

The Civic Federation,
The Federal Reserve Bank of Chicago
and
The National Tax Association
A Forum on Public Pension Funding

If the Pension Bomb Stops Ticking,
What Happens Next?

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“PENSIONS ARE PROMISES THAT ARE NOT TO BE BROKEN” – Saying on T-Shirt of Union Employee in a Corporate Bankruptcy

- To Keep Pension and OPEB Promises that Should Be Kept We must:
 - Recognize the Problem
 - Determine the Ability to Pay
 - If Necessary, Restructure the Payments with an Assured, Dedicated Source of Funding for Realistic and Attainable Benefits

Summary of Key Factors

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I. THE PENSION AND OPEBs CRISIS - THE HARD FACTS

- State and Local Public Employees are approximately 12% of the U.S. Workforce and have an Estimated \$750 Billion of Unfunded Pension Liabilities not Counting OPEB Liabilities
- Private/Corporate Workers make up over 80% of the U.S. Workforce and have an estimated \$450 Billion of Unfunded Liabilities
- Failure to Address the issue now will lead to potentially Larger Problems later

I. THE PENSION AND OPEBS CRISIS - THE HARD FACTS AND POSSIBLE SOLUTIONS - THE CURRENT STATE OF THE UNDERFUNDING OF PENSIONS AND OPEBS

- A. State and Local Government workers are approximately 12% of the nation's workforce - 16 million employees
- B. The Advent of Proposition 13 and other lower tax initiatives and movements which have gained strength since 1970 have the effect of lowering revenues and available dollars to pay off-balance sheet liabilities such as pension underfunding and other post employment benefits ("OPEBs")
- C. While available cash to pay for employee benefits was decreasing, local and state government sought to meet demand for services by adding more workers faster than other sectors
 - 1. Since 1970, state and local employees have increased by over 60% and have increased more than any other percentage of overall government employees (Federal, State and Local) from 77.8% to 85.6%

2. Extraordinary Personnel Growth and Future Pension Crisis* (Mortgaging your Grandchildren)

	NUMBER OF STATE EMPLOYEES	NUMBER OF LOCAL EMPLOYEES	PERCENTAGE OF STATE OF ALL GOVERNMENT EMPLOYEES	PERCENTAGE OF LOCAL OF ALL GOVERNMENT EMPLOYEES
1970	2,755,000	7,392,000	21.1	56.7
1997	4,732,608	12,000,608	24.2	61.4
Percent Increase from 1970	71.8%	62.3%	14.7%	8.3%

Pension obligations for Municipal Workers do not have priority in Bankruptcy and no protection for Deferred Compensation

- Demand for Funding Now
- In 1995 - 1996 Orange County Cut Thousands to Balance Budget

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- D. Meanwhile, demographics and actuarial assumptions have changed and there has been increased attention focused on the ability of state and local governments to pay the accrued costs of benefits for the expanding number of government employees
- E. In the United States, the unfunded pension liability of state and local governments could approach \$700 billion to \$1 trillion over the next ten years. The cost of unfunded health benefits promised to retirees could push the number even higher

F. The 2004 Wilshire Research Report has noted:

- Between 2002 and 2003, State Retirement Systems' Pension Assets fell (\$1.8 trillion to \$1.7 trillion) while liabilities increased (\$2.0 trillion to \$2.1 trillion)
- Of the 123 State Retirement Systems covered by the study, 93% are now underfunded, up from 79% in 2002 and 51% in 2001, and the average underfunded plan has a rate of assets to liabilities equal to 77%
- The total for all States of unfunded liabilities of State pension plans totaled in excess of \$400 billion as of 2003 (Wilshire's estimate for underfunding of all State pension plans as of 2004, given the improved investment returns of a full market, is at least in excess of \$375 billion. Another study by Standard & Poor's estimates the states' aggregate unfunded pension liabilities at \$284 billion based on fiscal 2004 data. Under either analysis, the underfunding is of a magnitude that must be dealt with)

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- According to Wilshire, in sixteen states, unfunded pension liabilities exceed the state budgets, up from nine states in the previous study
- Likewise, city and county retirement systems had in 2002 estimated pension assets of \$252.8 billion (\$35.3 billion less the pension liabilities of \$288.1 billion) and in aggregate having a funding ratio of 88% of liabilities
- In comparison, the S&P 500 companies had a funding ratio in 2002 of 83% assets of \$892 billion and liabilities of \$1.069 trillion
- The 2005 Wilshire Research Report for State Retirement Systems indicated improved investment returns and reduced underfunding and a funding ratio of assets to liabilities of 81% compared to 77%

G. The 2005 Wilshire Report on City and County Retirement Systems tells a Similar Story

- The Wilshire 2005 Report on City and County Retirement Systems concluded the asset shortfall for city and county pension plans is notably higher than for state retirement systems
- Of the sixty city and county retirement systems which provided actuarial data for 2004, Wilshire reports seventy-five percent have a market value of assets less than the pension liabilities or are underfunded
- As set forth on the following chart, 47 city retirement systems are underfunded in the amount of over \$52 billion. Interestingly, Wilshire concludes that there is no correlation between the allocation to equity in investment strategy and plan underfunding ratio. Overfunded plans appear to have approximately the same asset allocation pattern as underfunded plans

Retirement System	Report Date	Interest Rate (%) Assumption	Market Value of Assets	Actual Liabilities	Underfunded Amount	Funded Ratio (Market)
City of Austin ERS	12/31/04	7.75%	\$1,357	\$1,678	(\$321)	81.94%
Baltimore City ERS	6/30/04	8.00%	\$1,247	\$1,437	(\$190)	86.81%
Baltimore City Elected Officials RS	6/30/04	7.50%	\$13	\$15	(\$2)	89.88%
City of Baltimore Fire & Police	6/30/04	8.25%	\$1,896	\$2,396	(\$500)	79.14%
City of Baton Rouge & Parish ERS	12/31/04	7.75%	\$84.4	\$1,057	(\$213)	79.83%
City of Boston RS	12/31/03	8.00%	\$3,237	\$5,421	(\$2,184)	59.71%
Chicago Municipal EA & BF	12/31/04	8.00%	\$6,243	\$8,809	(\$2,566)	70.87%
Chicago Fireman's AB F	12/31/03	8.00%	\$1,110	\$2,517	(\$1,407)	44.08%
Chicago Policemen's AB F	12/31/04	8.00%	\$3,866	\$7,034	(\$3,168)	54.96%
Chicago Teachers PF	6/30/04	8.00%	\$10,244	\$12,106	(\$1,862)	84.62%
City of Cincinnati RS	12/31/04	8.75%	\$1,517	\$1,607	(\$90)	89.39%
Dallas ERF	12/31/04	8.25%	\$2,134	\$2,488	(\$354)	85.78%
Dallas Police and Fire	12/31/04	8.50%	\$2,485	\$3,074	(\$589)	80.84%
Denver ERP	12/31/03	8.00%	\$1,552	\$1,605	(\$53)	96.74%
Denver Public Schools RS	12/31/04	8.50%	\$2,556	\$2,961	(\$405)	86.32%
De troit Fire & Police	6/30/03	7.80%	\$2,878	\$3,722	(\$844)	77.34%
De troit General RS	6/30/03	7.90%	\$2,324	\$3,271	(\$947)	71.05%
Fort Worth ERF	9/30/03	8.50%	\$1,210	\$1,557	(\$347)	77.72%
Grand Rapids GR S	6/30/04	7.50%	\$30.7	\$30.8	(\$1)	99.68%
Houston Firefighters R & RF	6/30/02	8.50%	\$1,660	\$1,970	(\$310)	84.26%
Houston Municipal EPS	6/30/03	8.50%	\$1,266	\$3,278	(\$2,012)	38.62%
Houston Police	6/30/04	8.50%	\$2,423	\$3,000	(\$577)	80.76%
Jack sonville General EP P	9/30/04	8.40%	\$1,547	\$1,810	(\$263)	85.47%
Jack sonville Police & Fire PP	9/30/04	8.50%	\$73.9	\$1,222	(\$483)	60.49%
Kansas City Police ER S	4/30/04	7.75%	\$60.4	\$71.2	(\$108)	84.81%
Los Angeles City ERS	6/30/04	8.00%	\$6,895	\$8,534	(\$1,639)	80.80%
City of Los Angeles Water & Power	6/30/04	8.00%	\$5,961	\$6,422	(\$461)	92.83%
City of Memphis	6/30/04	7.50%	\$1,890	\$2,087	(\$197)	90.53%
Minneapolis ERF	6/30/04	6.00%	\$1,283	\$1,643	(\$360)	78.07%
Minneapolis Teachers' RFA	6/30/04	8.50%	\$76.3	\$1,730	(\$967)	44.12%
New York City ERS	6/30/03	8.00%	\$31,525	\$42,244	(\$10,719)	74.62%
New York City Police PF	6/30/03	8.00%	\$14,272	\$20,339	(\$6,067)	70.17%
New York City Teachers RS	6/30/02	8.00%	\$27,026	\$34,181	(\$7,155)	79.07%
No rfolk ERS	6/30/04	8.00%	\$81.6	\$84.6	(\$30)	96.50%
City of Okla klan d Police & Fire RS	6/30/02	8.00%	\$67.3	\$67.5	(\$2)	99.65%
Oklahoma City ER S	6/30/02	8.00%	\$33.9	\$37.3	(\$34)	90.89%
Orlando Firefighter PF	9/30/04	8.00%	\$19.2	\$20.6	(\$14)	93.06%
Orlando GEP F	9/30/04	8.00%	\$15.5	\$17.1	(\$16)	90.67%
Orlando Police PF	9/30/04	8.00%	\$28.2	\$30.1	(\$19)	93.60%
City of Phila delphia R S	6/30/02	9.00%	\$3,959	\$6,727	(\$2,768)	58.84%
Phoenix ERP	6/30/04	8.00%	\$1,446	\$1,495	(\$49)	85.81%
City of Richmond	6/30/03	8.00%	\$40.0	\$65	(\$25)	97%
San Antonio Police & Fire PF	9/30/04	8.00%	\$1,493	\$1,811	(\$318)	81.23%
San Diego City ERS	6/30/04	8.00%	\$3,018	\$4,113	(\$1,095)	72.52%
San ta Clara VTA ATU PP	6/30/04	8.00%	\$25.7	\$32.6	(\$6.9)	78.84%
St. Louis Public Schools RS	12/31/04	8.00%	\$1,061	\$1,196	(\$135)	88.67%
St. Paul Teachers' RFA	6/30/04	8.50%	\$87.2	\$119	(\$379)	99.17%
Totals:			\$15,9837	\$21,2020	(\$5,2189)	78.1%

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Source: 2005 Wilshire Report on City and County Retirement Systems

H. This is not a new problem. Historically, pension systems on the state and local level have been at various times underfunded for most of the last 50 years

The average funding ratio has grown and declined over time

PERIOD	FUNDING % OF TOTAL PENSION LIABILITIES*
Mid 1970's	50%
1990	80%
2000	100%
2003	77%

- Historically, extraordinary personnel growth plus political pressure contributed to the rise of pension liabilities
- The up market for investments in the late 1990's and between 2003-2005 has helped investor return and narrowed the underfunding gap
- However, there are implicit obstacles to solving pension liabilities
- Political pressure to increase pension benefits when current salaries are limited by restricted revenues

* Source: Standard & Poor's, Research: Managing State Pension Liabilities: A Growing Credit Concern, Jan. 2005.

- State and local legislatures listen and respond to employee unions and increase benefits without providing corresponding sources of funding
- The ever increasing demand for infrastructure improvements and expanded public safety services have more than strained state and local budgets
- Pension obligation bonds (“POB”) have masked the real systemic problem that needs to be addressed and have been a “band aid” and short term fix for significant budget loopholes and the consistent current underfunding of pension obligations
- Defined benefit plans (“DB”) (as compared to defined contribution plans (“DC”)) are for the most part doomed to failure - benefits promised cannot easily be provided, especially given the revenue restraints that state and cities face
- The transition to a DC plan which is less volatile, more predictable and, if funded currently, far safer
- The transition to DC plan from a DB plan is costly and complicated

- Expectations of government employees and unions are high and not easily changed and efforts to increase employees' contributions are not well received
- Many State Constitutions protect pension benefits from being changed retroactively and some prospectively
- In the absence of state constitutional provisions, certain states have adopted legislation prohibiting diminishing or impairing public employee pension rights
- A long-term fix is needed to transition DB plans (that don't work) to DC plans and to substitute increases in benefits to meet political needs with zero tolerance for underfunding as a current budget matter or with increasing benefits that have no funding source - Approximately 90% of public employee pension plans are defined benefit plans while less than 15% of private pension plans are defined benefit plans

I. The Recent San Diego Situation Illustrates the Potential for Disruption

- An alleged failure to disclose \$2 billion in unfunded pension liabilities
- Certain former officials accused of failing to disclose material information to the City Employees' Retirement System Board of Trustees
- Ratings Downgrade in face of revelations and problem accessing the Bond Market
- A report delivered by the City to the SEC admits there were disclosure misrepresentations or omissions in 15 bond offering documents

II. OPEBs – THE FEAR OF THE UNKNOWN

- Other Post Employment Benefits (healthcare, etc.) are generally a liability for retirees of 10-20 times the current annual benefits

II. OPEBs – THE FEAR OF THE UNKNOWN

- A. Other Post Employment Benefits (healthcare, etc.) are generally a liability for retirees of 10-20 times the current annual benefit payments
- B. The study and determination of this liability will be dynamic and uncertain given the volatility of health care costs
- C. GASB 45 will probably be a two edged sword - helpful disclosure but another previously undisclosed significant liability
- D. Bond financing of OPEBs without a total pension/OPEB solution may not be wise

IS THERE A SOLUTION?

YES

BUT IT HAS TO BE CRAFTED CAREFULLY

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III. CAN PENSION BENEFITS AND OPEBSs BE ROLLED BACK, REDUCED OR CHANGED?

- State Constitutional, Statutory Provisions and Case Law - Non-Impairment vs. Required to Save the Pension Plan
- Pension a Gratuity or Vested Right
- Labor Contracts and Pension Plan Flexibility
- Impairment When Change is Necessary

III. CAN PENSION BENEFITS AND OPEBSs BE ROLLED BACK OR REDUCED?

A. Different Approaches. States take different approaches in analyzing the pension rights of public employees and whether those rights can be modified. The chart set forth below summarizes some of these:

CATEGORIZATION OF CERTAIN STATE PUBLIC EMPLOYEE PENSION PROVISIONS

Specific state constitution prohibiting impairment of public employee pensions	General constitutional prohibition against impairment of contracts (applicability of pension depends on whether the courts view pensions as contractual obligations; also, states share their own Contract Clause with the U.S. Constitution)	State statute or case law prohibiting impairment of public employee pensions
Alaska, Hawaii, Illinois, Michigan, New Hampshire, New York,	Arkansas, Georgia, Indiana, Nebraska, New Jersey, Oklahoma, Rhode Island, Tennessee, West Virginia	Alabama, Arizona, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Idaho, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, Washington, Wisconsin, Wyoming

- B. States that by Specific Constitutional Provisions Prohibit Impairment. In certain States, there are Constitutional prohibitions specifically preventing any reducing or eliminating of pension benefits - State Constitutions prohibit altering (reducing or eliminating) state and local governmental contractual obligations to employees for pension benefits — a “vested” right (See e.g., Illinois, New York, Michigan, etc.)

- C. States that Prohibit Impairment on General Basis (General Constitutional Provisions). Some States rely on either the Federal or state constitution language prohibiting the impairment of contract to preclude a reduction in pension rights. These states include Georgia, Indiana, Oklahoma, Rhode Island and West Virginia

- D. Use of State Statutes to Protect Pension Rights. Some states have enacted statutory provisions which preclude local governments that establish pension and other post-employment benefits from diminishing or impairing those rights (*See e.g. Connecticut, Massachusetts and Maine*)
- E. Generally the Constitutional or Statutory Provisions Relate to Pension Rights as Compared to OPEBs. Some Courts have extended the protection against reduction in benefits to OPEBs and some have not
1. Accordingly, changes of pension benefits can only be done voluntarily or through Court ordered process
 2. Unions and employees generally do not easily agree to changes in pension benefits or OPEB
 - Change voluntarily may only be possible if the situation is desperate and there is imminent loss of jobs and income including benefits

3. The analysis states have undertaken in determining whether OPEBs can be modified are instructive
 - a. A divided Michigan Supreme in Studier v. Michigan Public School Employees' Retirement Board, 698 N.W. 2d 350 (Mich. 2005) determined that the term "accrued financial benefits" in Michigan Constitution refers only to benefit that increases over time such as retirement benefits and not health insurance benefits which are not protected by state or Federal constitutions
 - i. The Michigan State Constitution provides:

"The accrued financial benefits of each pension plan and retirement system of the State and its political subdivisions shall be a contractual obligation thereof and shall not be diminished or impaired thereby"
 - ii. The Michigan decision is in accord with earlier decisions in Colorado, Georgia and Tennessee. For example, Colorado has distinguished between quasi-pension type benefits protected from modification and ancillary benefits such as payments of health insurance premiums

- b. In 2003, Alaska's Supreme Court reached the opposite conclusion, namely, that a health benefit increase is constitutionally protected like retirement plans and cannot be changed and must be honored as a contractual obligation and cannot be reduced or eliminated without consent or just compensation. States that have sided with Alaska are New Jersey, Oklahoma, California and West Virginia
- c. Similarly, in *Calabro v. City of Omaha*, 247 Neb. 955, 531 N.W.2d 541 (1995), the Supreme Court of Nebraska considered whether the elimination of a supplemental cost-of-living benefit provided to plaintiffs by the City of Omaha unconstitutionally violated the firefighters' contract rights. The Court first determined that the supplemental cost-of-living benefit constituted a pension in which the plaintiffs obtained a vested, constitutionally protected contractual right because this supplemental benefit was directly related to the pension plan, and in order to receive this benefit, the employee also had to qualify for the pension plan. The Court then determined that the elimination of this supplemental benefit resulted in the unconstitutional impairment of the plaintiffs' contract rights
- d. By statute, the State of Maine distinguishes between those provisions of the public employee pension protected by the non-impairment clause and those that are not

F. The Illinois Approach

- Specific Constitutional Provision Adopted. Illinois adopted a specific constitutional provision in 1970 as part of the Constitutional Convention following the model of New York State and its court decision upholding such a provision
- How Constitutional Prohibition on Impairment Works. Article XIII, section 5, of the Illinois Constitution, which pertains to pension and retirement rights, provides that: "Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired." In *Felt v. Board of Trustees of the Judges Retirement System*, 107 Ill.2d 158, 89 Ill.Dec. 855, 481 N.E.2d 698 (1985): the Supreme Court of Illinois found unconstitutional an amendment to the Illinois Pension Code which changed the salary base for determining pension benefits from the judge's salary on the final day of service to the average salary over the last year in service. The Court found that the amendment violated the constitutional right of judges because it diminished their retirement benefits and impaired their contract rights under § 5 of article XIII of the Illinois Constitution

- Old Rule Pension Are Gratuities and Changeable; New Rule Pensions Are Vested Rights. Courts interpreting this Constitutional provision “have construed this provision as a guarantee that all public pension benefits are to be determined under a contractual theory rather than being treated as mere gratuities as some pensions had been previously.” *Smithberg v. Illinois Municipal Ret. Fund*, 306 Ill.App.3d 1139, 1142, 716 N.E. 2d 316, 319, 240 Ill.Dec. 183, 186 (3rd Dist. Ill. App. 1999). Thus, under this provision, statutory pension rights to public employees “cannot be altered, modified, or released except in accordance with usual contract principals.” *Smithberg*, 306 Ill.App.3d at 1143, 716 N.E.2d at 319, 240 Ill.Dec. at 186. *See also Bosco v. Chicago Transit Auth.*, 164 F.Supp.2d 1040, 1056 (N.D.Ill. 2001) (“The purpose of the provision is essentially to lock in an employee’s pension rights as they are stated under the employment contract, or as they exist by statute.”)

- Pursuant to this pension non-impairment clause, a public employee's rights to a pension is "based on the status of the system when his rights in the system vested, either at the time he entered the system or in 1971 when the 1970 Constitution [providing the non-impairment clause] became effective, whichever is later." *Bosco*, 164 F.Supp.2d at 1055-56. *See also People ex rel. Sklodowski v. State*, 182 Ill.2d 220, 229, 695 N.E.2d 374,377, 230 Ill.Dec. 884, 887 (Ill. 1998) ("This court has held that the contractual relationship is governed by the actual terms of the Pension Code at the time the employee becomes a member of the pension system."). And once the public employee's rights have vested, a member of the pension system, whether a current employee or a retiree, is contractually protected against a reduction in his or her benefits because such an alternation amounts to a contractual modification of the existing contractual agreement between the State and the member. *Kuhlmann v. Bd. Of Trustees of the Police Pension Fund of Maywood*, 106 Ill.App.3d 603, 608, 435 N.E.2d 1307, 1311, 62 Ill.Dec. 335, 339 (1st Dist. Ill. App. 1982)

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G. A Non-Impairment Law Is Not Intended to Stretch Pensions Beyond Their Elastic Limits

Pensions can be and need to be changed, but within certain structures

- (1) Right to modify must be clear in legislation, employment agreements and union contract (Rhode Island Municipal)
- (2) Adverse conditions which could lead to the failure of pension plan and the purpose of the legislation justify amendment (Vermont)
- (3) To balance adverse consequence of actuarially necessary changes to strengthen or improve the pension plan (Colorado, West Virginia)
- (4) Reasonable modifications that bear material relationship to theory of pension system and successful operation (Massachusetts)
- (5) Certain legislation by its nature cannot bind successive legislation and can be changed (Georgia)

H. The Non-Impairment Laws Are Not All-Encompassing and Have Been Held Not to Reach:

- benefits that accrue in the future
- reduction in mandatory retirement age
- reduction in hours or salary
- loss of benefits for non-compliance with the plan
- dismissal of public employee

even though such may indirectly affect the pension benefits received

- I. The Labor Contract or Agreement Should Permit Reductions and Changes that are Economically Required
 1. The failure to have properly worded pension plan or labor contract can be fatal to voluntary changes. It should permit modification and reduction at least prospectively. *See Sprague v. General Motors Corp.*, 92 F.3d 1425 (7th Cir. 1996); *In re Daskocil Cos.*, 130 B.R. 870 (Bankr. D. Kan. 1991)
 2. It is almost impossible to get every employee to agree to change and, absent a Collective Bargaining Agreement, consent of each affected employee is unlikely, especially if the state statute prohibits unilateral reduction or elimination of pension benefits
 3. Even with a union, voluntary change is resisted because of the precedent

J. Outside of a Bankruptcy Court Order, changes of pension obligations (unilateral reductions) are practically and politically unlikely

1. Most State Court Judges are elected by those affected if not directly or indirectly affected
2. This is a local rather than federal matter
3. Most pension plans are subject to State Constitutional or statutory provisions that will not permit the change
4. Pension benefit reduction is obviously unpopular and causes "morale" issues
5. But "Necessity knows no laws." Change may be mandated by the Reality of the Situation – If the Pension System will fail, Pensioners receive less, the purpose of the legislation will be frustrated and less is truly more, especially if less is assured

IV. WHAT CAN STATE OR LOCAL GOVERNMENTS DO?

- What is it: “Unwillingness to Pay” or “Inability to Pay”
- Consensual Rollback of Benefits - When less is more
- Mandated Changes - Actuarial Required When Pension Plan Rescue Is Necessary
- What Some States are Doing or Hope to do
 - 14 Steps to a Brighter Future
- Failure to Address the issue now will lead to potentially Larger Problems later
 - Defined Contribution vs. Defined Benefit Plans
 - Mis-use of Contribution Holidays
 - Lack of Dedicated Sources of Funding
 - No Requirements to make Annual Required Contribution (“ARC”)

IV. WHAT CAN STATE OR LOCAL GOVERNMENTS DO TO SOLVE A PENSION OR OPEB PROBLEM (WITHOUT RESORTING TO A COURT PROCEEDING)?

- First determine whether the problem is
 - “Unwillingness to Pay” or “Inability to Pay” problem
 - While both lead to the same result the Inability to Pay may require more drastic action
 - A. Voluntarily consenting to rollback of benefits from employees sufficient to solve the problem
 - Not likely and uncertain results
 - If the employees know the worst case, voluntary consent may be possible

- B. There are some actions that State or Local Governments can take to attempt to solve pension problem outside of a Court proceeding (States such as Arizona, California, Illinois, New York, Oregon and West Virginia have considered or taken some of these actions)
1. Review actuarial assumptions to make sure they are realistic and work. Too conservative assumptions can reveal problems that don't really exist and too liberal assumptions may miss a real problem
 2. Review investment policy and returns so that poor investment policies identified and changed before it is too late. Arbitrary rules of valuation or investment can contribute to underfunding. Market volatility can provide false comfort as compared to realistic valuation of assets with adjustment for market cycle. Be careful to avoid if possible losses not reflected in valuations and report accurately any deferral of gains
 3. Increase sponsor and/or employee contribution to the plan - easier said than done

4. Prohibit an increase in benefits without an identified revenue or funding source
 - Ban special legislation to benefit special employee groups
 - Require legislature to pass budgets that fully fund current pension obligations and pay a fair portion to cover the unfunded pension obligations
 - Eliminate automatic increases in pension benefits and end of career mega increases in salary
 - Create new and more independent advisors and retirement boards

5. Move from a DB Plan to DC Plan

- Start immediately with new hires and work on developing plan transition to defined contribution for current employees
- Transition can be accomplished as part of Big Fix - phase out of defined benefit plans and phase in defined contribution plans:
 - Issue POB for cash to cure underfunding and transition cost (transition costs from DB to DC plus underfunding dealt with by savings created, by increased contributions, cap on benefits, change from DB to DC, possible arbitrage on taxable bond proceeds and pension obligations as well as additional funding through bond proceeds)
 - Use “cure” as motivation for voluntary agreed termination of DB Plan and creation of DC Plan
 - If no agreed termination of DB plan, then phase out with new employees

6. Eliminate any automatic increases tied to indexes that cause costs or benefits to rise higher and faster than investment return (either a cap on increases in benefits or elimination of any automatic increase not specifically passed with recognized funding source)
7. No new pension benefits without specific dedicated funding
8. Refrain from POB or "Savings Plan" which provides temporary budget solutions but is not a long term fix. Any voluntary rollback of benefits or increase in employee contributions should not equate to effective lowering of contributions by the state or local government
9. Cap specific pension benefits for each employee category for state and local governments so that legislature or executive branches cannot grant end of career or politically motivated and selective increases which are unfair and costly

10. Beware of cash out programs or eliminate early retirement programs or money purchase options which may have untested assumptions and most likely cost more than anticipated
11. Change retirement age and years in service to reduce costs
12. Restrict alternative pension benefit to actual "high risk" jobs - public safety (police and fire) with lower age and service requirements
13. Consolidation of Pension Programs and duplication of function
14. Provide "Supervising Adult" designated state official for audit, review, reporting, transparency and accountability

C. The Difference Between DB and DC Plans

- The goal is to terminate DB plans and transition them to DC Plan through full funding to termination of the DB plan and commence a follow-on plan which is DC. History has shown DB plan are costly, unpredictable and subject to market volatility
- DB plan guarantees a specific benefit or income
 - Generally base formula (flat dollar amount multiplied by number of years worked or age or percentage of salary)
 - Market volatility cannot assume investment will always equate to full payment of benefits - there are fluctuations in what should be paid and that can change by how the market or investments perform
 - While DB plan may have years of no need for funding because of the up market, that can switch quickly in a down market and there is the risk

- DC Plan provides only a specific payment and no guarantee of a specific benefit or retirement income
 - No formula to determine retirement income
 - Market performance will affect ultimate payment
 - Employee bears risk of investment performance while employer does not get any benefit for investment success
 - Each employee has own account into which contribution will be made and investment income or losses will be added or deducted

CONTINUATION OF THE STATUS QUO

WILL NOT LEAD TO A

HAPPY ENDING

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V. FIND A SOLUTION OR RISK AN INEVITABLE MELTDOWN

- Workers Vested Rights and Use of the “Writ of Mandamus”
- Taxpayer Call to Arms - Unjustified Pension Obligations Are Invalid Debt Contrary to Constitutional Limitations or Abuse of Authority or Past Legislative Restrictions
- Stop the Bleeding and Share the Pain

V. A SOLUTION IS REQUIRED TO AVOID THE INEVITABLE MELTDOWN

If the problem of pension underfunding is not solved, competing interests will be aligned against each other

- The Workers Demand for Full Funding Now. On the one hand, workers will insist that the pension obligations are in fact debt of the unit of State or local government and consider seeking a writ of mandamus to require the State or municipality to levy taxes or take other action to satisfy the debt obligation
- The Demand to Invalidate Unjustified Pension Obligation. Tax payers and other creditors including the holders of the State or local government's general obligation bonds will seize on the debt argument. They will likely insist that in committing to make the pension and OPEB payments, the State or municipality violated state constitutional debt limitations which, under state law, such State or municipality does not have the power to violate. As a consequence, any undertaking assumed in violation of state law is invalid. (It has already begun in California as the Superior Court of Sacramento, California has ruled in invalidating bonds issued under the State Pension Bond Act. See *Pension Obligation Bonds Committed ex rel. California vs. All Persons Interested in the Matter of the Validity of the California Pension Obligation Bonds To Be Issued*, No. 04AS04303 (November 15, 2005))

- The Only Way Out is Change. Given the dynamics, there likely will be no winners in this battle. Significantly increasing taxes can lead to a revolt on the part of the taxpayer if not a death spiral to State or local government. A real resolution is required not a bailout. The urgency of the situation will be exacerbated by the retirement of the baby boomers. As noted, techniques to correct the situation include yearly Annual Required Contributions (ARC) at a level deemed actuarially sound, the transition from defined benefit to defined contribution plans, the freezing of current benefits and the adoption of new programs which specifically include the right to modify if necessary and require increased contributions by employees. Finally, the issuance of pension bonds with dedicated sources of payment pursuant to enabling legislation must be considered

VI. CAN BANKRUPTCY OR COURT PROCEEDINGS BE THE SOLUTION?

- States Cannot Go Bankrupt but Can Repudiate Indebtedness as Sovereign
- Local Governments Need State Authorization to File a Chapter 9 Bankruptcy Proceeding (Which may already be given)
- Chapter 9 Cases Deal with Adjustment of Debt not Debt Payment
- Pension and OPEB Obligations Have No Priority and Will Be Paid After Secured Creditors
 - Statutory Liens and Revenue Bonds and Priority Creditors Are to Be Paid First
- Courts Have Allowed Alteration of Pension Benefits
 - To Rescue Failing Plan
 - To Change Unworkable Legislation
 - To Balance Rights and Interests

VI. CAN THE UNDERFUNDING OF PENSIONS FOR STATE OR LOCAL GOVERNMENTS BE ADDRESSED IN COURT PROCEEDINGS?

- A. As noted earlier, pension plans and provisions for employee benefits should be written to permit modification, especially in the case of dire necessity or hardship to the governmental body. Absent that provision permitting modification, there may be difficulty in obtaining Court relief except for impossibility and, in addition, state constitutional provisions may prohibit any reduction in earned benefits
1. To Rescue Failing Plans. If the Pension Plan is to fail or is actuarially unsound, Courts have allowed change to provide a better outcome than uncontrolled collapse
 2. To Change Unworkable Legislation. Pension Plan base upon legislation (State or local) which does not work can and should be changed and courts have recognized the need and ability for such a change

3. To Balance Rights and Interests. Some Courts have attempted to balance the interest and benefits in authorizing change to Pension Plans
4. These Principles in Practice. Even states that find that their relevant contracts clauses prevent an impairment of pension rights, typically hold that adverse conditions which could lead to the failure of the pension plan and thus the purpose of the legislation itself, justify amendments to the plan. Thus in Colorado, a pension plan can be changed so long as any adverse modification is balanced by a corresponding change of a beneficial nature, a change that is actuarially necessary, or a change that strengthens or improves the pension plan. *McInerney v. Public Employees' Ret. Ass'n*, 976 P2d 348, 352 (Colo. App. 1999) Similarly, in Massachusetts modifications to a state retirement scheme can be permitted so long as such modifications are reasonable and bear some material relationship to the theory of a pension system and its successful operation. *Madden v. Contributory Retirement Appeal Board*, 729 NE2d 1095 (Mass. 2000)

5. Other Examples. The courts of Vermont have found that, even if a party's contract rights have been impaired, the contract clause is only violated where the impairment is not reasonable and necessary to achieve an important public purpose. Accordingly, an ordinance requiring greater contributions by employees along with increased benefits was not an impermissible impairment. *Burlington Fire Fighters' Ass'n v. City of Burlington*, 543 A.2d 686 (Vt. 1988) West Virginia has also adopted a balancing test holding that where a substantial impairment has been shown and a legitimate public purpose for the impairment is demonstrated a court must determine whether the adjustment of the rights and responsibilities of the contracting parties is based upon reasonable conditions and is of a character appropriate to the public purpose justifying the legislation adopted. *State ex rel. West Virginia Regional Jail & Correctional Facility Auth. v. West Virginia Inv. Mgmt. Bd.*, 508 SE2d 130 (W.Va. 1998)

- B. States as sovereign cannot file for bankruptcy under Federal Bankruptcy Code. States can repudiate indebtedness but examples of repudiation are rare. Retired employees could go to Court to enforce pension payments as a contract obligation recognized by State Constitutional provisions
1. Any repudiation by the state of pension liabilities would be politically inappropriate and adversely affect credit assessment
 2. During the Depression (1930's) the inability of state and local governments to have sufficient funds to pay employees resulted in payment by script while others (bondholders) got paid in cash
 3. Local governmental bodies may be authorized by state law to file for a Chapter 9 proceeding for municipal debt adjustment or, if a quasi municipal entity such as a municipal hospital or other quasi corporate entity or a conduit financing by a corporation, Chapter 11 may be available to reduce the related pension obligations

VII. GENERAL ANALYSIS OF CHAPTER 9

- Debtor Needs to Be a Municipality
- Need State Authorization to File (Specific Statutory Authorization)
- Only Deals with Debt Adjustment and Not with Politics, Governmental Affairs or Revenues

VII. GENERAL ANALYSIS OF CHAPTER 9

A. *Who Can Be a Debtor under Chapter 9?*

1. The requirements are found in Section 109(c) of the Bankruptcy Code

A Debtor must be:

- An entity that is municipality
- Specifically authorized (under State Law) to be a Debtor
- Insolvent
- Willing to effect a plan to adjust its debts

2. And meet one of the following requirements:

- The Debtor has obtained the agreement of creditors holding at least a majority in the amount of claims of each class that the Debtor intends to impair through its plan
- The Debtor has negotiated in good faith but failed to obtain the agreement of creditors holding at least a majority in the amount of claims of each class that the Debtor intends to impair under its plan
- The Debtor is unable to negotiate with its creditors because such efforts are impracticable or
- The Debtor must reasonably believe that a creditor may attempt to obtain a preference

B. *What is a Municipality?*

1. Under 11 U.S.C. §101(15):

An “entity” includes a person, estate, trust, governmental unit, and United States Trustee

2. Under 11 U.S.C. §101(27):

A “governmental unit” means United States, State, Commonwealth, District, Territory, municipality, foreign state, department, agency, or instrumentality of the United States (but not a United States trustee while serving as a Trustee), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state or other foreign or domestic government

3. Under 11 U.S.C. §101(40):

A “municipality” means political subdivision or public agency or instrumentality of a state

C. *How Does a Municipality Become a Debtor?*

1. Only the municipality can initiate the proceeding in accordance with the requirements of the state enabling legislation
2. There can be no involuntary Chapter 9 proceeding. Not only are involuntary proceedings constitutionally prohibited, but there is no statutory basis for an involuntary action. (Only Section 301 of the Bankruptcy Code providing for voluntary cases is incorporated into Chapter 9)

3. In *In re County of Orange*, 183 B.R. 594 (Bankr. C.D. Cal. 1995), the court held that the Orange County Investment Pool ("OCIP"), as an instrumentality of the County of Orange, was not an instrumentality of a state and hence not a municipality. (Some have criticized this decision suggesting the language "of a state" means the instrumentality must be subject to control by a state or municipal authority and that Congress intended the definition of "municipality" to be expansive.)
4. While the characterization of certain public/private partnerships may be open to question, most special districts that are formed under state statutes to perform certain public services or provide public utilities should qualify as "municipalities"

D. *Specifically Authorized*

- The Bankruptcy Reform Act of 1994 made it clear that, to be a Chapter 9 Debtor, the municipality must be specifically authorized in its capacity as a Debtor or by name
- Given the ruling in the Orange County case, that the OCIP was not specifically authorized since the California statute did not refer to an investment fund, current wisdom is that, unless the state statute makes it clear, risk that municipality may not be an eligible debtor

The following are statutory provisions in which states have authorized Chapter 9 filings for certain governmental entities

Ala Code § 11-81-3
Ariz Reve Stat Ann § 35-603
Ark Stat Ann § 14-74-103
Cal Gov't Code § 53760
Fla Stat Ann §218.01
Idaho Code § 67-3903
MSA § 5.3464; MCL § 141.1222
Mo Rev Stat § 427.100
Mont Code § 7-7-132(1)
NJ Stat Ann § 52:27-40
Neb Rev Stat § 13-402
NC Gen Stat § 23-48
Ohio Rev Code Ann § 133.36
Okla Stat Ann tit 62, § 283
Pa Stat Ann § 11701.261
SC Code § 6-1-10
TX Local Govt Code 140.00
Wash Rev Code Ann § 39.64.040

- Colorado has enacted legislation specifically authorizing its beleaguered special taxing districts to file a petition under Chapter 9. Section 32-1-1402 of the Colorado revised statutes states that “any insolvent taxing district is hereby authorized to file a petition authorized by federal bankruptcy law and to take any and all action necessary or proper to carry out the plan filed with said petition ...”
- Georgia prohibits the filing of Chapter 9 Bankruptcy (Ga. Code Ann § 36-80-5)
- The remaining 30 states are either unclear or do not have specific authorization

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E. *Insolvency*

1. As of the petition date, must meet the test of 11 U.S.C. §101(32) - unable to pay debts as they become due
2. The Bridgeport, Connecticut Chapter 9 was dismissed because evidence only supported finding that it might be unable to meet its debt obligations in the next year. *In re City of Bridgeport*, 129 B.R. 332 (Bankr. Conn. 1991)
3. No requirement that future tax increase be included in equation but municipality cannot deliberately budget itself into insolvency
4. Determination of solvency without substantial regard to either future potential revenues or shortfalls

VIII. TREATMENT OF PENSION AND OPEB LIABILITIES IN CHAPTER 9 PROCEEDINGS

- No Priority for Pension and OPEB Obligations
- Behind Secured Creditors - Statutory Lien, Revenue Bonds and Priority Claims

VIII. TREATMENT OF PENSION AND OPEBs IN A CHAPTER 9 PROCEEDING

A. Chapter 9 proceeding deals with municipal debt adjustment and is and should be the absolute last resort for a municipality

1. There have been only approximately 543 Chapter 9 proceedings since 1937 (312 between 1937-1972, 9 between 1973-1979, 172 between 1980-2005)
2. Generally, only small special purpose tax districts or smaller municipalities file as a last resort but there are exceptions, e.g., Orange County 1994, Bridgeport 1991, etc.
3. It should be a very dire situation that would be a predicate for a municipality's filing of a Chapter 9 to deal with pension obligations

B. Unlike a Chapter 7 or 11 proceeding for corporations, in a Chapter 9 there are:

1. No priority for wages, pensions or insurance benefits over general unsecured claims. In Chapter 7 or 11, under §507(a)(4) and (5) (effective 10/17/05), \$10,000 per employee priority for amounts earned but not made within 180 days of the filing of bankruptcy. (Even if it did apply, for a City with 1,000 employees, there would be a possible priority of \$10,000,000)
2. No provision for special standard and hearing before there can be a modification of labor contract. There is no requirement for a determination after hearing that modification or rejection is so necessary to reorganization that without such modification a reorganization would not be possible. In a Chapter 9, labor contract can be modified or rejected based upon business judgment that, balancing the hardship of rejection or reduction in benefits is outweighed by likelihood of "liquidation". For municipality, liquidation is unlikely even though continued municipal operation may be threatened.

3. No requirement on the municipality to supply sufficient information sharing with employees or unions in order to reject or modify pension or OPEB. Section 1113 and 1114 of Bankruptcy Code is not part of Chapter 9 authorization
4. Accordingly, in Chapter 9, pension benefits and OPEBs receive no special treatment (unlike corporations in Chapter 11) and will be treated and adjusted just like other unsecured obligations
5. Special revenue bonds, interest payments on bonds (pre-petition) and statutory liens in favor of bonds and notes shall all be paid prior to unsecured claims including pension benefits and OPEBs without any priority

6. Workers and Unions might make a constitutional challenge to a Bankruptcy Court's authority to adjust pension benefits asserting that adjustment of pension benefits or OPEBs obligations is unconstitutional. While Sections 903 and 904 of the Bankruptcy Code reserve State power to control municipalities and the Bankruptcy Court has no authority over political or governmental powers of a municipality or its property, revenues or the use and the enjoyment thereof, the Bankruptcy Court in a Chapter 9 has the power to approve a Plan of Debt Adjustment that deals with all contractual obligations. Accordingly, state constitutional provisions regarding pensions are contractual obligations that cannot unilaterally be eliminated or diminished by the municipality. However, this would not appear to prohibit the Bankruptcy Court from approving a Plan of Debt Adjustment in a Chapter 9 if it is specifically authorized by the State

IX. TREATMENT OF PENSION AND OPEB LIABILITIES IN CHAPTER 11 PROCEEDINGS

- \$10,000 per Employee Priority Claim Ahead of Unsecured Creditors for Wage, Pension and Health Care Claims Accrued and Unpaid 180 Days Prior to Filing
 - (5,000 employees = up to \$50,000,000 of priority claim)
- Procedures for Information Sharing and Required Court Hearings to Terminate Union Contracts and Pension and Retirees Benefits
 - To modify as necessary for a Plan of Reorganization or balance of the equities and assure that all creditors are treated fairly and equally (§§1113 and 1114 of Bankruptcy Code)

IX. TREATMENT OF PENSION BENEFITS AND OPEBs IN CHAPTER 11 PROCEEDINGS

- A. There are special priorities and provisions governing labor agreements, pensions and OPEBs and the modification of such
 - 1. Section 1113 of the Bankruptcy Code deals with the standard for rejection and requires a Court hearing after sharing of all relevant information by the corporation with the unions or employees. The Labor Agreements could not be modified without a Court determination after hearing that reorganization is not possible without modification of the labor contract

2. Section 1114 of the Bankruptcy Code provides for a retiree committee and representatives to be appointed to represent the interests of retirees for medical and health care benefits and any modification of existing contracts and benefits can only be done after appointment of the committee and representatives. Modification of medical and health care benefits is permitted when there is a failure of negotiations to obtain a resolution and a Court hearing and determination by the Court that the modification is fair and equitable and the reorganization of the Debtor is not possible without such modification
3. Priority for pension and health care benefits payment not made within 180 days of filing bankruptcy under Section 507(a)(4) and (5) which provides up to \$10,000 per employee priority for wages, sick leave, pension and health care payments earned but not paid during 180 days prior to filing

B. Process for Terminating Pension Plan

1. Corporate pension plans are employer-sponsored pension plan statutorily vested under ERISA. Municipal and state pension plans are not covered by ERISA but private corporations and “non-municipal” public companies such as private hospitals, could be covered by ERISA
2. ERISA provides for 3 types of terminations
 - voluntary standard - plan fully funded
 - voluntary distress - plan underfunded
 - involuntary termination - PBGC implemented
3. Any voluntary termination must satisfy certain notice disclosure and other procedures under ERISA and Bankruptcy Court approval of contract modification

4. If union is involved under Section 1113 of the Bankruptcy Code, the termination must have the consent of the union
5. Alternatives to termination of pension plan
 - IRS funding waiver (generally limited to 2 years)
 - Plan "freezing" benefits and contribution
 - Restoration of funding
6. The debtor employer must proceed with 3 concurrent processes
 - Initiate distress termination proceedings in Bankruptcy Court
 - Proceed with negotiations and PBGC administrative process
 - Administrative filings, disclosures and backup material
 - Formal and informal negotiations with PBGC
 - 60 to 90 day notice to all affected parties of proposed termination
 - Administrative review by PBGC upon requisite findings by Court
 - Section 1113 proposal, disclosure, negotiations and rejection/modification process, as noted above

C. Overview of PBGC Claim in Bankruptcy

1. PBGC has two major and somewhat overlapping claims against bankruptcy sponsors of pension plans, namely:

- “Plan Asset Insufficiency” claim arising on termination of a pension plan (it amounts to the difference between the value of pension plan assets at the time of termination and the value of the pension plan vested obligations to its participants)
- “Unpaid Funding Contributions” claims which may be a subset of the prior claim
- In addition, the PBGC sometimes files “premium claims”
- (PBGC’s premium payment regulation requires payments by plan sponsors for the plan year in which termination of an underfunded plan is initiated and for each year thereafter until the plan is terminated)

2. ERISA Lien - Section 4068 of ERISA creates a lien in favor of PBGC upon all property of any employer who does not pay an obligation arising from unfunded benefit liabilities to the PBGC under ERISA Section 4062-64

- Lien cannot exceed 30% of collective net worth of the employer
- Tax priority if lien not perfected prior to bankruptcy filing up to 30% of the net worth of Debtor
- PBGC has asserted that if pension plan is terminated pre-petition (and the PBGC's lien is not perfected), PBGC asserts an eighth priority under §507(a)(9) of the Bankruptcy Code. Also, PBGC has asserted administrative claim ahead of general unsecured debt payment to the extent the employer's termination liability in excess of 30% net worth increased after filing bankruptcy petition and before pension plan termination. Courts have generally not recognized these PBGC asserted claims as priority or administrative claims and treated them as general unsecured claims

- No tax priority for PBGC claim. Generally, Courts have refused to grant tax priority for any of PBGC claim since no ERISA claims are included in Section 507 (not a tax due and owing), no lien ripening into perfected lien given automatic stay prevents perfection of the lien
- No administrative priority for PBGC claims. Generally it is a claim for pre-petition labor service so it should be treated as general unsecured claim and there is no post-petition benefit for the pre-petition services. However, if the claim relates to post-petition services, then administrative priority may be granted

X. ACTIONS THAT CAN BE TAKEN TO AVOID THE PENSION BENEFIT AND OPEBS CRISIS

- Checklist of Actions to Reduce Pension Benefits and OPEB Liability or to Assure Payment and Fair Treatment
 - Constitutional, Statutory or Contractual Provisions that provide necessary Flexibility
 - Realistic Actuarial Assumptions and Investment Policies
 - Best Practices and Limit on Increases and Benefits that do not have Dedicated Funding Source
 - Elimination of Waste and Necessity of a Balanced Budget - No Short-Term Fix - No Contribution Holidays
 - Willingness to Pay
 - Ability to Pay and Ability to Modify Benefits
 - Use of Supervising Adult - Transparency, Reporting and Responsibility - Who Should It Be?

X. CHECKLIST OF ACTIONS THAT CAN BE TAKEN TO REDUCE PENSION BENEFITS AND OPEBs

- A. Draft or Amend Constitutional Provisions, Labor Agreements, Legislation and Pension Plan to permit reduction or modifications in benefits to preserve the viability of Plan and its actuarial soundness, give government financial ability and status or at least on a prospective basis permit reduction or modification. - It all starts at the beginning
- B. Know the facts - is your pension plan underfunded? What is the going forward liability for OPEBs? Is any full funding due to a bull market so that contribution should not be adjusted downward? Are the actuarial assumptions current and appropriate? Is full funding or underfunding due to actuarial mistakes or miscalculations?
- C. Regardless of investment return, minimum pension funding should be made. There should be no contribution holiday just because it is an up market because it can soon be a down market

- D. Limit or cap pension benefits for categories of jobs and avoid end of the career salary bumps to inflate pension benefits. There should be no special cases. Trees don't grow to the sky so pension benefit should not be unlimited
- E. Budget deficits should not be balanced by reduced pension contributions no matter what the current return is or how well future make up payments may be intended
- F. The best approach is to make sure sufficient funding of a pension plan is done every year without fail

- G. If a problem arises, address it promptly and cure it that year or adopt a program for a long term fix. Short term band aids don't work
- H. The solution may be a voluntary rollback of future benefits. Consensual change is hard but, if the plan permits it and employees are facing dire circumstances, it can be done and it is preferred to other more drastic and less cooperative efforts
- I. Remember most State Constitutions make pension benefits a "vested" right as a government obligation that cannot be avoided without consent of each worker. Courts have sparingly permitted modification in dire situations to:
 - 1. Assure actuarial soundness and fulfillment of Legislative purpose
 - 2. Balancing of Interests and vested rights with ability to pay
 - 3. Rescue failing pension plans - less is more especially if it is assured

J. Absent a solution there is no winner to the ensuing legal meltdown. Locally elected state court judges, who may be under similar plans of retirement, may not provide much relief especially if the State Constitution prohibits it. Unions and workers can enforce their pension or OPEBs rights by means of:

1. Suit for Declaratory Judgment requesting the Court to determine their rights under the plan to payment. *See Alabama Housing Finance Authority and Central Bank of the South v. Verex Assurance Inc.*, 1994 WL 384017 (M.D. Ala.)
2. Suit for breach of contract
3. Writ of mandamus to force local official to raise taxes to pay for legitimate government debt (need a debt for mandamus). *See Delaware River Port Authority v. Thornburgh*, 493 A.2d 135, (Pa. 1985)
4. Likewise, taxpayers can object to improvident pension increases or benefits on the basis of invalidating any increase or "debt" that exceeds Constitutional debt limits or prior legislative restrictions or questioning whether such increased benefits exceeded the authority of the elected official or legislature

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- K. If investment performance is poor, it is a time for change. There should be real accountability for investment policy and returns
- L. The simplest solution (although not the easiest to accomplish) is to increase sponsor or employee contribution
- M. Prohibit or cap pension benefits or OPEBs with real source of continued funding for increased cost. Eliminate automatic increase and end of career salary bumps
- N. Transition to DC plan from a DB plan
- O. Refrain from POB or savings approaches that merely fix short term budget issues

- P. Only use cash out programs and early retirement programs that work and eliminate those that add to pension costs
- Q. Change the retirement age and years in service for new hires or current employees or both on a going forward basis
- R. A Chapter 9 provides no benefit to employees. Unlike Chapter 11, there are no special procedures or required Court hearings and no priority for pension benefits or OPEBs and, in fact, pension benefits and OPEBs are treated just like other unsecured claims
- S. Use of a designated "Supervising Adult" - to provide necessary transparency, reporting and responsibility

S. In Chapter 11 proceedings, dealing with “non-municipal debtors”, there can be some protection for pension benefits and OPEBs

- \$10,000 per employee priority claim for wages, pension benefit payment, health care payments, vacation, sick leave due earned but not paid within 180 days prior to bankruptcy filing (this starts for cases after 10/17/05, before that it is \$4,000 for 90 days)
- Required discovery, court hearings and standard findings for court for modification of CBA or termination of pension plan or reduction in health care benefits §§1113 and 1114 of the Bankruptcy Code
- Standard is higher than for Chapter 9’s; requires showing that without modification to labor contract or pension plan, then reorganization would be impossible

XI. THE BEST FIX FOR A TROUBLED PENSION PLAN

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XI. THE BEST FIX FOR A TROUBLED PENSION PLAN

Determine Whether Problem is “Unwillingness to Pay” or “Inability to Pay”

- “Unwillingness to Pay” requires education of all parties as to the downside risks of a Legal and Funding Meltdown
 - Threat From Workers to have “Writ of Mandamus” to Levy Additional Taxes to Pay Benefits
 - Threat of Taxpayer to Invalidate Benefits (but if there is ability to pay this may be unsuccessful) and to “Unelect” current Government Officials
 - The Orange County Bankruptcy
 - Who really gets hurt?
- “Inability to Pay” - More Drastic Action is Required
 - Educate all Concerned of the Dire Results of the Impending Meltdown
 - Make sure all Wasteful Government Spending is Eliminated (or as much as possible) so you know what you can legitimately afford - a Realistic Cash Flow Plan
 - Determine what Adjustments to Pension and OPEB Obligations are necessary given a Realistic Cash Flow Plan
 - Review 14 Step Plan (Section IV.B.) and implement that which is necessary
 - The Message is that an Assured, Dedicated Funding Source is always Better and More Than the Dynamic Uncertainty of the Status Quo

Assuming the pension plan is a DB which has gotten out of hand by poor investment return, increasing retirement costs, transition from a DB Plan to a DC Plan

- All new employees automatically in the DC Plan
- Provide incentive or motivation for current workers to transfer to DC Plan
- Use POB to transition the costly efforts to phase out DB Plan to DC Plan and provide a sufficient funding
- This program would be in coordination with other saving techniques as noted above

XII. CONCLUSION

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XII. CONCLUSION

The Pension and OPEB Funding shortfall will not disappear with the passage of time. Something has to be done or meltdown will occur. There are ways of dealing with the problem:

- Identify the Problem and Stop the Bleeding
 - "Ability to Pay" vs.... "Willingness to Pay"
 - Review the 14 Steps for Action
 - Make Sure Constitutional Statutory and Contractual Provisions Reserve the Right to Modify When Necessary
- Share the Pain if Necessary
 - Modification may be necessary
 - Consensual is best
 - Modification is possible without Consent
 - To rescue the Pension Plan or OPEB benefits and establish Actuarial Soundness
 - To preserve and not frustrate the purpose of the Legislation
 - To balance the interests with vested rights and the art of the possible
- To Do Nothing Is Not Acceptable and Delays a Resolution and Creates an Even Larger Problem