

Surprising Decision in New Jersey Pension Funding Case

June 15, 2015

MarketWatch Blog by Alicia H. Munnell



Alicia H. Munnell is a columnist for *MarketWatch* and director of the Center for Retirement Research at Boston College.

New Jersey Supreme Court rules pension funding legislation unconstitutional.

I was surprised by the New Jersey Supreme Court decision regarding the state's failure to make contributions to the state's public pension plans. Essentially the State of New Jersey made a deal in 2011 for public employees to increase their contributions and give up some of their benefits in exchange for the state's commitment to fund the pensions. The state did not live up to its side of the bargain and, when challenged, argued that its commitments were unconstitutional. The Supreme Court agreed. If I were a New Jersey public employee, I would be really mad.

Here's my understanding of the legal story. In 2011, the New Jersey legislature enacted "Chapter 78" to address the underfunding of the state pensions. Public employees gave up their cost-of-living adjustments and increased their contributions in exchange for a promise that the state would ramp up to full funding over seven years. Chapter 78 further provided that the promised state contributions be included in all annual appropriations acts as a dedicated line item, and that each member of the state's pension

system would have a contractual right to the required contribution amount. Failure of the State to make the required contribution would be an impairment of the contractual right of each employee.

New Jersey made its required pension contributions for fiscal years 2012 and 2013. For 2014, however, Governor Christie announced that the State would not make the full contribution due to an “emergency” created by a severe and unanticipated revenue shortfall. This decision was upheld by the courts. For fiscal year 2015, Governor Christie exercised his line-item veto and deleted a substantial portion of the State’s required pension payment from the Legislature’s appropriations bill. In response, State employees and unions acting on their behalf brought suit claiming that failure to make the required contribution was a violation of Chapter 78 and an impairment of contractual rights under the Contract Clauses of both the New Jersey and U.S. Constitutions.

The Contract Clause of the U.S. Constitution provides that no State shall pass any law impairing the obligation of contracts. The corresponding provision of the New Jersey Constitution is substantially similar. Judicial decisions have developed a three-part test to determine whether State action constitutes a violation of the Contract Clause. The first step is to determine whether a contractual obligation exists. The next question is whether the State action constitutes a substantial impairment of its contractual obligation. The final question is whether, despite being a substantial impairment of a contractual obligation, the State action is reasonable and necessary to serve an important public purpose.

After suit was brought, the State filed a motion to dismiss, claiming that Chapter 78 could not create a valid contract right because it violated the Debt Limitation and Appropriations clauses of the New Jersey Constitution.

The Debt Limitation clause provides that, unless approved by the voters, the State cannot by contract or statute create a binding and legally enforceable multi-year obligation. (The Debt Limitation clause was adopted in 1844 because of concerns about binding obligations imposed on future generations of taxpayers and because of unchecked speculation by the state.) The Appropriations clause requires annual appropriations by the Legislature, incorporated into a single balanced budget, in order for funds to be drawn from the State treasury.

The trial court rejected the State's motion to dismiss and entered summary judgment for the plaintiff employees and unions. The State appealed. On June 9, 2015 the New Jersey Supreme Court ruled, in a 5-to-2 decision, that Chapter 78's attempt to create an enforceable long-term financial contractual obligation, payable by the State through dedicated line items in future annual appropriation acts, fell squarely within the prohibitions of the Debt Limitation clause, and also violated the Appropriations clause. Because it found no ambiguity in the New Jersey Debt Limitation clause, the Court declined to follow decisions in other States interpreting debt limitation clauses of their state constitutions to be limited to borrowing.

The New Jersey Supreme Court's decision acknowledged that the intent of Chapter 78 was to create an enforceable contract right, but because Chapter 78 violated provisions of the New Jersey Constitution it could not create a valid and enforceable contract, and, therefore, there was no violation of the Contracts Clause.

So here are my questions. Why is it ok for the state to make unconstitutional commitments? And if the state does not have to live up to its side of the contract, why should the public employees live up to their side?

