

**THE FAILED SYSTEM: UNDERSTANDING NEW JERSEY'S
PENSION CRISIS AND SUGGESTING PRACTICAL SOLUTIONS**

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I. INTRODUCTION

New Jersey's public pension system is on the brink of disaster. The state, its employees, and taxpayers face a crisis as the state's pension liability exceeded \$40 billion in 2015, and the funding ratio of the state's pension systems fell to 51.5%.¹ According to Moody's Investors Service, the unfunded liability in 2016 is \$55 billion.² New Jersey's pension system reached its current precipice due to chronic underfunding of the system by the state. In fact, New Jersey's annual average contribution over the past seven years is 13.5%, the lowest in the nation.³

The state's chronic underfunding of the pension system continues despite comprehensive pension reforms passed in 2011. The 2011 reforms resulted in bi-partisan legislation, whereby the state promised to fund the pension systems in exchange for a reduction of benefits and elimination of cost of living increases for public employees.⁴ A reduction of pension benefits, when combined with underfunded pensions systems, victimizes public employees. The vast majority of public employees do not qualify for the federal Social Security system, and resultantly have limited guaranteed retirement income outside of their pension benefits.⁵ The status of New Jersey's pension system has been exacerbated by the 2008 financial crisis, which hindered the United States economy and damaged nearly every public pension system in the nation. The financial crisis identified a consistent issue that faces public pensions: when the economy is doing well and state revenues are high, pension funds usually enjoy strong investment returns and

¹ Samantha Marcus, *N.J. Public Worker Pension Fund Gap Widens to \$40B*, NJ.COM (Apr. 23, 2015, 5:40 PM), http://www.nj.com/politics/index.ssf/2015/04/nj_pension_fund_gap_widens_to_40b.html [hereinafter *N.J. Public Worker*].

² Samantha Marcus, *Losing Pension Court Case Could Cost N.J. Big, Moody's Warns*, NJ.COM (January 21 2016), http://www.nj.com/politics/index.ssf/2016/01/losing_state_supreme_court_pension_case_could_cost.html. Moody's noted that under different accounting standards, the unfunded liability measures as high as \$113 billion. The liability could also increase by 30%, as the New Jersey Supreme Court rules that state and local governments must restore retirees' cost-of-living increases. State employees are seeking reinstatement of cost-of-living increases in *Berg v. Christie*, which was heard by the NJ Supreme Court in March 2016.

³ *Id.*

⁴ *Details of N.J. Public Worker Pension and Health Benefits Reform Bill*, NJ.COM (June 23, 2011, 5:41 PM), http://www.nj.com/politics/index.ssf/2011/06/details_of_nj_public_worker_pe.html.

⁵ U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-322, STATE AND LOCAL GOVERNMENT PENSION PLANS: ECONOMIC DOWNTURN SPURS EFFORTS TO ADDRESS COSTS AND SUSTAINABILITY 5 (2012), available at <http://www.gao.gov/assets/590/589043.pdf>.

thus have relatively low contribution needs.⁶ Conversely, when the economy is performing poorly, state revenues decrease, social needs increase, and pension funds experience losses, necessitating larger contributions to offset the shortfall.⁷

In response to gross underfunding of the pension system, state employees filed suit against the State of New Jersey seeking relief from Governor Chris Christie's failure to satisfy the contribution obligations of N.J.S.A. § 43:3C-9.5(a)-(b). In *Burgos v. State of New Jersey*, the Supreme Court of New Jersey rendered a controversial ruling that alarmed state employees and state legislators concerned with the solvency of the pension systems.⁹ The court found that despite clear evidence of the legislature's intent to create a contract requiring the state to contribute certain annual payments to the pension systems, the 2011 Pension Reform Act did not create a contractual relationship, and, therefore, the state is not required to satisfy the obligations specified in the 2011 reforms.¹⁰ The court's decision undermined the trust of the public employees and led to a call for immediate reform to alleviate the distressing position of the state's pension liabilities.

This Note discusses New Jersey's pension systems and frames practical solutions that could alleviate the state's alarming unfunded pension liabilities. Part II of this Note provides a historical overview of New Jersey's pension system, including an analysis of state jurisprudence on pension laws. Part III analyzes the New Jersey Legislature's proposed constitutional amendment, its current status, and if passed, the effect of the amendment on the state's pension obligations. Part IV compares New Jersey's pension system to those of other states with broader constitutional protections for state contributions to public pensions. Part V suggests practical solutions to the state's pension crisis and provides a discussion of those solutions with Assemblyman Wayne DeAngelo and Assemblyman Jack Ciattarelli.

⁶ Amy B. Monahan, *State Fiscal Constitutions and the Law and Politics of Public Pensions*, 2015 U. ILL. L. REV. 117, 130 (citing U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 5).

⁷ *Id.* at 130.

⁹ *Burgos v. State of New Jersey*, 118 A.3d 270, 274 (2015).

¹⁰ *Id.*

II. NEW JERSEY'S PENSION SYSTEM

A. Overview

The vast majority of state governments provide defined-benefit pension plans to state employees.¹¹ In defined-benefit pension plans, employees receive an annual monetary and healthcare benefit upon retirement.¹² In exchange for the annual retirement benefit, employees contribute a portion of their salary each year to the pension fund, which is then invested by the state.¹³ This system places the investment risk in the hands of the employer, the state of New Jersey, which is responsible for paying the annual benefits to retirees.¹⁴ Critically, if the pension fund does not accrue at a rate large enough to cover the pension benefits promised to retirees, the state is obligated to cover the difference.¹⁵

Unlike many public sector and state pension plans, most private sector employers utilize defined-contribution plans such as the 401(k) or 403(b).¹⁶ Defined-contribution plans do not guarantee retirees a specific benefit, but rather, the employees withdraw their retirement funds at their own discretion.¹⁷ The employee's retirement account is funded through employee salary contributions, employer contributions, and performance of the pension investments, and, with this plan, employees determine the amount of their contribution to an individual pension account, with the employer providing a matching contribution.¹⁸ The employee is responsible for management of the pension fund and makes his or her own investment decisions.¹⁹ Additionally, federal

¹¹ Kellogg Insight, *Pensions in Peril: The Funding Status of State-Sponsored Pension Plans* (Mar. 1, 2010), available at http://insight.kellogg.northwestern.edu/article/pensions_in_peril.

¹² *Id.*

¹³ Anthony Randazzo, *Pension Reform Case Study: Michigan*, Policy Study No. 434, REASON FOUNDATION 12 (Mar. 2014), http://reason.org/files/pension_reform_michigan.pdf.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *See id.* There are tax implications depending on when the employee withdraws funds from their account. *See What are Defined-Contribution Retirement Plans?*, TAX POLICY CENTER, <http://www.taxpolicycenter.org/briefing-book/what-are-defined-contribution-retirement-plans> (last visited May 17, 2016).

¹⁸ Randazzo, *supra* note 13. The matching contribution is generally capped a specified percentage. If an employee contributes in excess of the specified percentage, the State/employer is not obligated to match the contribution beyond the specified cap. *See, e.g.,* Randazzo, *supra* note 13, at 15.

¹⁹ Randazzo, *supra* note 13, at 12. Defined-benefit plan investments are managed

regulations stipulate that defined-contribution plans achieve 100% funding or address underfunding within specified periods of time, thereby insulating the system from the underfunding issues present in defined-benefit plans.²⁰ Once the employer provides the applicable contribution, the employer has no additional obligations to the employee's pension fund.²¹

New Jersey utilizes a defined-benefit pension plan whereby participants are guaranteed a calculable amount of benefits payable upon retirement.²² New Jersey utilizes five primary pension systems for retired employees: (1) the Public Employees' Retirement System ("PERS"); (2) the State Police Retirement System ("SPRS"); (3) the Police and Fireman's Retirement System ("PFRS"); (4) the Teachers' Pension and Annuities Fund ("TPAF"); and (5) the Judicial Retirement System ("JRS").²³ In 2013, there were 400,452 employees participating in state pension plans.²⁴ New Jersey's pension and retirement program provides state employees a non-forfeitable right to receive benefits through N.J.S.A. § 43:3C-9.5(a)–(b).²⁵ N.J.S.A. § 43:3C-9.5(a)–(b) stipulates that the participants in the pension and retirement systems are entitled to calculable benefits which cannot be reduced once the right to the benefit has attached.²⁶ The benefits of the pension system are paid using revenues from employee contributions, public employer contributions, and investment returns.²⁷ The question continually presented to legislators, pensioners, taxpayers, and the New Jersey

by the employer. See *What's the Difference Between a Defined Benefit Plan and a Defined Contribution Plan?*, CNN MONEY, http://money.cnn.com/retirement/guide/pensions_basics.money.com/index3.htm (last visited May 17, 2016).

²⁰ Alicia H. Munnell and Mauricio Soto, *State and Local Pensions are Different from Private Plans*, CTR. FOR RETIREMENT RESEARCH AT BOSTON COLLEGE, 5 (Nov. 2007), http://crr.bc.edu/wp-content/uploads/2007/11/slp_1.pdf.

²¹ Randazzo, *supra* note 13.

²² *Burgos*, 118 A.3d at 274 (noting the benefit to which participants are entitled is determined based on their final average salary and years of service).

²³ See N.J. STAT. ANN. §§ 43:15a-1–161 (West 2016) (enacting PERS); N.J. STAT. ANN. §§ 53:5A-1–47 (West 2016) (establishing SPRS); N.J. STAT. ANN. §§ 43:16-1–21 (West 2016) (enacting PFRS); N.J. STAT. ANN. §§ 43:18A:66-1–93 (West 2015) (creating TPAF in its present form); and N.J. STAT. ANN. §§ 43:6A-1–47 (West 2016) (enacting JRS).

²⁴ N.J. DEP'T OF THE TREASURY, TRUTH & CONSEQUENCE, STATUS REPORT OF THE NEW JERSEY PENSION AND HEALTH BENEFIT STUDY COMMISSION 10 (September 25, 2014) [hereinafter TRUTH & CONSEQUENCE].

²⁵ *Burgos*, 118 A.3d at 274.

²⁶ N.J. STAT. ANN. § 43:3C-9.5(a)–(b) (West 2016).

²⁷ *Burgos*, 118 A.3d at 274.

judiciary, is what benefits state employees are guaranteed under N.J.S.A. § 43:3C-9.5(a)-(b), and whether the state legislature can enact reforms which alter and, in some instances, diminish the benefits to which state employees are entitled. The New Jersey judiciary evaluates this question through a series of previous decisions, beginning with the *Spina v. Consolidated Police & Fireman's Fund* in 1964.²⁸

i. *Spina v. Consolidated Police & Fireman's Fund*

Spina was a precedential ruling by the Supreme Court of New Jersey that shaped the future of challenges to funding of the pension systems. In *Spina*, members of the police and fireman's pension plans challenged N.J.S.A. § 43:16-1, which was amended to increase the retirement age to 51 and the minimum years of service to 25.²⁹ Prior to the amendment, police and fire department pensioners were entitled to benefits at age 50 and after 20 years of service.³⁰ The *Spina* plaintiffs argued that because the legislative enactment increased the retirement age and minimum years of service, it violated their contractual right to retirement benefits and was therefore constitutionally invalid.³¹ This position is based on the argument that an increase to the retirement age and minimum years of service materially alters the benefits of police and fire pensioners. The *Spina* court disagreed, citing a history of case law where New Jersey courts had held that "the Legislature may revise pension plans which governmental employees are required to join."³² Of particular significance, the court' found that "the terms and conditions of public service in office or employment rest in legislative policy rather than contractual obligation, and hence may be changed except, of course insofar as the State Constitution specifically provides otherwise."³³ Thus, the *Spina* court established that the state pension systems do not create a contractual agreement between state employees and the legislature, entitling state

²⁸ *Spina v. Consolidated Police & Fireman's Fund*, 197 A.2d 169 (1964).

²⁹ *Spina*, 197 A.2d at 393.

³⁰ *Id.*; N.J. STAT. ANN. § 43:16-1 (West 2016). The Police and Fire Pension Fund statute was amended in 2001, raising the retirement age to 60 years for police officers, 65 years for firemen, and 70 years for fire department employees. The minimum years of service remains 25 years for all members of the Police and Fire Pension Fund. *Id.*

³¹ *Spina*, 197 A.2d at 393.

³² *Id.* at 398 (citing *Laden v. Daley*, 132 N.J.L. 440 (Sup. Ct. 1945); *Bader v. Crone*, 116 N.J.L. 329 (Sup. Ct. 1936); *Bennett v. Lee*, 104 N.J.L. 453 (Sup. Ct. 1928); *Barnett v. Pension Comm'n &c.*, 100 N.J. Eq. 473 (Ch. 1927)).

³³ *Spina*, 197 A.2d at 399.

employees to fixed pension benefits.³⁴ This created a concern for public employees: if there is no contract guaranteeing that the legislature will not alter their benefits, what benefits are guaranteed? The answer to this question, according to the *Spina* court, is that pension benefits are not black and white, but rather fall within a gray area subject to the discretion of the state legislature.³⁵

ii. *New Jersey Education Association v. State of New Jersey*³⁶

The *Spina* case addressed part one of the pension question: whether state employees' rights are violated when the legislature enacts changes to the benefits retirees are entitled to receive. The *NJEA* case identified the second question in the fight for public pensions: are pensioner's rights violated if the pension system is not adequately funded?³⁷ In *NJEA*, the court noted that *Spina* "did not address the precise question of whether the plaintiffs had a contractually enforceable interest in future contributions to ensure the ongoing fiscal integrity of the pension system."³⁸ However, the *NJEA* court relied on the holding in *Spina*, that "traditional contract rights do not apply in the realm of public pensions," and emphasized that the statutory language of N.J.S.A. § 18A:66-18(d) did not create a contract which bound the legislature to provide annual contributions.³⁹ This conclusion was derived from the New Jersey Constitution's Appropriations Clause and the Debt Limitations Clause, which "grant our Legislature sweeping and exclusive powers of appropriation and preclude one Legislature from binding future legislatures with respect to prospective appropriations."⁴⁰ Ultimately, the *NJEA* decision reaffirmed that public pensions do not create an enforceable contract right, insulated from alteration or reform, and established that state employees do not have right to systematic funding of their pension fund.⁴¹

Both the *Spina* and *NJEA* decisions, while founded on sound

³⁴ *Id.*

³⁵ *Id.* at 403.

³⁶ *New Jersey Educ. Ass'n v. State*, 412 N.J. Super. 192 (App. Div. 2010).

³⁷ *NJEA*, 412 N.J. Super. 192 at 210–11.

³⁸ *Id.*

³⁹ *Id.* at 212–13.

⁴⁰ *Id.* at 212 (citing *City of Camden v. Byrne*, 82 N.J. 133, 151–54 (1980)) (emphasis added).

⁴¹ *Id.* at 215. The court stressed the distinction between an employee's non-forfeitable right to receive benefits, and the funding method adopted to assure payment of those benefits. *Id.* The non-forfeitable right to benefits that have already attached (vested) cannot be reduced, nor can their receipt be denied. *Id.*

legal principles, provided an outlet for the State of New Jersey to ignore the pension promises made to its state employees. The unintended effects of these decisions are felt by legislators, state employees, and tax-payers, culminating in the precarious position facing us today.

B. State of the Pension System

The state of New Jersey's pension system is dire. According to a study by the National Association of State Retirement Administrators, New Jersey's record of funding its pension system is the worst in the country.⁴² Pension system funding is evaluated by comparing the amount a state contributes to the system against the Annual Required Contribution ("ARC"). From 2001 to 2013, New Jersey averaged 38% of the ARC.⁴³ Pennsylvania and New Jersey were the only states in the nation to average less than 50%.⁴⁴ All but six states contributed at least 75% of their ARC.⁴⁵ Additionally, the funded ratio of New Jersey's pension has decreased each year since 2003.⁴⁶ In 2003, New Jersey's pension systems were 93.5% funded.⁴⁷ In 2013, New Jersey's pension systems were 62.8% funded.⁴⁸ The funding ratio fell to 51.5% in 2015.⁴⁹ According to Moody's Investors Service, the unfunded liability in 2016 is \$55 billion.⁵⁰ New Jersey's annual average contribution over the past seven years is 13.5%, the lowest in the nation.⁵¹

To place those numbers in perspective, if New Jersey's system was funded at the same rate as 2003, the liability would be approximately \$9 billion.⁵² In an effort to address the fiscal health

⁴² Keith Brainard and Alex Brown, *Spotlight on the Annual Required Contribution Experience of State Retirement Plans, FY 01 to FY 13*, NAT'L ASS'N OF STATE RETIREMENT ADMIN.'S (Mar. 2015).

⁴³ *Id.* at 8.

⁴⁴ *Id.*

⁴⁵ Samantha Marcus, *NJ Pension System Most Underfunded of All 50 States*, NJ.COM (Mar. 12, 2015), http://www.nj.com/politics/index.ssf/2015/03/nj_pension_system_most_underfunded_of_all_50_state.html.

⁴⁶ *The Fiscal Health of State Pension Plans*, PEW CHARITABLE TRUSTS (July 31, 2015), <http://www.pewtrusts.org/en/multimedia/data-visualizations/2015/the-fiscal-health-of-state-pension-plans>.

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ See *N.J. Public Worker*, *supra* note 1.

⁵⁰ Samantha Marcus, *Losing Pension Court Case Could Cost N.J. Big, Moody's Warns*, NJ.COM (Jan. 21, 2016), http://www.nj.com/politics/index.ssf/2016/01/losing_state_supreme_court_pension_case_could_cost.html.

⁵¹ *Id.*

⁵² *The Fiscal Health of State Pension Plans*, PEW CHARITABLE TRUSTS (July 31, 2015),

of the pension system resulting from the State's conduct following each of the decisions, the Christie administration, the state legislature, and state employee union's negotiated and enacted significant reforms in 2011.

C. Chapter 78–2011 Pension Amendment

In 2011, N.J.S.A. § 43:3C-9.5(c) was amended by the New Jersey Legislature in response to increasing unfunded liabilities of the state's retirement system and pension funds.⁵³ The Amendment increased employees' contributions to the funds and enhanced the eligibility requirements for new members.⁵⁴ Additionally, the Amendment indefinitely suspended cost of living adjustments ("COLAs") for both current and future retirees.⁵⁵ In exchange for the increased contributions and suspension of COLAs, the 2011 Amendment introduced terms that required that the state make certain annual contributions to the pension funds, addressing the unfunded liabilities and restoring the funds to "fiscally sound levels."⁵⁶ Additionally, the Amendments added language which explicitly declared "the existence of a contractual right in pension-system members," and set forth "that the state employers' failure to comply with the full-contribution requirement is 'deemed' an impairment of that right as to each member, that either members or the trustees of the Funds themselves could enforce."⁵⁷

The 2011 Amendment was a by-product of years of underfunding the pension system and demands for reform. Legislators balanced the interests of the retirees who spent their working careers contributing to the pension system, and who are statutorily entitled to their benefits, against the tax burden on New Jersey's taxpayers, who would foot the bill to ensure the solvency of the pension system.⁵⁸ The state of the pension system emerged from

<http://www.pewtrusts.org/en/multimedia/data-visualizations/2015/the-fiscal-health-of-state-pension-plans> (calculating New Jersey's total pension liability at approximately \$137 billion).

⁵³ See Pension and Health Benefits Reform, STATE OF NEW JERSEY DEP'T OF TREASURY, available at <http://www.state.nj.us/treasury/pensions/reform-2011.shtml> (last visited May 17, 2016).

⁵⁴ N.J. STAT. ANN. §. 43:3C-9.5(c) (West 2016).

⁵⁵ 2011 N.J. ALS 78 (2011) (amending N.J. STAT. ANN. § 43:3B-2).

⁵⁶ Burgos, 118 A.3d at 274.

⁵⁷ *Id.* at 276.

⁵⁸ Adam J. Elias, *A Simple Suggestion for Substantial Protection: Amending the New Jersey Constitution to Create Contractual Rights For Public Employees to Their Pension Benefits*, 44 RUTGERS L.J. 89, 91 (2013) (citing Jarrett Renshaw, *A Historic Defeat for State Unions in Victory for Christie, Assembly Backs Cuts to Benefits and Pensions*, STAR-LEDGER

years of underfunding by the state, poor returns during the 2008 recession, and an unprecedented number of retirees participating in the system.⁵⁹

Despite the startling figures above, New Jersey's pension system shows little sign of improvement under the current gubernatorial administration. Governor Christie contributed \$484 million in 2012, \$1 billion in 2013, \$696 million in 2014, and \$681 million in 2015 to the state's pension systems.⁶⁰ While these payments exceed the aggregate amounts of the previous gubernatorial administrations, the payments fall well below the ARC.⁶¹ Comparatively, the statutorily required contribution from 2011 to 2015 was \$17.7 billion.⁶² The total payments made by the Christie administration equaled \$2.861 billion or 16% of the contribution required under N.J.S.A. § 43:3C-9.5(c).⁶³ In response to Governor Christie's chronic underfunding of the pension system (and the underfunding of previous governors), state employees filed suit against the state in *Burgos v. State of New Jersey*.⁶⁴

D. *Burgos v. State of New Jersey*

In 2014, the state contributed \$696 million of the required \$3.7 billion ARC.⁶⁵ Additionally, the state did not account for the requisite funding in the 2015 Appropriations Act submitted by Governor Christie and ratified by the New Jersey State Legislature.⁶⁶ Resultantly, state employees sued the state, arguing that the state failed to satisfy its contractual obligations under N.J.S.A. § 43:3C-9.5(c).⁶⁷ In response, the state did not dispute that it failed to satisfy its obligations under N.J.S.A. § 43:3C-9.5(c), but argued that the requirements of N.J.S.A. § 43:3C-9.5(c) violated the Debt Limitations Clause of the New Jersey Constitution, and therefore N.J.S.A. § 43:3C-9.5(c) did not create a binding obligation on the

(June 24, 2011)).

⁵⁹ *Id.* (noting that 20,000 employees retired in 2010, an increase of 60% over 2009).

⁶⁰ TRUTH & CONSEQUENCE, *supra* note 24.

⁶¹ Mark Magyar, *The Truth About N.J.'s Pension Crisis and How to Fix it*, NJ.COM (Jan. 5 2016), http://www.nj.com/opinion/index.ssf/2016/01/the_truth_about_njs_pensio_n_crisis_and_how_to_fix.html.

⁶² TRUTH & CONSEQUENCE, *supra* note 24.

⁶³ TRUTH & CONSEQUENCE, *supra* note 24.

⁶⁴ *Burgos v. State of New Jersey*, 118 A.3d 270, 274 (2015).

⁶⁵ *Id.*

⁶⁶ *Id.* at 290.

⁶⁷ *Id.* at 274.

state to provide the specified funding.⁶⁸ In other words, the state argued that a law passed and ratified by the current legislative regime violated the New Jersey Constitution, and therefore did not obligate the state to provide the requisite funding to the pension system.

The employees argued that the state's failure to provide the requisite funding violated the Contract Clause of the U.S. Constitution.⁶⁹ Under the Contract Clause of the U.S. Constitution, states may not pass legislation that impairs the obligations of contracts.⁷⁰ Additionally, the New Jersey Constitution provides: "the Legislature shall not pass any . . . law impairing the obligation of contracts, or depriving a party of any remedy for enforcing a contract which existed when the contract was made."⁷¹ Furthermore, "[l]egislation unconstitutionally impairs a contract when it (1) 'substantially impair[s] a contractual relationship,' (2) 'lack[s] a significant and legitimate public purpose,' and (3) is 'based upon unreasonable conditions and . . . unrelated to appropriate governmental objectives.'"⁷² The critical question before the court, however, was not whether New Jersey substantially impaired a contractual relationship, but whether a binding contractual relationship existed at all. To determine whether the 2011 reforms created an enforceable contract, the court evaluated two issues. First, did the Legislature speak with sufficient clarity to evince intent to create a contractual right?⁷³ Second, did state law grant the Legislature the authority to enter into the binding and enforceable contract in question?⁷⁴

Addressing the question of whether the legislature clearly evinced intent to create a contractual right, the court concluded that the legislature and Governor Christie clearly expressed intent that the 2011 reforms create a contractual right to reduce the pension liabilities to safe levels.⁷⁵ In particular, Governor Christie's remarks in 2011 that, "[t]he [pension payment] schedule is codified into legislation we have right now and makes it a contractual right of folks in the pension system to have those payments made,"

⁶⁸ See generally *id.* at 275–280.

⁶⁹ *Id.*

⁷⁰ U.S. CONST. art. I, §10, cl 1.

⁷¹ N.J. CONST. art. IV, §7, ¶ 3.

⁷² *Burgos*, 118 A.3d at 280.

⁷³ *San Diego Police Officers' Ass'n v. San Diego City Emps.' Ret. Sys.*, 568 F.3d 725, 737 (9th Cir. 2009).

⁷⁴ *Indiana ex rel. Anderson v. Brand*, 303 U.S. 95, 100 (1938).

⁷⁵ *Burgos*, 118 A.3d at 282–83.

evidenced the legislature's intent to create a contractual relationship.⁷⁶ Thus, because a contractual right was created, the question that follows is whether the legislature had the authority to create the contractual relationship currently at issue. Here, the Supreme Court of New Jersey determined that the legislature exceeded its authority and violated the Debt Limitation Clause of the New Jersey Constitution in passing Chapter 78, therefore invalidating any contractual relationship created by the 2011 Pension Reform Amendments.

The Debt Limitation Clause of the New Jersey Constitution states:

The Legislature shall not, in any manner, create in any fiscal year a debt or debts, liability or liabilities of the State, which together any previous debts or liabilities shall exceed at any time one per centum of the total amount appropriated by the general appropriation law for that fiscal year, unless the same shall be authorized by a law for some object or work distinctly specified therein . . . [N]o such law shall take effect until it shall be submitted to the people at a general election and approved by a majority of the legally qualified voters of the State voting thereon.⁷⁷

The court agreed with the state's arguments and held that the legislature and the Governor did not have the authority to enact an enforceable, legally binding financial agreement through statute.⁷⁸ The court found that the "shall not . . . create in any fiscal year a debt or debts, liability or liabilities" language of Debt Limitations Clause prohibits the creation of debts or financial obligations of the state through statute, and further noted that efforts to create such obligations outside of the annual appropriations act will not have binding effect.⁷⁹ In other words, irrespective of the contractual language of N.J.S.A. § 43:3C-9.5(c), the Debt Limitations Clause renders the obligations of N.J.S.A. § 43:3C-9.5(c) a mere expression

⁷⁶ See *NJ Citizen Action Joins Pension Lawsuit*, POLITICKER NJ (Apr. 28, 2015), <http://politickernj.com/2015/04/nj-citizen-action-joins-pension-lawsuit/>; see also Mark J. Magyar, *Sweeney Urges Pension Funding Overhaul to Reduce Impact on State Budget*, NJ SPOTLIGHT (Oct. 28 2014), <http://www.njspotlight.com/stories/14/10/28/sweeney-urges-pension-funding-overhaul-to-save-nj-s-troubled-plagued-system/> (noting legislative leader's assertion that Chapter 78's language expresses clear legislative intent to create contractual obligation).

⁷⁷ N.J. CONST. art. VIII, §2, para. 3.

⁷⁸ *Burgos*, 118 A.3d at 283.

⁷⁹ *Id.*; see *supra* Part II (This holding was predictable in light of the *NJEA* decision where the New Jersey Supreme Court found that the language of N.J. STAT. ANN. § 18A:66-18(d) did not evidence the Legislature's intent to create a contract. In *NJEA*, the court reached this conclusion in light of the statutory language, and the New Jersey Constitution's Debt Limitations and Appropriations Clauses. The *NJEA* decision in effect, laid the foundation for the court's ruling in *Burgos*. While the court in *Burgos* found that the statutory language clearly evinced the parties' intent to create a contract, the Debt Limitations and Appropriations Clauses prevent such a holding.)

of the need to appropriate funds to alleviate the state's pension liabilities, without the consequence of mandating that intent be satisfied through action in reality. Thus, the legislature's efforts in 2011 and the governor's signature and promises in enacting N.J.S.A. § 43:3C-9.5(c) were made hollow when the state continued to underfund the pension funds and retirement systems.

III. RESPONSE TO THE *BURGOS* DECISION: CONSTITUTIONAL AMENDMENT

In response to the New Jersey Supreme Court's decision in *Burgos*, Democratic legislators introduced legislation that amends the New Jersey Constitution, mandating contributions to the state pension and retirement funds.⁸⁰

The proposed legislation amends Article VII of the New Jersey Constitution (adding Section IV), and amends the language of Article VIII, Section II, paragraphs 2 and 3.⁸¹ If passed, beginning in 2017, New Jersey would be required to contribute 50% of the full annual contribution each year (until 2021), and an additional payment increasing by at least 12.5% of the full annual contribution required for each subsequent fiscal year until 2021.⁸² The state contributions would be required on a quarterly basis and must be at least 25% by August 1, 50% by November 1, 75% by February 1, and 100% by May 1 of the state fiscal year.⁸³ Finally, the full annual contribution requirement would take effect in 2021 and would be required each year thereafter.⁸⁴ Additionally, the Amendment to Article VIII, Section II, paragraph 2 states that "[n]o general appropriation law for a fiscal year will be enacted without including appropriations for the State contributions to each retirement system and pension fund for public employees administered by the State."⁸⁵

While legislators cannot guarantee passage of the amendment, they are optimistic in its proactive effect.⁸⁶ According to a Rutgers-Eagleton poll released on February 29, 2016, 49% of voters support

⁸⁰ Samantha Marcus, *Sweeney's Bold Play Could Trump Christie on N.J. Pensions*, N.J.COM (December 7, 2015), http://www.nj.com/politics/index.ssf/2015/12/sweeney_calls_for_constitutional_amendment_on_pens.html.

⁸¹ S. Res. 184, 216 Leg. at 2 (2015).

⁸² N.J. S. Res. 184, at 2, 30-42 (2015).

⁸³ Con. Res. 118, 216th Leg., Reg. Sess. (2015).

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ Telephone interview with Assemblyman Wayne DeAngelo (D-Hamilton), N.J. Assemblyman (March 18, 2016).

the proposed constitutional amendment.⁸⁷ Additionally, both Assemblyman DeAngelo and Ciattarelli voiced their belief that the amendment would pass if placed on the November ballot.⁸⁸ However, even if the amendment does not pass, State Senator Jim Whelan (D-Atlantic County) stated that “[t]he constitutional amendment at least will get the unions back to the table.”⁸⁹ Senator Whelan further noted that “the state’s public workers’ unions need a measure of good faith from the state,” and emphasized that any good will of the state was undermined when the unions agreed to higher payments only to have the state renege on its pledge for increased contributions in the last pension reform agreement.⁹⁰

A. Support for Constitutional Amendment

On March 18, 2016, Assemblyman Wayne DeAngelo, representing the 32nd Legislative District, provided a telephone interview to discuss ACR 3, the companion legislation to SCR 184. The legislation proposes an amendment to the New Jersey Constitution to require payments to state-administered retirement plans and creates enforcement mechanisms to ensure that the state satisfies its funding obligations.⁹¹ In the 32nd Legislative District, Assemblyman DeAngelo represents one of the state’s largest groups of public employees and is the assistant business manager for the IBEW Local Union 269.⁹²

In 2015, Assemblyman DeAngelo voiced his concern with the *Burgos* decision, calling the decision “a significant blow to middle-class public employees, teachers and public safety workers.”⁹³ Assemblyman DeAngelo echoed public workers and the Democratic

⁸⁷ Andrew George, *Poll: N.J. Voters Split on Pension Amendment, Favor \$15 Minimum Wage*, NJBIZ.COM (March 1, 2016), <http://www.njbiz.com/article/20160301/NJBIZ01/16030988/poll-nj-voters-split-on-pension-amendment-favor-15-minimum-wage> (The same poll indicated that 40% of voters oppose the constitutional amendment, and 11% are unsure of their position on the issue).

⁸⁸ Telephone Interview with Assemblyman Wayne DeAngelo, *supra* note 86; Interview with Assemblyman Jack Ciattarelli (R-Somerville), N.J. Assemblyman, in Trenton, N.J. (March 14, 2016).

⁸⁹ Paul Brubaker, *New Jersey’s Pension Crisis Can be Fixed. Here’s How*, NJ.COM (Dec. 21, 2015, 9:21 AM), http://www.nj.com/opinion/index.ssf/2015/12/new_jerseys_pension_crisis_can_be_fixed_heres_how.html.

⁹⁰ *Id.*

⁹¹ See A. Res. 3, 216th Leg. (2015).

⁹² Telephone Interview with Assemblyman Wayne DeAngelo, *supra* note 86.

⁹³ News Release, Assembly Democrats, DeAngelo : Pension Decision Hurts Public Employees (June 9 2015), available at <http://www.assemblydems.com/Article.asp?ArticleID=9727>.

Caucus following the *Burgos* decision, calling upon the governor and the legislature to pay its “fair share of the pension system.”⁹⁴ “Failure to do so,” according to Assemblyman DeAngelo, “will deepen the cracks in the foundation of our state budget and economy.”⁹⁵ Finally, Assemblyman DeAngelo stated, “we must consider steps necessary to make the employer-employee agreement between government and employee binding when it comes to pension, benefits and compensation.”⁹⁶ Assemblyman DeAngelo, joined by members of the Democratic Caucus, took the first step toward creating a binding agreement with the proposal of ACR 3 and SCR 184.

B. Issues with the Constitutional Amendment

Critics of the legislation immediately voiced their concerns arguing that, given the relatively small portion of the populace benefiting from the constitutional amendment, an amendment is not proper place to fix the state’s growing pension crisis.⁹⁷ Assemblyman Jack Ciattarelli is among the critics of the legislation.⁹⁸ Assemblyman Ciattarelli provided an in-person interview at the State House on March 14, 2016 to discuss the proposed constitutional amendment and elaborate on his proposals for reform.

Assemblyman Ciattarelli believes that, if passed, the proposed constitutional amendment will have disastrous consequences for the State of New Jersey, noting that even if the state made its ARC, the pension system would still be underfunded and in a precarious position.⁹⁹ Assemblyman Ciattarelli pointed to three factors which contributed to the pension crisis: (1) the state’s failure to make the annual required contribution; (2) the unrealistic benefits promised to pensioners which, “simply put, were not and remain unrealistic” given the state of the pension system and the state budget; and (3) the healthcare benefits pensioners are entitled to which further burden the state budget.¹⁰⁰ An amendment to the state constitution, according to Assemblyman Ciattarelli, does not fix a broken system.

⁹⁴ *Id.* (Failure to [pay its fair share] will prove that the state’s budget is balanced squarely on the backs of public employees.”).

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ Interview with Assemblyman Jack Ciattarelli (R-Somerville), N.J. Assemblyman, in Trenton, N.J. (March 14, 2016).

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

Part of the support for the constitutional amendment is the theory that, if the state makes the annually required contribution, the unfunded liability will decrease because of cash infusion and a modest growth rate of 4%. This position is supported by evidence in Michigan and West Virginia, in addition to consensus among pension analysts, which note that the best way to increase funding for a pension system is through larger contributions and the resultant investment growth.¹⁰¹ Assemblyman Ciattarelli responds by asking, "What happens if the growth rate fails to meet expectations?"¹⁰² This question is particularly relevant because the fiscal health of the system is determined by investment assumptions.

While the system may improve if the growth rate meets expectations, the financial crisis of 2008 is an all too recent reminder of what happens when growth rates fail to meet expectations, or in some instances, result in investment losses. Assemblyman Ciattarelli vehemently supports state employees and their right to receive benefits, but notes the practical realities of the state's financial situation.¹⁰³ Simply put, a constitutional amendment may cause a cash infusion to the pension funds, but will not result in a return to adequate funding levels. The amendment will, however, impose limitations to the state budget and in years where the state budget does not have the funds to satisfy the pension obligation, the inflexible constitutional provision will force either cuts to funding for other state programs or tax increases for what is already one of the most heavily taxed states in the country.¹⁰⁴

Assemblyman Ciattarelli offers an alternative solution to the "disastrous" constitutional amendment. Ciattarelli's plan is predicated on three components: (1) change to a defined-contribution plan; (2) municipal funding for a percentage of teacher's pension benefits; and (3) pension healthcare benefit

¹⁰¹ See *infra* Part V.

¹⁰² Interview with Assemblyman Jack Ciattarelli (R-Somerville), N.J. Assemblyman, in Trenton, N.J. (March 14, 2016).

¹⁰³ *Id.*

¹⁰⁴ Erin Carlyle, *The Best and Worst States for Taxes*, FORBES.COM (April 15, 2015), <http://www.forbes.com/sites/erincarlyle/2015/04/15/the-best-and-worst-states-for-taxes/#1d9ad584725c> (New Jersey ranks as the second most taxed state in the country. New York is number 1, and neighboring Connecticut is number 3); Sandra Block, *Worst States to Live in For Taxes*, KIPLINGER.COM (September 2015), <http://www.kiplinger.com/slideshow/taxes/T054-S001-least-tax-friendly-states-in-the-u-s/index.html> (According to Kiplinger, New Jersey is the third least tax friendly state in the country. New Jersey has the highest property taxes as well).

reform.¹⁰⁵ The first component of Ciattarelli's plan would require all newly hired teachers participate in a new defined-contribution 401(k) plan, and all teachers with less than 10 years in the pension system would have their account switched to the defined-contribution 401(k) plan.¹⁰⁶ Part two of the Ciattarelli proposal is the most interesting and innovative component of his proposal. Ciattarelli suggests that all new hires would have their pension paid for by the local school district, not the State of New Jersey.

Under Assemblyman Ciattarelli's proposal, municipalities must fund at least 25% of the local school budget through local tax levies, and communities cannot abate school property taxes on new developments.¹⁰⁷ This, according to Ciattarelli, would ensure fairness for funding of the pension system and taps into more stable funding source for the pension system: local property taxes.¹⁰⁸ Assemblyman Ciattarelli noted that the financial crisis of 2008 is among the reasons for the state's pension liability increase. The crisis affected pension investments; but, more importantly, it also impinged economic growth in the state. New Jersey's portion of the pension contribution is derived from the state budget, and the budget's primary funding source is the New Jersey sales and income tax. Thus, when New Jersey's economy struggled, state revenues suffered, and the state failed to make the appropriate pension contribution. While the state's failure to fund the pension system is not excusable according to Ciattarelli, the 2008 financial crisis identified a critical issue with our pension system: the financial health of the system is reliant upon a volatile source of funding.¹⁰⁹ Consequently, Assemblyman Ciattarelli's proposition provides a funding mechanism tied to local property taxes—a large, stable revenue source.

The third and final component of Assemblyman Ciattarelli's plan addresses healthcare benefits to pensioners.¹¹⁰ The plan would

¹⁰⁵ Interview with Assemblyman Jack Ciattarelli (R-Somerville), N.J. Assemblyman, in Trenton, N.J. (March 14, 2016).

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*; Jack Ciattarelli, *A Reform Plan to Solve Teachers Pension Problem*, NJ.COM (August 27 2015), http://www.nj.com/opinion/index.ssf/2015/08/a_reform_plan_to_solve_teachers_pension_problem_on.html (noting that presently some communities fund as little as 15% of their school budget, whereas others fund 90% of the local school budget).

¹⁰⁸ Interview with Assemblyman Jack Ciattarelli (R-Somerville), N.J. Assemblyman, in Trenton, N.J. (March 14, 2016).

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

discontinue “Cadillac” health insurance plans for all newly hired teachers and all other participants at the end of the current contract.¹¹¹ Additionally, if an employee’s pension salary and social security benefit exceeds \$50,000 per year, they would not receive a reimbursement for Medicare B/Medicare gap payments. Furthermore, if an employee’s pension salary and social security benefit exceeds \$30,000 per year, the employee would not receive a Medicare B reimbursement.¹¹² At first blush, this component of the proposal is undesirable to current participants; however, Assemblyman Ciattarelli suggests that the savings would be passed on to the employees by decreasing their contribution to the fund, therefore increasing take-home pay.¹¹³ This pay could then be reinvested by the employee into supplemental health insurance to alleviate the loss of certain healthcare benefits, or the employee could spend the additional salary in any other way he or she chooses.

Both the supporters and critics of New Jersey’s proposed constitutional amendment offer convincing arguments for their position. The undisputed fact presented to pensioners, legislators, and New Jersey taxpayers is that the fiscal health of the pension system can and should not be ignored, and the decisions by previous administrations to underfund the system cannot continue. Part V of this note will analyze the sagacity of ACR 3 and SCR 184 and the viability of Assemblyman Ciattarelli’s proposal. To evaluate ACR 3 and SCR 184, this note looks to the seven states with Constitutional protection for pension benefits and the states that have changed from a defined-benefit to a defined-contribution plan for an example and evidence to determine the most prudent road toward a fiscally sound pension system.

IV. OTHER PUBLIC PENSION FUNDS

Currently, seven states have provisions in their constitutions which explicitly provide protection for pension benefits.¹¹⁴ New York, Illinois, and Alaska’s Constitutions protect past and future benefits.¹¹⁵ Michigan, Louisiana, Arizona, and Hawaii provide

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ Liz Farmer, *How Are Pensions Protected State-by-State?*, GOVERNING THE STATES & LOCALITIES (January 28, 2014), <http://www.governing.com/finance101/gov-pension-protections-state-by-state.html>.

¹¹⁵ *Id.*

protection for past benefits only.¹¹⁶ Additionally, Michigan, Alaska, and West Virginia switched from a defined-benefit to a defined-contribution pension system to address their growing unfunded pension liability. Part V evaluates the pension history of the New York, Michigan, Alaska, and West Virginia to help assess the viability of the proposed constitutional reforms in New Jersey.

A. Michigan

Michigan has three primary state pension systems: the Public School Employees' Retirement System ("MPERS"), State Police Retirement System ("MSPRS"), and the State Employees' Retirement System ("MSERS").¹¹⁷ Article IX, §24 of the Michigan 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 which shall not be diminished or impaired thereby."¹¹⁸ The language "accrued financial benefits" indicates protection for past or accrued benefits, but does not protect future benefits. This distinction provides Michigan with the legislative flexibility to reform pension benefits so long as the reforms do not diminish accrued benefits. Resultantly, Michigan has repeatedly enacted significant reforms in the past 20 years in an effort to reduce the unfunded liability and address financial state of the three state pension systems.¹¹⁹

The first example of Michigan's pension reform efforts occurred in 1996 with the passage of legislation which froze the defined-benefit pension fund for new participants and created a defined-contribution pension system for new and future hires.¹²⁰ At the time of the 1996 reforms, Michigan had two main pension funds, MSERS and MPERS.¹²¹ The funding ratio for both funds in 1996 was 86.2% and the unfunded liability estimated at \$6 billion. Additionally, in the eight years preceding the 1996 reforms, Michigan contributed at least 77% of its ARC and typically exceeded

¹¹⁶ *Id.*

¹¹⁷ *Public Sector Retirement Systems Pension Fund Information*, THE PEW CHARITABLE TRUSTS (2015), available at <http://pewtrusts.org/m/media/assets/2015/07/state-pension-data-excel-sheet-71415.xlsx>.

¹¹⁸ MICH. CONST. art. IX, § 24.

¹¹⁹ Anthony Randazzo, *Pension Reform Case Study: Michigan*, Policy Study No. 434, REASON FOUNDATION 12 (Mar. 2014), http://reason.org/files/pension_reform_michigan.pdf.

¹²⁰ *Id.*

¹²¹ *Id.* (MSERS had 412,121 members in 1996. MPERS had 101,567 members.).

the ARC to offset years where the ARC fell below 100%.¹²² The 1996 reform had two primary features: (1) closing the MSERS defined-benefit fund, thereby isolating the current participants and limiting the number of pensioners to those currently enrolled in the system; and (2) creating a defined-contribution system, with automatic enrollment for all new hires.¹²³ The question following the reform is whether the shift from a defined-benefit to a defined-contribution plan preserved the fiscal health of the MSERS pension system.

In 1996, the MSERS defined-benefit system had an unfunded liability of \$0.5 billion and a funding ratio of 93.4%.¹²⁴ By 2012, the unfunded liability was approximately \$5.4 billion with a funding ratio of 65.5%.¹²⁵ At first blush, the statistics appear to indicate that the shift to a defined contribution system did not preserve the fiscal health of the MSERS system. In fact following the reform, Michigan systematically underfunded the system, failing to provide the requisite ARC and causing the drastic growth in unfunded liability.¹²⁶ Despite the statistics, proponents of the 1996 reform suggest that, absent the reform, the \$5.4 billion unfunded liability would have increased and retirement benefit costs would have reached unsustainable levels.¹²⁷ Analysis of the MPSERS indicates that individuals in that school of thought are likely correct.

Unlike the MSERS defined-benefit system, the MPSERS system did not shift to a defined-contribution plan with the 1996 reforms. In 1996, MPSERS had an unfunded liability of \$6 billion, and a funding ratio of 78.9%. By 2012, the funding ratio was 64.7% and the unfunded liability of \$22.4 billion.¹²⁸ The declining funding ratio of the MSERS defined-benefit system is product of a number of factors. One of the factors is the change to a defined-contribution system because the number of employees contributing to the defined-benefit fund remained stagnant (or decreased) while benefits remained the same (or increased) with the growing life expectancy of retirees. The MPSERS system, however, experienced a comparable decreased funding ratio even though the number of contributing employees continued to grow. The explanation for the

¹²² *Id.* at 7.

¹²³ *Id.* at 15.

¹²⁴ *Id.* at 18.

¹²⁵ Anthony Randazzo, *Pension Reform Case Study: Michigan*, Policy Study No. 434, REASON FOUNDATION 12 (Mar. 2014), http://reason.org/files/pension_reform_michigan.pdf.

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

continued failure of MPSERS is a combination of economic factors and importantly financial mismanagement. Thus, while both the MSERS and MPSERS systems suffered significant funding ratio decreases, the facts are inconclusive as to whether that the financial health of the MSERS system would be even worse had the Michigan legislature not enacted the 1996 reform shifting to a defined-contribution plan. The Mackinac Center for Public Policy estimates that the shift to defined-contribution plans saved taxpayers between \$2.3 and \$4.3 billion; however the experiences of West Virginia and Alaska, discussed below, suggest otherwise.¹²⁹

B. New York

New York has three state-administered pension systems. The primary systems are the New York State and Local Employees Retirement System (“ERS”), the New York State Teachers Retirement System (“NYSTRS”), and the New York State and Local Police and Fireman Retirement System (“PFRS”).¹³⁰

Since the reforms, New York’s funding and yearly ARC have continued to rank among the best in the nation. However, a comparison from 2003 to 2013 does not tell the entire story regarding the state of New York’s pension system. According to the Pew Charitable Trust, from 2004 to 2009, the assets of the New York pension system exceeded the total liability. In other words, from 2004 to 2009, New York’s pension system did not have an unfunded liability. Notably, New York contributed 100% from 2003 to 2013.¹³¹ Despite contributing 100% of the ARC and having a pension system with a funding ratio in excess of 100% from 2004 to 2009, New York’s funding ratio decreased each year from 2009 to 2013. In 2013, New York’s unfunded pension liability was estimated at \$20 billion and the funding ratio stood at 88.7%.¹³² New York’s funding ratio has decreased from 99.4% in 2003 to 88.7% in 2013.¹³³ The decrease in funding ratio may be explained by the effect of the 2008 financial crisis on the investment returns

¹²⁹ Mackinac Center for Public Research, *Michigan’s Pension Underfunding Problem*, MACKINAC.ORG (2015), <https://www.mackinac.org/20884>.

¹³⁰ Center for Retirement Research, *New York State Summary*, BOSTON COLLEGE (Feb. 2013), <http://crr.bc.edu/wp-content/uploads/2013/02/New-York.pdf>.

¹³¹ *Id.*

¹³² Public Sector Retirement Systems, *The State Pensions Funding Gap: Challenges Persist*, PEW CHARITABLE TRUSTS (Jul. 31, 2015), <http://www.pewtrusts.org/en/multimedia/data-visualizations/2015/the-fiscal-health-of-state-pension-plans/> (New York’s funding ration ranked 6th nationally in 2013).

¹³³ *Id.*

of the pension fund. In response to the 2008 financial crisis, New York enacted pension reforms which increased employee contributions and invoked significant cuts to benefits for new hires.¹³⁴ Employee contributions in ERS increased from 7% of payroll to 18%, NYSTRS increased from 7% to 13%, and PFRS increased from 14% to 25%.¹³⁵ Additionally, all three systems increased the age and tenure required to receive benefits, increased the salary averaging periods, and reduced the benefit factor.¹³⁶ The history of New York supports the position of Assemblyman Ciattarelli, which points out that, even when a state makes 100% of its ARC, the funding ratio for the pension system continues to decrease. This suggests that economic factors significantly affect the return on pension investments and, when the rate of return falls below predicted levels, the system will suffer—regardless of the state’s contribution. That being said, failure to make an ARC guarantees an even greater unfunded liability, as demonstrated by New Jersey.

C. West Virginia

The West Virginia Teachers Retirement System (“TRS”) was significantly underfunded because the state failed to make the appropriate contributions.¹³⁷ In 1991, West Virginia adopted a defined-contribution 401(k) plan to address the historical underfunding of the system and alleviate the burden of the unfunded liability.¹³⁸ West Virginia closed the pre-existing defined benefit plan to new members, and new hires were placed in the defined-contribution plan.¹³⁹ However, the change resulted in an increase in the unfunded obligation because the decreasing number of active teachers contributing to the fund could not offset the growing number of retired teachers still participating in the defined benefit plan.¹⁴⁰ By 2005, the TRS distributed benefits to

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ National Institute on Retirement Security, *Case Studies of State Pension Plans that Switched to Defined Contribution Plans 2* (Feb. 2015), http://www.rsa-al.gov/uploads/files/Case_Studies_State_Pension_Plans_that_switched_to_DC_Plans.pdf.

¹³⁸ Eli Lehrer & Steve Stanek, *The State Public Pension Crisis: A 50 State Report Card 24* (2010), available at <http://www.legis.nd.gov/files/committees/63-2013nma/appendices/gf073013appendixf.pdf?20160417231816>.

¹³⁹ *Id.*

¹⁴⁰ National Institute on Retirement Security, *Case Studies of State Pension Plans that Switched to Defined Contribution Plans 2* (Feb. 2015), http://www.rsa-al.gov/uploads/files/Case_Studies_State_Pension_Plans_that_switched_to_DC_Plans.pdf.

approximately 27,000 active teachers, while less than 18,000 active teachers contributed to the fund.¹⁴¹

Additionally, as of April 2005, members of the defined-contribution plans discovered that the account balances would not provide adequate retirement income—while their defined-benefit counterparts experienced a return 1.6% greater than the average defined-contribution return.¹⁴² Resultantly, West Virginia decided to place new hires back in the defined contribution plan and permitted already participating defined-contribution members to opt-in to the defined-benefit plan.¹⁴³ Most significantly, West Virginia exceeded the ARC between 2003 and 2013, including excess contributions of \$290.1 million in 2006 and \$1.2 billion in 2007.¹⁴⁴ As of 2013, West Virginia's Teacher Retirement System was 58%—an increase of 23% from 2005.¹⁴⁵ The plan is expected to be fully funded by 2034.¹⁴⁶

The National Institute on Retirement Security suggests that the health of West Virginia's system is a reflection of the switch back to a defined-benefit plan and indicates that changes to defined-contribution plans increases retirement costs.¹⁴⁷ While the timing of West Virginia's return to a defined-benefit plan correlates with increased ARC payments, the National Institute on Retirement Security does not provide clear evidence that the change created additional revenue enabling the state to make its ARC payments. The situation in West Virginia may support this conclusion; however the critical takeaway from West Virginia is that when states satisfy 100% of the ARC, the health of the pension system can improve.

D. Alaska

Alaska's primary pension systems are the Public Employees' Retirement System ("PERS") and the Teachers' Retirement and Pension System ("PRPS").¹⁴⁸ Unlike each of the states discussed in

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.* at 3.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ National Institute on Retirement Security, *Case Studies of State Pension Plans that Switched to Defined Contribution Plans* 3 (Feb. 2015), http://www.rsa-al.gov/uploads/files/Case_Studies_State_Pension_Plans_that_switched_to_DC_Plans.pdf.

¹⁴⁷ *Id.* at 4.

¹⁴⁸ *Alaska PERS/TRS Defined Contribution Retirement Plan*, CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE (Apr. 2011), available at <http://crr.bc.edu/wp-content/uploads/2011/09/Alaska-2.pdf>.

this section, and nearly every state in the nation, Alaska currently utilizes a defined contribution plan for participants in the public pension system.¹⁴⁹ In 2005, Alaska instituted a mandatory defined contribution plan wherein employees contribute 8% of their salary, and employers contribute 5% for general employees and 7% for teachers.¹⁵⁰ The change to a defined contribution plan was a response to the state's \$5.7 billion unfunded liability.¹⁵¹ Despite the shift to the defined-contribution plan, Alaska only contributed 47% of the ARC to PERS and 45% of the ARC to PRPS in 2005, thereby increasing the unfunded liability to \$6.9 billion.¹⁵² By 2013, Alaska's unfunded liability rose to approximately \$9 billion and the system was 52.3% funded.¹⁵³ Notably, the funding ratio for Alaska's pension systems continued to decrease despite contributions of 90.2% of its ARC in 2013 and at least 80% from 2008 to 2012.¹⁵⁴

In West Virginia, the clear correlation with the improving unfunded liability ratio lay with the excess ARC payments, which circumstantially corresponded to the return to a defined benefit plan. Alaska's situation, however, provides concrete evidence that a switch to a defined-contribution plan leads to immediate increased pension costs. From 2008 to 2012, Alaska contributed at least 80% of the ARC, yet the pension liability increased by \$2.1 billion. Additionally, any increase in liability resulting from the financial crisis of 2008 should have been offset by the market recovery from 2009 to 2013, yet this was not the case in Alaska. Therefore, the evidence suggests that the source of the increased liabilities is a product of the decreased employee contributions resulting from the closure of the defined-benefit plan—implying that the defined-contribution plan at a minimum increases short-term pension costs, and potentially causes additional damage to the financial state of the pension fund.

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ National Institute on Retirement Security, *Case Studies of State Pension Plans that Switched to Defined Contribution Plans* 9 (Feb. 2015), http://www.rsa-al.gov/uploads/files/Case_Studies_State_Pension_Plans_that_switched_to_DC_Plans.pdf.

¹⁵² *Id.*

¹⁵³ *The Fiscal Health of State Pension Plans*, THE PEW CHARITABLE TRUSTS (July 31, 2015), available at <http://www.pewtrusts.org/en/multimedia/data-visualizations/2015/the-fiscal-health-of-state-pension-plans>.

¹⁵⁴ *Id.*

V. ANALYSIS OF THE CONSTITUTIONAL AMENDMENT AND PROPOSED SOLUTIONS

A. *Constitutional Provisions: What is the Effect?*

Based on the overview of Michigan, New York, and Alaska, whose State Constitutions explicitly provide protection to employees by requiring funding of pension systems, it appears that enacting a constitutional provision has mixed, unconvincing results. Each of the seven states with constitutional protections contributed at least 75% of the ARC in 2013 and contributed at least 70% each year since the 2008 financial crisis.¹⁵⁵ This figure is unsurprising as constitutional protections for pension funding would have a direct correlation to consistent ARC payments, because a failure to satisfy this obligation would likely constitute a violation of the state constitution and in many cases would explicitly implicate a constitutionally protected contract right. However, the state-by-state analysis above clearly demonstrates that satisfaction of ARC payment requirements is not necessarily an indicator of a healthy state pension system. Of the seven states with constitutional protection, four states were less than 60% funded, and six of the seven states fell below the 80% threshold for a healthy pension system.¹⁵⁶ Additionally, and of greater significance, the funding ratio for five of the seven states has continued to decrease each year, an indicator that the pension systems continue to struggle in spite of constitutional protections.¹⁵⁷

While the *Spina* decision discussed in Part II laid the foundation for the New Jersey judiciary's review of future pension challenges, it also valuable for evaluating the current state of the New Jersey pension systems. The reality of defined benefit plans is that the benefits promised to pensioners and the legislation passed to help secure those benefits only postpone future pension crises.¹⁵⁸ As the *Spina* court noted in 1964,

all these [pension] funds had in common [is] the promise of inevitable doom. The reason was that the annual revenues were not related to the ultimate cost of pension benefits, so that while current income might suffice for the earlier pensioners, the day had come when little or nothing would remain for others, even of their own contributions to the fund. Accordingly, there were periodic crises, in connection with which long-range solutions were offered, only to be rejected in favor of something

¹⁵⁵ See *supra* Part III.

¹⁵⁶ See *supra* Part III.

¹⁵⁷ See *supra* Part III.

¹⁵⁸ *Spina*, 197 A.2d at 393.

more palatable for the moment.¹⁵⁹

An amendment guaranteeing pension payments in the New Jersey Constitution is another example of the “something more palatable for the moment,” ignoring the need for a long-range solution.

A constitutionally guaranteed pension payment in the New Jersey Constitution would protect the funding of the severely underfunded pension system; however, the practical effect of such an amendment is either (1) slashing of funding for other state programs, or (2) significant tax increases for what is already the most heavily taxed state in the nation. As Michael Bloomberg, former Mayor of New York City, stated in 2008, “New York City is spending so much money on pensions . . . that we have far less to spend on core services, such as public safety, education, parks, and senior centers.”¹⁶⁰ Mayor Bloomberg’s statements are illustrative of the problem currently facing New Jersey and the disaster that would be posed by a constitutional amendment requiring annual pension payments. Additionally, New York State’s pension system has contributed 100% of its ARC and continues to see its funding ratio decrease.¹⁶¹ While it is critical for New Jersey to make its annual contributions, imposing a constitutional restriction on future pension reform is not the solution. Presently, “there is no state in the Union that has enshrined public pension payments into its state constitution.”¹⁶² It is imperative that New Jersey not be the first.

B. Hybrid Defined Benefit–Defined Contribution System

One of the most common ideas that emerge in pension reform discussions is transitioning from defined-benefit to defined-contribution plans. Assemblyman Ciattarelli cited a transition to a defined-contribution plan as one of the components of his proposed pension reform.¹⁶³ While the issues facing New Jersey’s pension system are not identical to those facing other states, an analysis of states that have shifted to a defined contribution plan may illustrate the merits of defined contribution plans for public

¹⁵⁹ *Id.* at 394.

¹⁶⁰ Michael Bloomberg, *Why Pension Reform Is Fair & Vital*, NEW YORK POST, Dec. 18, 2008, http://www.nypost.com/seven/12182008/postopinion/opedcolumnists/why_pension_reform_is_fair_vital_144747.htm.

¹⁶¹ *See supra* Part IV.

¹⁶² Alfred Doblin, *A Public Pension is Not a Constitutional Right*, NORTHJERSEY.COM (Jan. 11 2016, 9:31 AM), <http://www.northjersey.com/opinion/a-public-pension-is-not-a-constitutional-right-1.1489107>.

¹⁶³ Interview with Assemblyman Jack Ciattarelli, *supra* note 97.

employees. Defined-contribution systems are favored in certain jurisdictions because it alleviates pressure on state budgets and taxpayers that are responsible for the increased liability emerging from missed investment targets or longer benefit payments resulting from increased life expectancy.¹⁶⁴ However, the experience of Michigan, West Virginia, and Alaska suggest that a defined-contribution plan is not a viable option.¹⁶⁵ Additionally, a report published by the Keystone Research Center suggests that a switch to a defined benefit plan would increase New Jersey's unfunded liability.¹⁶⁶ Many factors contribute to the fiscal health of a pension system; however, projecting increased costs resulting from a defined-benefit to a defined-contribution plan is straight forward. "Pension fund managers rely on investment returns to pay for two-thirds of retirement benefits—twice the amount covered by employer and employee contributions combined."¹⁶⁷ Thus, closing a defined contribution plan cuts off the additional funds contributed by new employees, while vested employees retire and cease making their salary based contributions to the system. This, in effect, increases the unfunded liability of the pre-existing defined-benefit plan by reducing the overall rate of return, while simultaneously requiring contributions to the new defined-benefit plan. Quite simply, a standalone defined-contribution plan would decrease costs, but a transition to a defined-contribution plan does not remove New Jersey's pre-existing defined-benefit obligations to vested retirees.

C. Proposed Solution and Conclusion

In 2016, New Jersey's unfunded liability pension liability was estimated at \$55 billion.¹⁶⁸ The liability has increased each of the past ten years and continues to be neglected. New Jersey enacted comprehensive pension reform in 2011, increasing employee contributions, increasing the retirement age, diminishing healthcare benefits, and eliminating cost of living adjustments.¹⁶⁹ The reform

¹⁶⁴ Randazzo, *supra* note 13.

¹⁶⁵ See *supra* Part IV.

¹⁶⁶ See Stephen Herzenberg, *How to Dig an Even Deeper Pension Hole*, KEYSTONE RESEARCH CENTER (Oct. 2014), available at http://njpp.org/assets/reports/NJPPKRC_PensionsOct2014.pdf.

¹⁶⁷ *Id.* at 3.

¹⁶⁸ Samantha Marcus, *Losing Pension Court Case Could Cost N.J. Big, Moody's Warns*, NJ.COM (Jan. 21 2016), http://www.nj.com/politics/index.ssf/2016/01/losing_state_supreme_court_pension_case_could_cost.html.

¹⁶⁹ See *supra* Part II.

was recognized both in New Jersey and throughout the country as an example of bi-partisan compromise to fix one of the nation's worst pension systems. Despite the 2011 reforms, the state has failed to live up to its end of the bargain, contributing 18.6% of its ARC, the worst in the nation.¹⁷⁰ The state's failure to make its annual contribution has further damaged an already broken system and continues the habitual "kicking of the can" for future legislators and taxpayers to deal with. Blame can be attributed to both sides; however, the debates over responsibility only ignore the practical reality: the system continues to head toward the brink of disaster and the any solution will require leadership in both parties.

Assemblyman DeAngelo co-sponsored ACR 3, which would amend the New Jersey Constitution and force the Republican administration to makes its ARC. The amendment would make New Jersey the first state in the nation to provide constitutional protection for pension payments.¹⁷¹ A constitutional amendment is a dramatic measure; however, Assemblyman DeAngelo points to the state's continual underfunding of the system and unfulfilled promises from 2011. From Assemblyman DeAngelo's perspective, additional compromise is unrealistic' because the current administration has "eroded any goodwill" they had at the negotiating table.¹⁷² Finally, Assemblyman DeAngelo suggests that the money for the ARC is in the budget, yet the current administration refuses to appropriate the funds for the ARC.¹⁷³ The constitutional amendment forces the state's hand and will move the system on the path to recovery.

Contrary to Assemblyman DeAngelo's position, Assemblyman Ciattarelli calls the proposed constitutional amendment a catastrophic error, which will place unnecessary constraints on the

¹⁷⁰ Elise Young, *N.J.'s 18.6% Pension Funding Least in U.S., Moody's Finds*, BLOOMBERG.COM (Jan. 15, 2016), <http://www.bloomberg.com/news/articles/2016-01-15/n-j-s-18-6-pension-funding-least-in-u-s-moody-s-finds>.

¹⁷¹ New York's, Michigan's, Alaska's, Arizona's, Hawaii's, Illinois', and Louisiana's constitutions protect certain pension benefits from being diminished or reduced, but do not constitutionally mandate the state to make its ARC. See Stephen Eide, *Constitutional Public Pension Guarantees: Unfair, Unaffordable, and Bad Policy*, MANHATTAN INSTITUTE FOR POLICY RESEARCH (Aug. 2013), http://www.manhattan-institute.org/pdf/ib_25.pdf.

¹⁷² Telephone Interview with Assemblyman Wayne DeAngelo, *supra* note 86 (Assemblyman DeAngelo said that there have not been any discussions with the Republican leadership regarding future reforms or any prospective discussions on the subject. Assemblyman DeAngelo advised that current plan is to wait on the voters' decision regarding the pension amendment).

¹⁷³ Telephone Interview with Assemblyman Wayne DeAngelo, *supra* note 86.

legislature in years when investment returns fall below projections. In years where projections fall short, the state would be responsible for the ARC, in addition to the funding shortfall resulting from poor returns. As Governor Christie noted, "education, health care, crime, our environment, support for the poor, [and] protection for our children . . . would all be subject to elimination to pay for the pensions of 800,000 current and former employees."¹⁷⁴ This statement may stretch the truth, but it also points out the reality of our financial situation: the pension system's funding problem is not solved by the state making its ARC, and a constitutional amendment will only serve to bind the state to an obligation which will have calamitous effects on funding for critical areas, or may further burden the taxpayers. Assemblyman Ciattarelli echoes this sentiment arguing that placing additional fiscal constraints on the budget, while potentially increasing budgetary obligations, will lead to either significant cuts to funding for critical state programs or shift the burden to the backs of taxpayers.¹⁷⁵ Recognizing each of these positions, the practical solution falls at the intersection of both Assemblyman DeAngelo's amendment and Assemblyman Ciattarelli's proposal.

The proposed constitutional amendment, while a drastic measure, seems imperative given the years of irresponsible financial management of our pension system. In particular, Governor Christie's decision to renege on the promises of 2011 and deflect blame to pensioners and the Democratic leadership suggests that, absent a different administration, good faith negotiations are unlikely. That said, obligating the state to constitutionally mandated funding sets the stage for future disaster. The alternative proposal is comprised of constitutional protections comparable to those provided by Michigan, Louisiana, Arizona and Hawaii. Each state's constitution protects past or accrued benefits, but does not guarantee future benefits.¹⁷⁶ Additionally, to alleviate the concerns of pensioners, the state would obligate itself to fund the pension system to guarantee the future benefits and those already accrued through an ARC.

In exchange for an amendment which protects future benefits

¹⁷⁴ Robert Steyer, *Gov. Christie Derides Plan for New Jersey Constitutional Amendment on Pension Contributions*, PIONLINE.COM (January 12 2016), <http://www.pionline.com/article/20160112/ONLINE/160119952/gov-christie-derides-plan-for-new-jersey-constitutional-amendment-on-pension-contributions>.

¹⁷⁵ Interview with Assemblyman Jack Ciattarelli, *supra* note 97.

¹⁷⁶ See *supra* Part III.

and guarantees a constitutionally protected ARC, two components of Assemblyman Ciattarelli's plan should be accepted to increase funding and offset a portion of the state's obligation. First, the state should adopt the proposed healthcare cuts—in particular the elimination of "Cadillac healthcare" plans.¹⁷⁷ This proposal is controversial because it decreases healthcare benefits, however the benefits provided already exceed what is necessary, and the savings by decreasing benefits would (1) provide additional funding for the pension system, and (2) could be provided in the form of increased salary to pension participants whose salary contribution would decrease as well.¹⁷⁸ The increased take-home pay for pension participants could then be reinvested in supplemental healthcare, or spent in anyway desired. Second, the state should adopt the funding proposal whereby no community is permitted to fund less than 25% of their local school budget through the local tax levy, and communities cannot abate school property taxes on new developments.¹⁷⁹ Shifting a portion of the funding burden to municipalities guarantees funding through property taxes—a stable funding option, not directly tied to the state's economic health—and resultantly provides additional funding for the pension system through the decreased funding provided to certain school districts. This portion of the proposal would provide equitable distribution for school funding throughout the state and would alleviate the new burden on the state budget through the constitutional amendment.

The proposal above seeks to recognize the goals of each side of the pension debate and offer a compromise that serves both pensioners and taxpayers. However, a perfect solution to New Jersey's pension crisis does not exist. The proposed constitutional amendment in ACR 3 and SCR 184 is an imperfect response, but the inaction of the current administration and continued neglect for the pension system is an even greater calamity. Ignoring the problem created the \$55 billion unfunded liability and similar behavior only serves to further harm every citizen of the state. The time has come for inaction to stop. Only through the collective efforts of everyone involved can New Jersey stave off the impending fiscal disaster and hopefully preserve everyone's financial future.

¹⁷⁷ Interview with Assemblyman Jack Ciattarelli (R-Somerville), N.J. Assemblyman, in Trenton, N.J. (March 14, 2016).

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*