIL OF FISCAL FEDERALISM (2006); Paul E. Peterson & Daniel Nadler, *Freedom to Fail: The Keystone of American Federalism*, 79 U. CHI. L. REV. 251 (2012). *But see* Terrance O'Reilly, *A Public Pensions Bailout: Economics and Law*, 48 U. MICH. J.L. REFORM 183, 187 (2014) (arguing that a federal bailout of public pension plans is likely).

244. It is unclear whether such federal involvement in state debt work-out would be permissible under the U.S. Constitution. See sources cited *infra* note 245 for a more detailed look at the legal issues involved in state bankruptcy-like solutions.

245. For a detailed look at the possibility of state bankruptcy, see generally Anna Gelpern, *Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt*, 121 YALE L.J. 888 (2012); Richard M. Hynes, *State Default and Synthetic Bankruptcy*, 87 WASH. L. REV. 657 (2012); David A. Skeel, Jr., *States of Bankruptcy*, 79 U. CHI. L. REV. 677 (2012).

standards on public pension plans in exchange for providing a solution to their unfunded liability.[246]

III. HOW LAW ALLOWS PENSION DEBT TO ACCUMULATE AND PREVENTS FULL FUNDING COMMITMENTS

Part II presented a harsh reality for pension plan participants. If their pension trust runs out of funds to pay benefits, it is highly unlikely that they will have legal recourse to full benefit payments. If nothing else, this should motivate pension participants to ensure that their plan enjoys a healthy funding level. For as long as there are assets held in the trust, participants will be able to secure benefit payments. This Part examines how law actually works against this goal—in both permitting enormous amounts of pension debt to lawfully accumulate and in preventing efforts to force adequate annual funding.

A. Why Pension Debt Is Not Debt

Nearly every state has a constitutional balanced budget requirement[247] and a limitation on the state's ability to incur debt.[248] Yet despite these requirements and prohibitions, states have accumulated trillions of dollars in unfunded pension liabilities.[249] As the Subparts below will explain, balanced budget requirements in no way ensure that adequate pension contributions are made, and debt limitations have been interpreted consistently to exclude pension debt from their reach.

1. Balanced Budget Requirements

The specifics of balanced budget requirements vary among the states,[250] but for our purposes it is sufficient to note that forty-nine states have some type

246. Such requirements could be relatively easily adopted through the tax code requirements that current apply to qualified retirement plans. All public plans are typically tax qualified, and the federal government could easily condition this tax benefit on the satisfaction of specific funding requirements, just as it does for private-employer retirement plans.

247. *See* Steven M. Sheffrin, *State Budget Deficit Dynamics and the California Debacle*, 18 J. ECON. PERSP. 205, 206 (2004) (noting that every state except Vermont has some type of balanced budget requirement).

248. *See* Kiewiet & Szakaly, *supra* note 180, at 67 (noting that only five states lack some type of constitutional limitation on debt).

249. MUNNELL & AUBRY, *supra* note 3, at 4.

250. *See* Yilin Hou & Daniel L. Smith, *A Framework for Understanding State Balanced Budget Requirement Systems: Reexamining Distinctive Features and an Operational Definition*, 26 PUB. BUDGETING & FIN. 22, 22 (2006). Constitutional requirements are often thought of in five

of requirement to submit or pass a balanced budget.[251] Each of the distressed states mentioned in Part II—Illinois, Kentucky, New Jersey, and Pennsylvania—in fact have fairly stringent balanced budget requirements, with each requiring the governor to both propose and sign a balanced budget.[252] None of the distressed states is permitted to carry over a deficit to the next budgetary period.[253]

Yet despite the fact that these states have stringent balanced budget requirements, we also know that each of these states carries significant debt in the form of unfunded pension liabilities. Balanced budget requirements do not in any way prevent pension underfunding. Arguably, such requirements actually contribute to the incentives to underfund pensions because they significantly constrain appropriations, and pension contributions are costs that are easy to push into the future.[254] Balanced budget requirements are structured to ensure that expenditures within a budgetary period match revenue inflows during that same period. They do not require any specific appropriations to be made, nor do they prevent all sorts of game playing, such as shifting the payment of certain expenses forward a few days to push them into the next budget, or attempting to speed up the collection of revenue to artificially boost revenue estimates for a given budget year. The only pension expense taken into account for purposes of balanced budget amendments is the actual appropriation that is made in the budget bill. It is therefore simple to control the expense for balanced budget purposes simply by allocating a lower contribution. Finally, balanced budget requirements do not, by themselves, prohibit the state from using debt to balance its budget.

different categories: (1) the governor must submit a balanced budget; (2) the legislature must pass a balanced budget; (3) the state may carry over a deficit, but it must be corrected in the next fiscal year; (4) the state may not carry a deficit to the next biennium; and (5) the state may not carry a deficit over to the next fiscal year. *Cf.* ADVISORY COMM'N ON INTERGOVERNMENTAL RELATIONS, FISCAL DISCIPLINE IN THE FEDERAL SYSTEM: NATIONAL REFORM AND THE EXPERIENCE OF THE STATES 37–38 (1987).

251. *See* Sheffrin, *supra* note 247, at 206. Vermont, the only state without a balanced budget requirement, still behaves as though it is subject to such a requirement. *Id.*

252. ILL. CONST. art. VIII, § 2; KY. CONST. § 171; N.J. CONST. art. VIII, § 2; PA. CONST. art. VIII, §§ 12, 13.

253. *See* NAT'L ASS'N OF STATE BUDGET OFFICERS, BUDGET PROCESSES IN THE STATES 52 tbl.9 (2015).

254. *See, e.g.*, Monahan, *supra* note 16, at 128–29.

2. Debt Limitations

a. In General

Most state constitutions do, however, contain significant limitations on the state's ability to incur debt.[255] Such provisions were included in state constitutions in response to reckless borrowing by state legislatures in the nineteenth century, often to finance canals and railroads, which subsequently left many states in financial distress.[256] Several states, in fact, repudiated their debts.[257] The problem was not limited to state-level borrowing. As difficulties with municipal debt became obvious, most state constitutions included similar debt limitations on municipalities.[258]

In large part, debt limitations were (and are) thought of as necessary because of the nature of legislative bodies.[259] Politicians who desire to be reelected have an incentive to borrow money to spend on current constituents and push repayment obligations onto future legislatures.[260] Extra money to spend on constituents is always good, but raising taxes is not. It is better for politicians to debt-finance those expenditures in order to make a future generation pay for them. And while we normally rely on electoral politics to act as a check on legislative behavior, current voters have no reason to vote debt-incurring legislators out of office because voters are not visibly or presently harmed by the debt.[261] As one New York judge said, "Now, as then, great expenditures may be lightly authorized if payment is postponed. To place the burden upon our children is easy. Nor do we scrutinize so closely the expenditures to be made if that be done."[262] Constitutional debt limitations, then, are meant to address "a perceived institutional defect of legislatures: the inability to account for the future costs of present decisions to incur debt."[263]

While the language varies among states, state constitutions generally prohibit a state from incurring debt in excess of a specified amount, absent voter

255. Kiewiet & Szakaly, *supra* note 180, at 67 (noting that only five states lack some type of constitutional limitation on debt).
256. *See* Stewart E. Sterk & Elizabeth S. Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 WIS. L. REV. 1301, 1306–10 (1991) (providing an early history of debt limitations).
257. *Id.* at 1308.
258. *Id.* at 1313.
259. *See id.* at 1321–24.
260. *Cf. id.* at 1322.
261. *See id.* at 1321–24.
262. People v. Westchester Cty. Nat'l Bank of Peekskill, 132 N.E. 241, 244 (N.Y. 1921).
263. Sterk & Goldman, *supra* note 256, at 1323–24.

approval of such debt.[264] Most states are permitted to engage in short-term borrowing to cover revenue shortfalls,[265] and many also contain provisions allowing indebtedness in order to "repel invasion, suppress insurrection, or . . . provide for the public defense."[266] But most state courts describe constitutional debt limitations as at their heart forbidding "one generation from stealing the earnings of another, at least without a vote of the people"[267] because "debt today leads directly to cuts in services tomorrow."[268] The purpose of constitutional debt limitations has also been described as to "strictly limit the power of the legislature to financially obligate future legislatures without the permission of the people by means of a direct vote[,]"[269] and further that such limitations are "the keystone guaranty of the state's fiscal responsibility."[270] Each generation, it has been said, should be "left free to make its own trades with its own money."[271]

Of course, a constitutional debt limitation's ability to prevent a current legislature from indebting future generations depends in large part on how debt is defined and how courts interpret such definition. "As commonly . . . understood, a debt includes every obligation by which one person is bound to pay money to another. [But] [w]hen used in the constitutional sense [(referred to, for ease of reference, as "constitutional debt")], it is given a meaning much less broad and comprehensive . . . ."[272] In Illinois, for example, the constitutional language defines debt as "bonds or other evidences of indebtedness which are secured by the full faith and credit of the State or are required to be repaid, directly or indirectly, from tax revenue and which are incurred by the State . . . ."[273] This definition has been interpreted to include only situations in which the state borrows funds through the issuance of bonds or other paper indebtedness.[274] As a result, the narrow definition operates to prohibit only

264. *See, e.g.*, ILL. CONST. art. IX, § 9; KY. CONST. §§ 49, 50; N.J. CONST. art. VIII, § 2, ¶ 3; PA. CONST. art. VIII, § 7.
265. *See, e.g.*, PA. CONST. art. VIII, § 7. Such provisions also allow states to budget in anticipation of revenue collection. *See* Sterk & Goldman, *supra* note 256, at 1314.
266. KY. CONST. § 49; *see also* WASH. CONST. art. VIII, § 2; N.J. CONST. art. VIII, § 2, ¶ 3; PA. CONST. art. VIII, § 7.
267. McGuffey v. Hall, 557 S.W.2d 401, 411 (Ky. 1977).
268. Booth v. Sims, 456 S.E.2d 167, 176 (W. Va. 1995).
269. Hayes v. State Prop. & Bldgs. Comm'n, 731 S.W.2d 797, 802 (Ky. 1987).
270. *McGuffey*, 557 S.W.2d at 409.
271. *Id.* at 410.
272. Hubbell v. Herring, 249 N.W. 430, 434 (Iowa 1933) (citation omitted).
273. ILL. CONST. art. IX, § 9.
274. Constitutionality of General Assembly Reducing Scheduled State Contributions to the Retirement Systems, Op. Ill. Att'y Gen. No. 05-005, 5 (2005) (citing 3 JOHN W. LEWIS, RECORD OF PROCEEDINGS: SIXTH ILLINOIS CONSTITUTIONAL CONVENTION 1926–34, 2095–2111 (1972); 5 JOHN W. LEWIS, RECORD OF PROCEEDINGS: SIXTH ILLINOIS

situations in which the state enters the marketplace to borrow money, not when it simply incurs a future liability.[275]

A critical requirement for constitutional debt, as interpreted by most courts, is that the obligation to repay be certain and unavoidable. Because debt limitations were intended to prevent the current legislature from financially burdening future taxpayers, many courts focus on whether the liability at issue is absolute in determining whether it constitutes debt under the constitution.[276] A mere possibility that future legislatures will have to appropriate money is insufficient to create a constitutional debt.[277] The obligation must be binding and not contingent, requiring the state to pay it by levy and collection of general taxes.[278] General obligation bonds, which typically involve pledges of the state's "full faith and credit," are treated as absolute liabilities and therefore debt for constitutional purposes.[279] On the other hand, revenue bonds, where bondholders have recourse only to the revenues generated by the project for which the bonds were issued, are typically not considered constitutional debt.[280]

b. As Applied to Pension Liability

Despite the fact that the core purpose of debt limitations is to prevent the current legislature from financially binding future generations, unfunded pension liabilities appear to do exactly that. After all, if a pension plan does not hold assets sufficient to cover benefit payments, and those benefits are to be paid, the shortfall must be made up by future legislative appropriations. There are

CONSTITUTIONAL CONVENTION 3848–72, 3896–3907 (1972)). Other states have adopted similar definitions. *See, e.g.*, Vill. of Chefornak v. Hooper Bay Constr. Co., 758 P.2d 1266, 1269–70 (Alaska 1988); Rochlin v. State, 540 P.2d 643, 647–48 (Ariz. 1975) (en banc); State *ex rel.* Wittler v. Yelle, 399 P.2d 319, 324 (Wash. 1965) (en banc).

275. Op. Ill. Att'y Gen. No. 05-005, *supra* note 274, at 5.

276. *See, e.g.*, Wilson v. Ky. Transp. Cabinet, 884 S.W.2d 641, 645 (Ky. 1994) (emphasizing that debt is only created where there is a legal obligation that extends beyond the current budget period).

277. *Id.*

278. *Id.* at 644 (citing State Budget Comm'n v. Lebus, 51 S.W.2d 965 (Ky. 1932)); *see also* Johnson v. Pa. Hous. Fin. Agency, 309 A.2d 528, 536 (Pa. 1973) (holding that there must be a "mandatory obligation" on the legislature in order to be considered constitutional debt).

279. *See* Christine Sgarlata Chung, *Government Budgets as the Hunger Games: The Brutal Competition for State and Local Government Resources Given Municipal Securities Debt, Pension and OBEP Obligations, and Taxpayer Needs*, 33 REV. BANKING & FIN. L. 663, 693 (2014) (describing general obligation bonds as involving a pledge of the government's taxing power); *see also* Rivers v. City of Owensboro, 287 S.W.2d 151 (Ky. 1956) (holding that general obligation bonds of a municipality are constitutional debt because they are subject to payment through coercion of general municipal taxes).

280. R.T.K., Annotation, *Constitutional or Statutory Requirement of Prior Approval by Electors of Issuance of Bonds or Incurring of Indebtedness, by Municipality, County, or State, as Applicable to Bonds or Other Instruments Not Creating Indebtedness*, 146 A.L.R. 604 (1943).

multiple explanations for why constitutional debt limitations have failed to prevent such underfunding and have allowed such burdens to be placed on future generations.

First, as noted above, some states have either defined (or interpreted) their debt limitation to encompass only formal marketplace borrowing, where the state seeks to receive cash today in exchange for a promise to repay in the future, secured by some type of paper indebtedness.[281] Because pension liabilities do not involve formal marketplace borrowing, it is not considered constitutional debt under such a definition.[282] For example, Illinois has taken the position that while reducing current contributions to a retirement plan may "necessitate funding increases in later years," such action does not create constitutional debt because the amount of benefits due to participants has not been increased and therefore the state has not "'incurred' any additional debt."[283]

Courts have also suggested that unfunded pension benefit obligations are not debt because they are payable only from a special fund, and debt that is not payable from general revenue (and does not therefore jeopardize the state's fiscal health) is not constitutional debt.[284] In some states, the statute establishing the pension plan explicitly provides that all benefits under the system will be paid from a specific fund or funds, not from general assets, thereby implying that payment is limited to those funds.[285] As a result, if law is explicit that retirement benefits are only payable out of the relevant trust fund, and the state has affirmed the special fund doctrine, pension debt can be disregarded for constitutional purposes.

Another approach taken by courts has been to categorize pension liabilities as "contingent debts" because the exact amount owed by future legislatures cannot be predicted with any certainty.[286] Following from the classification of pension liabilities as contingent is a finding that the liability is not constitutional

281. *See, e.g.*, *Wilson*, 884 S.W.2d at 645.
282. *See, e.g.*, *Rochlin*, 540 P.2d at 647–48; Op. Ill. Att'y Gen. No. S-1265 (July 14, 1977); *Wittler*, 399 P.2d at 324; Op. Ill. Att'y Gen. No. 05-005, *supra* note 274, at 5.
283. Op. Ill. Att'y Gen. No. 05-005, *supra* note 274, at 7. Note that this explanation is somewhat curious, as it implies that if benefits were increased it would create debt, and also that the original promise of benefits might be considered debt.
284. *See, e.g.*, West v. Trotzier, 196 S.E. 902 (Ga. 1938); State *ex rel.* Wittler v. Yelle, 399 P.2d 319 (Wash. 1965) (en banc); Booth v. Sims, 456 S.E. 2d 167, 176 (W.Va. 1994) ("[P]ension systems are constitutional for the same reasons that special revenue bonds are constitutional."). For a discussion of the principle that debt payable solely from a special fund is not debt, see *Long v. Napolitano*, 53 P.3d 172, 186–87 (Ariz. Ct. App. 2002).
285. *See, e.g.*, KY. REV. STAT. ANN. § 161.420 (LexisNexis 2009). *But see* 71 PA. CONS. STAT. § 5951 (2010) (stating that pension benefits "are hereby made obligations of the Commonwealth").
286. Columbia Cty. v. Bd. of Trs. of Wis. Ret. Fund, 116 N.W.2d 142, 152 (Wis. 1962).

debt, for constitutional debt must be of a fixed, certain amount.[287] Essentially, it is only when the contingency occurs that the liability will be considered a debt.[288] In this context, the contingency would lapse only when the pension fund ran out of money to pay benefits. And at that point, the amount owed would be considered constitutional debt, provided the funding situation was such that payments beyond the current legislative budget period were definitively required. Absent a specific exemption, constitutional debt cannot be enforced unless approved by voters. As a result, constitutional debt limitations would seem to reinforce the conclusion of Part II, above, that once the pension trust fund is exhausted, participants will not be able to effectively enforce their rights to benefits. There is an argument, however, that the legislature would never know with certainty the amount of funding that would be due in any future legislative session—even if the plan was wholly unfunded—thereby maintaining pension liability's status as nondebt for purposes of constitutional limitations.

While a variety of rationales have been used, the conclusion has been uniform to date: Amounts owed to pension plan beneficiaries are not a debt of the state, as that term is used in the state's constitution. The result is that current legislatures are permitted to spend future generations' money, in contravention of the express purposes of state debt limitations. We may not know precisely how much future generations will owe because of uncertainty regarding rates of return and participant demographics, but that does not change the fact that a future generation will be responsible for making up the shortfall.

Perhaps, then, state law should be changed to treat pension debt on equal footing with other debt. Such an approach likely would have worked well had it been in place prior to the accumulation of massive pension debt. If constitutional debt limitations had encompassed pension debt from the time public pension plans were created, we could have effectively prevented pension debt. After all, if pension debt were considered constitutional debt, the legislature would be forced to adequately fund pensions on an annual basis or receive voter approval to underfund. If the state were unable to meet the funding obligation or did not receive voter approval for the shortfall, it would need to lower benefits for the year at issue in order to ensure that all promises made were funded. But it is less clear that law reform at this stage would have a positive effect. If tomorrow all state constitutions were amended to clarify that unfunded pension liabilities were considered debt, the effect might be to simply make pension debt explicitly unenforceable. There is, perhaps, an argument for law reform to provide, on a

287. *Id.*
288. *Id.*

prospective basis, that pension debt shall be considered constitutional debt. Doing so should effectively foreclose the ability of a state to underfund its pension. The reality, however, is that pension debt fluctuates based on investment returns and demographics. As a result, constitutional debt limitations might not perfectly achieve funding discipline.

B. The Inability to Use Law to Create Funding Discipline

Thus far, this Article has argued that: (1) in the event that a pension plan runs out of assets to pay benefits, it is highly unlikely that participants could effectively use the judicial system to secure benefit payments; and (2) that state balanced budget requirements and debt limitations actually contribute to the likelihood that public plans will be underfunded, making a strong case for identifying a method that ensures adequate, annual pension appropriations.

Law may also contribute in other ways to incentivize the underfunding of pensions. In those states that have very strong legal protection of pension benefits, participants may have a false sense of security regarding the likelihood of payment, and therefore fail to monitor or lobby for adequate pension funding. Given these political, legal, and structural incentives to underfund, perhaps law could be modified in order to be used as a form of precommitment device to force legislatures to make the required annual contributions.

I have written elsewhere about some of the many impediments that stand in the way of achieving such funding discipline through the rule of law.[289] In order to have any hope of creating a legally enforceable funding requirement, the funding requirement needs to be spelled out in much more detail than is currently the norm.[290] Essentially, the legal requirement would need a high degree of mathematical precision, while also maintaining some degree of flexibility for years of fiscal crisis.[291] In addition, a clever enforcement mechanism would be needed—given that courts do not hold the power of the purse.[292] One possibility would be to enshrine a self-executing appropriation in the state constitution. But a recent New Jersey Supreme Court decision illustrates yet another obstacle to the use of legal funding standards.

In order to deal with its substantially underfunded pension plans, New Jersey enacted significant pension reform legislation in 2011.[293] While the

289. Monahan, *supra* note 16.
290. *Id.* at 161–62.
291. *Id.* at 161–62, 166–67.
292. *Id.* at 164–65.
293. Act of June 28, 2011, ch. 78, 2011 N.J. Laws 551.

legislation reduced benefits for participants, in return it put in place what looked to be a binding, legally enforceable obligation for the state to fund the pension plan annually in order to make up the staggering funding shortfall.[294] Specifically, the law provided that participants had a contractual right to the annually required contribution, and that the failure of the state to make the required contribution "shall be deemed to be an impairment of the contractual right,"[295] thereby making a failure by the state to fund the pension plans unconstitutional under the Contracts Clause.[296]

In the first two fiscal years following enactment, the legislature and governor complied with the pension funding requirement.[297] While the legislature appropriated sufficient funds to comply with the funding requirement in the third fiscal year (2014), the Governor, acting through an executive order shortly before the end of the fiscal year, reduced the pension contribution by $886 million in order to respond to a "severe and unanticipated revenue shortfall."[298] Participants promptly sued in order to force the pension contribution, but the court held that, given the Governor's responsibility to ensure that appropriations do not exceed revenue in a given fiscal year, shortchanging the pension contribution was within the Governor's emergency powers and also a lawful exercise of the state's police powers under the Contracts Clauses of the New Jersey and U.S. Constitution.[299] There were only a few weeks left until the end of the fiscal year, and the court agreed with the Governor that cutting from elsewhere in the budget at that point in the fiscal year would be more drastic (and detrimental) than a lowered pension contribution.[300]

294. *Id.* at 609–11 (amending N.J. STAT. ANN. 43:3c-9.5(c) (West 2011)).
295. *Id.* at 611.
296. The Contracts Clause of the United States Constitution provides that states shall not impair the obligation of contracts. New Jersey's state constitution contains substantially similar language. As a result, state legislation that "substantially" impairs a contract is unconstitutional unless it is found to be a valid exercise of the state's police power to protect the health, safety, and welfare of its citizens. States may exercise their police power where "reasonable and necessary" to achieve an important public purpose. In order to be "reasonable," the U.S. Supreme Court has held that it must be the least drastic means of achieving the policy goal. U.S. Tr. Co. of N.Y. v. New Jersey, 431 U.S. 1, 30–31 (1977). As a result, the New Jersey statutory funding provision would require annual contributions to be made to the pension plans unless reducing the contributions was the least drastic means of addressing some type of fiscal situation.
297. Burgos v. State, 118 A.3d 270, 277 (N.J. 2015).
298. *Id.* at 278.
299. Burgos v. State, No. MER-L-1267-14, 2014 N.J. Super. Unpub. LEXIS 3103 (N.J. Super. Ct. Law Div. June 25, 2014), *rev'd*, 118 A.3d 270 (2015).
300. *Id.* at 72–74, 76–83.

In fiscal year 2015, again citing a reduction in projected revenue, the proposed budget was revised to reduce pension contributions by $1.57 billion.[301] The legislature, however, passed an appropriations bill with the full pension contribution, along with companion bills that established new taxes in order to increase the revenue available for budgeting.[302] The Governor then exercised his line-item veto, deleting $1.57 billion of the state's required pension payment, and vetoed outright the companion bills establishing the new taxes necessary to pay for the required pension contributions.[303]

The reduced fiscal year 2015 pension contribution was also challenged in court, with the trial court holding that the reduction in funding was an unconstitutional impairment of contract by the state under both the New Jersey and U.S. Constitution.[304] The state appealed to the New Jersey Supreme Court, which held that the statutory funding requirement was unenforceable on the grounds that it *created debt* in violation of the New Jersey Constitution.[305]

To many, this result will seem to be counterintuitive. After all, the funding requirement was put in place to pay off existing liabilities. Yet from a constitutional perspective, the money owed to pensioners is not constitutional debt for the reasons explained in Part II.B.1—to the extent it is debt, it is debt that is subject to future appropriations. Attempting to fix future appropriations in order to adequately fund the pension plans was itself debt because it was an absolute, fixed liability that would prevent future legislatures from making their own budgetary trades.

The holding of this case is consistent with the core concern of the constitutional debt limitations, which is to prevent current legislatures from binding future legislatures. As the court explained, "the Framers intended to empower the people of the State by giving them the final word in respect of creating financial commitments that might impair the State's fiscal health and have inter-generational repercussions."[306] Because voters had not approved the

301. *Burgos*, 118 A.3d at 278–79. The reduction was announced by the State Treasurer.
302. Assemb. No. 3484, 217th Leg. (N.J. 2016); Assemb. No. 3485, 216th Leg. (N.J. 2014); *see also Burgos*, 118 A.3d at 278–79. The "new taxes [were] colloquially referred to as a 'corporate business tax surcharge' and a 'millionaire's tax.'" *Burgos*, 118 A.3d at 278 n.2.
303. *Burgos*, 118 A.3d at 278–79.
304. Burgos v. State, No. MER-L-1267-14, 2015 N.J. Super. Unpub. LEXIS 1786 (N.J. Super. Ct. Law Div. Feb. 23, 2015).
305. *Burgos*, 118 A.3d at 292.
306. *Id.* at 284.

pension funding commitments, and because the court found them to require future appropriations, the statute was held to be unconstitutional.[307]

Additionally, the court focused on the broad language in New Jersey's constitution. Recall that many states interpret the debt limitation to apply only to traditional, paper indebtedness. New Jersey's constitution, however, uses encompassing language that covers "debts" or "liabilities" created "in any manner."[308] Under general principles of statutory interpretation, the court disposed of any arguments that only traditional borrowing or debt instruments were covered by the debt limitation.[309] The court explicitly stated that the debt prohibition is broad enough to reach "long-term financial obligations addressing so-called operating expenses."[310]

The troubling outcome for public employees in New Jersey is that while pensioners have a right to their earned benefits, they cannot use law to effectively ensure that such benefits are funded. And given that courts are adamant that appropriations are entirely within the control of the legislative and executive branches, it becomes questionable whether the right to pension benefits is a right at all. As the dissent explained: "The dismal logic of the majority's decision is that the political branches, in accordance with the State Constitution, can let the pension fund run dry and leave public service workers pauperized in their retirement."[311]

The reasoning of the New Jersey Supreme Court may very well be followed in other states if they enact pension funding requirements. And in such states, using law to impose funding discipline would require either a constitutional amendment to exempt pension funding requirements from debt limitations, or voter approval. In states like Illinois, which limit "debt" to traditional forms of borrowing, there is much less risk that a court would strike down funding requirements as unconstitutional debt. Nevertheless, it will likely remain very difficult to use law to effectively enforce pension funding discipline.

CONCLUSION

The clear takeaway from this Article is that participants in significantly underfunded public pension plans should be very concerned about the security of

307. While not at issue in this case, this line of reasoning suggests the possibility that pension promises may themselves be unconstitutional debt. Pension promises likely survive the constitutional debt analysis precisely because they are unenforceable.
308. *Burgos*, 118 A.3d at 287.
309. *Id.*
310. *Id.* at 288.
311. *Id.* at 300 (Albin, J., dissenting).

their benefits, as it is highly unlikely that legal remedies will be available to compel the payment of benefits once the applicable trust fund is depleted. And this conclusion holds regardless of the strength of the state's legal protection of public pension benefits. The necessary legal remedies to address nonpayment are simply not available. The payment of pension benefits in the event of fund depletion will come down to the political will to pay such benefits. It is therefore worth briefly considering the risk that politicians will allow pension benefits to go unpaid—what I will refer to as the political risk of nonpayment.

Various analogs to the public pension problem exist. In fact, the same issues arise anytime the state promises something in the future that is of value to constituents. Social Security is an obvious example. There is no legal right to Social Security. If the federal government stopped paying benefits, or Congress stopped funding the program, individuals would have no legal recourse. We would have to depend on politicians to continue the program and find the money to pay for it. The political risk of simply abandoning Social Security, however, is probably very low. It is a program that pays benefits to a huge percentage of Americans and enjoys a great deal of popularity among that broad population.[312]

But contrast the political risk of Social Security reductions with the political risk of pension nonpayment. State and local pensions are subject to the same risk that the sovereign will change the terms of the deal. But unlike Social Security, the number of individuals adversely affected by pension nonpayment is a much smaller percentage of the population.[313] In addition, a majority of state and local citizens would benefit from reducing or eliminating public employee pensions, given that the money that would have gone to pensions could go to some other public purpose. Finally, the current political climate in some states and localities disfavors public workers, making cuts an even more attractive political target. The political risk of pension nonpayment thus looks much more significant than similar risks for Social Security.

A better analog to the public pension situation might be welfare programs, which entail significant costs that provide benefits to only a small percentage of the population. These programs, however, are typically structured as joint federal/state programs, which provides an incentive for the

312. Craig Copeland, *Social Security Reform Issues*, 58 WASH. & LEE L. REV. 1203, 1203 (2001).
313. States average 237 full-time equivalent state and local employees per 10,000 residents, although this figure does not include teachers. *States With Most Government Employees: Per Capita Rates by Job Type*, GOVERNING: THE STATES & LOCALITIES, http://www.governing.com/gov-data/public-workforce-salaries/states-most-government-workers-public-employees-by-job-type.html [https://perma.cc/2SRA-G3VT].

state to participate (and to comply with relevant federal guidelines) because failing to do so would involve leaving funds on the table. As a result, politicians may be more likely to protect welfare benefits than pension benefits. The federal government directly encourages states to operate social welfare programs, and the populations served are (at least in some localities) considered to be deserving of assistance.

As one can see, the political risk of nonpayment facing state and local pension participants is not unique; anyone who relies on a government program faces a similar risk. But state and local pension participants may face a greater degree of risk because states bear the full cost of benefits, and the general population would benefit (in some cases significantly) from nonpayment. What might save pension benefits from political nonpayment, however, is the fact that these are benefits that were earned through services performed for the state. Even with the significant financial burden, the broader population may favor full (or near-full) payment of benefits out of a sense of fairness. While it is difficult to predict how the political winds will blow in the event of pension fund depletion, it is critical that all parties understand that payment of benefits will ultimately be a matter for political resolution.