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Practice Group(s):

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Court Strikes New Jersey Pension Funding Agreement

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The national spotlight on public pension plans shifted to the state of New Jersey last month. After decisions in Oregon and Illinois (see K&L Gates Client Alerts: Changing the Rules in the Middle of the Game and Illinois Supreme Court Holds Public Pension Cutbacks Unconstitutional), the Supreme Court of New Jersey struck down an express agreement to fund the state pension plan.[1] In *Burgos v. State of New Jersey*, a majority of the New Jersey Supreme Court found the state constitution's "Debt Limitation Clause" prohibited the legislature from binding the state to the pension funding scheme.

State's Plan to Bridge the Funding Gap

The New Jersey Department of Treasury administers the five New Jersey public pension funds. The plans are defined-benefit and are paid for by employee contributions, public employer contributions and investment returns. In 1997, the New Jersey legislature enacted Chapter 113 of the Laws of New Jersey, granting public pension plan members a "non-forfeitable right to receive benefits."[2]

The plans were underfunded due to a "severe and unanticipated revenue shortfall."[3] In 2011, the legislature enacted an amendment to Chapter 78, requiring the state's timely contribution to pension funds.[4] The amendment required the state to make an annual required contribution ("ARC") equal to the sum of the annual normal contribution and the annual unfunded accrued actuarial liability contribution. The legislature did not require the state to start paying the full ARC amount immediately, but rather implemented a schedule to ease in the ARC over the next seven years:

FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018
1/7 of ARC	2/7 of ARC	3/7 of ARC	4/7 of ARC	5/7 of ARC	6/7 of ARC	7/7 of ARC

The state's failure to comply with this full contribution was "deemed to be an impairment" of members' contractual rights.[5]

The state made its required contributions in FY2012 and FY2013. In 2014, Governor Chris Christie signed into law the FY2014 Appropriations Act, including an appropriation for the

[1] *Burgos v. State of New Jersey*, A-55-14 (075736).

[2] *Id*. at 6.

[3] *Id*. at 15.

[4] Chapter 78, as amended, provides: "…The amount of the State's annually required contributions shall be included in all annual appropriations acts as a dedicated line item. Each member of the [State's pension system]…shall have a contractual right to the annual required contribution amount being made by the member's employer or by any other public entity…" N.J.S.A. 43:3C-9.5(c).

[5] Chapter 78, N.J.S.A. 43:3C-9.5(c).

state's full required contribution for that year. On May 20, 2014, Governor Christie issued an executive order reducing the payments for FY2014. Plan members and unions filed complaints, but the Law Division upheld the governor's determination.

In 2015, the FY2015 Appropriations Bill included an appropriation for the state's full required contribution for that year. The governor exercised his line-item veto power to delete the pension payment. Plan members and unions amended their complaints, and the trial court granted them summary judgment. The state appealed to the Supreme Court of New Jersey.

No Contract Existed

The court first acknowledged that the New Jersey and United States Constitutions prohibit the passage of laws impairing the obligation of contracts.[6] Although the legislature spoke with intent to create a contract, it lacked authority to enter into such a contract because it acted contrary to other constitutional provisions, specifically the Debt Limitation Clause.

Under the New Jersey Constitution, the power and authority to appropriate funds is vested in the Legislature.[7] The Debt Limitation Clause of the of the New Jersey Constitution was adopted in 1844 and provides: "The Legislature shall not, in any manner, create…debt or debts, liability or liabilities of the State, which…shall exceed at any time one per centum of the total amount appropriated…for that fiscal year[.]" The clause excepts laws that have been approved by the people at a general election.

The majority's reasoning hinged on defining the pension funding obligation as a "debt," one which exceeded 1 percent of total appropriations for the fiscal year and had not been approved by the people in a general election. Because the pension contribution scheme in Chapter 78 violated the Debt Limitation Clause, the legislature had no authority to pass such contractual rights. As the majority explained, it is not a clash of constitutional provisions (the Debt Limitation Clause and the Contracts Clause), because there was no contract in the first place. "Chapter 78's contractual language creates, at best, the equivalent of appropriations-backed debt that is accompanied by a strong legislative expression of intent to provide future funding."[8]

The majority emphasized that the judiciary has no authority in the budgetary process. Citing *City of Camden*, the court suggested that even if a statute conferred substantive rights, it would "in no way diminish[ ] the Legislature's constitutional control over the state fisc."[9]

Illinois Case Distinguished

In a footnote, the majority explained that Illinois lawmakers clearly created a substantive constitutional right that could not be diminished, and "diminution in benefits was the issue before the court, not a purported right to a specific funding scheme."[10] Although the Illinois Constitution does contain a "State Debt" clause, *In re Pension Reform Litigation* was different because the legislation in question reduced members' benefits. The New Jersey legislation did not reduce benefits; rather, the challenged statutes purportedly bound the state into paying its contribution to the plan.

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[6] *Burgos* at 23.
[7] *Id*. at 42.
[8] *Id*. at 9.
[9] *Id*. at 47 (citing *City of Camden v. Byrne*, 82 N.J. 133, 148 (1980)).
[10] *Id*. at 29 n.4.

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Dissent: Pension Obligation is Not a Debt

Chief Justice Rabner's dissent explains, "Never before until today, has the Debt Limitation Clause been applied to the *ordinary operating expenses* of government, such as deferred compensation earned by public workers and payable as pension benefits."[11] Because the Debt Limitation Clause was not implicated, the justice opined, the legislature's enactment of Chapter 78 was valid and a contract exists. "[T]he State must have known that Chapter 78 was in compliance with [the Debt Limitation Clause and Appropriations Clause] when passed by the Legislature and signed by the Governor."[12]

Conclusion

The court's use of the Debt Limitation Clause to invalidate an "agreement" to fund the pension plan is a novel decision. Although other state constitutions contain debt limitation provisions, accrued unfunded liabilities are typically not considered a "debt." The court noted that it did not consider the pension members' contract rights to benefits and the decision did not reduce them. But without adequate funding, the security of the members' benefits is certainly in question. This case suggests that the members' rights to an adequately funded pension plan might need to be found inherent in their constitutional rights to a pension. This case also calls into question other transactions the state entered into after the 1844 adoption of the Debt Limitation Clause; if a transaction created debt of more than 1 percent total appropriations and was not approved in a general election, it may be challenged as violating the Debt Limitation Clause.

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[11] *Burgos v. State of New Jersey*, A-55-14 (Rabner, C.J., dissenting) (emphasis added).
[12] *Id*. at 25.

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