No. 16-1466

In the Supreme Court of the United States

MARK JANUS,
Petitioner,

v.

AMERICAN FEDERATION OF STATE, COUNTY, AND MUNICIPAL EMPLOYEES, COUNCIL 31, ET AL.,
Respondents.

On Writ of Certiorari to the
United States Court of Appeals
for the Seventh Circuit

BRIEF OF AMICUS CURIAE NATIONAL CONFERENCE ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICUS CURIAE AND SUMMARY OF ARGUMENT[1]

The National Conference on Public Employee Retirement Systems ("NCPERS") is the largest trade association for public-sector pension funds, representing more than 500 funds throughout the United States and Canada. It is a unique non-profit network of trustees, administrators, public officials and investment professionals who collectively manage nearly $3.5 trillion in pension assets held in trust for approximately 21 million public employees and retirees—including firefighters, law enforcement officers, teachers, and other public servants.

NCPERS submits this brief to address factual claims made by certain amici for the Petitioners about the effects of public-sector collective bargaining on state and local government pensions. Although this case comes to the Court without a developed factual record, some amicus briefs urge the Court to overturn *Abood v. Detroit Board of Education*, 431 U.S. 209 (1977), based on the argument that public-sector collective bargaining has caused pension underfunding and municipal bankruptcies. These claims rely on conflating pension underfunding and financial problems that exist in many states—both those that prohibit and

[1] Letters from the parties consenting generally to the filing of briefs amicus curiae are on file with the Court. Pursuant to Rule 37.6, counsel for amicus state that no counsel for a party authored the brief in whole or in part, and that no person other than amicus or its counsel made a monetary contribution to fund the preparation or submission of the brief.

permit free-riding—with public-sector unionization, when there is no evidence of a causal relationship.

In fact, history shows that state and local government employers established their pensions well before public-employee collective bargaining was permitted and that they did so for the same reasons as other employers—to attract and retain qualified employees. *McGrath v. Rhode Island Ret. Bd.*, 88 F.3d 12, 16-17 (1st Cir. 1996) ("[E]volving legal doctrine recognizes that the promise of a pension is part of the compensation package that employers dangle to attract and retain qualified employees.") More fundamentally, rather than public-employee unionization, recent pension underfunding is primarily the product of (1) states' long-term failures to make regular, actuarially determined contributions and (2) financial volatility, particularly due to the Great Recession. Likewise, municipal bankruptcies are the result of a myriad of complex factors, but cannot be attributed to public-sector unionization.

Thus, amici are incorrect when they assert that collective bargaining has been the "most significant cause of the nationwide public pension crisis," or that Illinois' pension liabilities can be attributed to public-sector unions. Brief Amicus Curiae of Pacific Legal Foundation, Goldwater Institute, The Fairness Center, Empire Center for Public Policy, Inc., Pioneer Institute, Inc., Reason Foundation, Individual Rights Foundation, and Yankee Institute for Public Policy in Support of Petitioner (the "Pacific Legal Foundation Brief") at 13; Brief of Jason R. Barclay and James S. Montana, Jr., Former General

Counsel to Governors of the State of Illinois, as Amici Curiae in Support of Petitioners (the "Barclay Brief") at 14.

Similarly, the brief filed by State Attorneys General for the States of Michigan, et al. (the "State Attorneys General Brief") misrepresents the facts when it claims that collective bargaining caused unfunded pension liability and the eventual bankruptcies in Detroit, and Stockton and San Bernardino, California. State Attorneys General Brief at 10-19.

But not only are amici wrong on the facts, they also fail to appreciate that these issues are not new. Funding concerns about public pensions were widely reported and debated in Congressional and other reports at the time of *Abood*. *See, e.g.*, Staff of the House Comm. on Educ. and Labor, 95th Cong., 2d Sess., *Task Force Report on Public Employee Retirement Systems* 143 (Comm. Print 1978) [hereinafter *Task Force Report*] (stating that for decades the "alarm has been sounded . . . as to the inadequate funding of some public employee retirement systems"). Then, as now, Illinois faced well-documented pension concerns, attributable to the lack of regular, actuarially determined contributions. *See In re Pension Reform Litigation*, 32 N.E.3d 1, 6 (Ill. 2015). Worse still, numerous public pensions operated on a pay-as-you-go basis, without prefunding benefits at all. Nevertheless, and notwithstanding these issues, *Abood* struck a balance between political concerns and the government's role as an employer to uphold fair-share laws. There is no special justification for upsetting that balance now, least of all because of amici's misrepresentations about public pensions or municipal bankruptcy.

ARGUMENT

I. There Is No Causal Relationship Between Public-Sector Collective Bargaining and Pension Underfunding or Municipal Bankruptcy

Significant portions of the State Attorneys General Brief and the Barclay Brief are dedicated to drawing a connection between public pension underfunding and public-employee unionization, to insinuate that public-employee unions and the mandatory collection of agency fees causes these problems. But the idea that collective bargaining is responsible for pension underfunding or state and local fiscal problems is not supported by history or the facts.

A. Public Pension Problems Stem Primarily from Underfunding and the Great Recession Rather than Public-Employee Unionization or Agency Fees

1. States and Local Governments Established Pensions for Their Employees Well Before Public Employees Were Permitted to Collectively Bargain

Public pensions serve a vital role in the United States economy, because they provide both retirement security to millions of Americans and economic stimulus. Jennifer Erin Brown, Nat'l Inst. on Ret. Sec., *Pensionomics 2016: Measuring the*

Economic Impact of DB Pension Expenditures 1 (2014), https://goo.gl/zwdsF7 (estimating $2.21 in economic output for every dollar paid of pension benefits and $9.19 for every dollar contributed to pension funds). However, it is wrong to attribute public pensions or any pension funding problems to public-sector collective bargaining. States created public retirement systems over 100 years ago to fund benefits for police, firefighters, teachers, and other public servants, but did not widely permit public-sector collective bargaining until the late 20th century, many decades after the enactment of the National Labor Relations Act in 1935.

Although the federal government provided pension benefits to Revolutionary War and Civil War soldiers, the first state pension law was enacted in New York state in 1857, to provide lump-sum payments to New York City police officers injured in the line of duty. *Task Force Report*, *supra*, at 61. This benefit was expanded in 1878 to provide a lifetime pension to police officers who reached age 55 and had completed 21 years of service, and similar service-related retirement systems were created for police officers, fire fighters, and teachers in New York, Boston, and other cities before the 1900s. *Id.* Manhattan's retirement plan for teachers, for example, was established in 1894. Nat'l Conference on Public Emp. Ret. Sys., *The Evolution of Public Pension Plans: Past, Present and Future* 3 (2008), https://goo.gl/gXL4qk. At least six state teacher retirement systems date back to the beginning of the 20th century: North Dakota and California established plans in 1913, followed by Massachusetts in 1914, Connecticut and

Pennsylvania in 1917, and New Jersey in 1919. *Id.*; *see also* Robert L. Clark et al., *State and Local Retirement Plans in the United States* 1 (2011) [hereinafter *State and Local Retirement Plans*] (by 1930 more than 20 states maintained pension plans for public school teachers).

The number of plans increased throughout the beginning of the 20th century, and the exclusion of state and government employees from Social Security provided particular impetus for their growth around the time of the New Deal. Roughly half of the larger state and local plans were established between 1931 to 1950. *Task Force Report*, *supra*, at 61; *see also State and Local Retirement Plans*, *supra*, at 76-78 (showing overwhelming majority of plans for teachers and state employees established before 1950). Among the largest existing state and local pension plans by assets, the predecessor to the California Public Employees Retirement System (CalPERS) was created in 1931, the New York State and Local Retirement System comprises two pension systems created in 1921 and 1966, the Florida Retirement System represents the merger of retirement systems created in 1939 and 1945, and the Teacher Retirement System of Texas was established in 1937. *See* 1931 Cal. Stat. 1442, 1445; N.Y. Retire. & Soc. Sec. Law §§ 10, 310, 422 (McKinney 2017); Fla. Stat. § 121.011 (2017); Tex. Const., art. III, § 48a (1937) (repealed and replaced with similar provision in 1975); *State and Local Retirement Plans*, *supra*, at 26, 44.

The overwhelming majority of states offer their employees some form of defined-benefit pension, as do most local government employers. They established these plans for the same reason that private-sector employers provide pension and other benefits—to attract and retain workers and to ensure that workers are provided for in their old age or in the event of disability. *See, e.g.*, Cal. Gov't Code § 20001 (West 2017) (retirement system serves "to effect economy and efficiency in the public service by providing a means whereby employees who become superannuated or otherwise incapacitated may, without hardship or prejudice, be replaced by more capable employees"); Ariz. Rev. Stat. § 38-712 (2017); Robert L. Clark et al., *A History of Public Sector Pensions in the United States* 7 (2003) ("[P]ensions were introduced in the public sector to help public administrators attract and retain quality workers, to provide them with performance incentives, and to retire them in an orderly fashion.").

Notably, state and local government employees are paid less than comparable private-sector workers, and even factoring in pension and other benefits, still earn less or roughly the same. Keith A. Bender & John S. Heywood, Ctr. for State & Local Gov't Excellence and Nat'l Inst. on Ret. Sec., *Out of Balance? Comparing Public and Private Sector Compensation Over 20 Years* 3 (2010), https://goo.gl/6D4Vw4; Jeffrey Keefe, *Public-Sector Workers Are Paid Less Than Their Private-Sector Counterparts—And the Penalty Is Larger in Right-to-Work States*, Economic Policy Institute (Jan. 14, 2016), https://goo.gl/R7ttVY; Alicia H. Munnell, *State and Local Pensions: What Now?* 168-169

(2012). The Census Bureau reports that in 2015, the average annual pension benefit for retired state and local employees was $26,684. Phillip Vidal, U.S. Dep't of Commerce, Bureau of Census, *Annual Survey of Public Pensions: State- and Locally-Administered Defined Benefit Data Summary Brief: 2015* 3 (2016), https://goo.gl/dEDsbG. At the same time, more than a quarter of state and local government employees continue to be ineligible for Social Security, and must rely almost exclusively on pension benefits for retirement security. Dawn Nuschler et al., Cong. Research Serv., R41936, *Social Security: Mandatory Coverage of New State and Local Government Employees* 1 (2011), https://goo.gl/yTXeP4. Considering that state and local pension systems had 20.4 million members and provided benefits to nearly 10 million retirees in 2015, public pensions are a crucial way to provide retirement security to this nation's public servants. Vidal, *supra*, at 3.

Just like the laws authorizing public pension systems, the state-law protections for pension rights precede state and local government collective bargaining. For instance, the guarantee in Illinois that public pensions are contractual obligations that "shall not be diminished or impaired" was established by constitutional convention in 1970, more than a decade before collective bargaining. *See, e.g.*, *In re Pension Reform Litigation*, 32 N.E.3d at 16; Eric M. Madiar, *Is Welching on Public Pension Promises an Option for Illinois? An Analysis of Article XIII, Section 5 of the Illinois Constitution*, 48 J. Marshall L. Rev. 167 (2014). Similarly, the case law and state constitutional provisions in California, Michigan, and many other states that protect public-employee pensions from being eliminated or reduced have existed for much longer than collective bargaining rights. *See, e.g.*, *Kern v. City of Long Beach*, 179 P.2d 799 (Cal. 1947) (finding that public-employee pension rights are contractual obligation protected against impairment); Mich. Const. art. IX, § 24 (adopted as part of 1963 state constitution). This underscores a point entirely ignored by amici: that public pensions are protected against changes because of state law, not because of unions.[2]

Unlike state and local pension systems, public-employee collective bargaining rights did not become widespread until the 1960s and 1970s. The National Labor Relations Act excluded state and local government employees from its scope, and it took more than two decades before Wisconsin became the first state to permit public-sector collective bargaining in 1959. Joseph Slater, *Public Workers: Government Employee Unions, the Law, and the State, 1900-1962*, at 158 (2004). By 1966, only 16 states had enacted laws allowing any public

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[2] In fact, more often than not, public-sector unions cannot change their pension benefits through bargaining, because pension provisions are not the product of collective bargaining. Rather, because these benefits are established by statute, and protected against impairment by case law and state constitutional provisions, public employees typically cannot negotiate different pension formulas or benefit levels. It follows that the elimination of agency fees or even public-sector collective bargaining would have no impact on these obligations, nor would overturning *Abood* create more money for state and local governments, contrary to what amici insinuate.

employees to collectively bargain. *Id.* at 190-191. And even though most major public pension plans were established by the 1970s, by 1980, only about half of state and local government employees had the right to collectively bargain. Jeffrey H. Keefe, *Laws Enabling Public-Sector Collective Bargaining Have Not Led to Excessive Public-Sector Pay* 9 (2015), https://goo.gl/yrNGr8. As of 2010, 62.8% of state and local government workers had that right. *Id.*

California, for example, gave public employees a limited right to meet and confer over employment conditions in 1961, but the law "placed no obligation on either the employer or employees to attempt to reach an agreement on terms and conditions of employment, i.e., to negotiate in good faith." *Pac. Legal Found. v. Brown*, 624 P.2d 1215, 1219 (Cal. 1981). Over the next decade, the state took additional steps toward permitting limited forms of collective bargaining, including when Governor Ronald Reagan issued Executive Order R-25-71, directing the state and its colleges and universities to bargain with employee unions in good faith. *Id.* But notwithstanding Governor Reagan's order, it was not until 1975 that California created a comprehensive administrative scheme for public-employee collective bargaining, and even then higher-education and state employees did not have statutory collective bargaining rights until the late 1970s. *Id.*

By contrast, California created its retirement systems decades earlier, with the advent of the California State Teachers' Retirement System (CalSTRS) in 1913, CalPERS in 1932, and legislation authorizing counties to create their own retirement systems in 1937. *See* 1913 Cal. Stat. 1423; 1931 Cal. Stat. 1442; 1937 Cal. Stat. 1898.

In the case of Illinois, the state did not grant public employees collective bargaining rights until 1983, when the Illinois Public Labor Relations Act and the Illinois Educational Labor Relations Act were passed. *See* 5 Ill. Comp. Stat. 315/1-315/28 (2017); 115 Ill. Comp. Stat. 5/1-5/21 (2017); Gregory M. Saltzman, *Public Sector Bargaining Laws Really Matter: Evidence from Ohio and Illinois*, in *When Public Sector Workers Unionize* 41, 50-52 (Richard B. Freeman & Casey Ichniowski eds., 1988). Yet Illinois established its pension plans much earlier: in 1915 for its teacher pension plan, in 1939 for the municipal employees' retirement fund, and in 1944 for its state employee plan. *State and Local Retirement Plans*, *supra*, at 24, 42; *see also McFarlane v. Hotz*, 82 N.E.2d 650, 652 (Ill. 1948); 1915 Ill. Laws 649; 40 Ill. Comp. Stat. 5/14-103.03 (2017).

Thus, basic history belies the causal story told by amici, and as explained below, there are further reasons to find no relationship between fiscal health or pension funding levels and collective bargaining.

2. Underfunding Also Exists in States that Permit Free-Riding or Prohibit Public-Sector Collective Bargaining

In their effort to conflate public-sector collective bargaining and pension underfunding, amici ignore the fact that states that permit free riding by union non-members—so-called "right-to-work" states—and states that prohibit all public-sector collective bargaining experience pension underfunding. Conversely, there are also states with fair-share laws that have well-funded public pension plans.

South Carolina, for example, does not permit public-sector collective bargaining and is among 28 states without a fair-share law to prevent free riding. Nat'l Council of State Legislatures, *Right to Work Resources*, https://goo.gl/RMYubt. From the period of 1995 to 2016, that state created a $24-billion pension debt, and as of 2015, its state pension funded ratio was estimated at 58%.[3] Legislative

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[3] Government Accounting Standards Board (GASB) standards require public pensions to report certain financial information about the system's funding status, including assets and unfunded pension liabilities. Gov't Accounting Standards Bd., *Statement No. 68 of the Government Accounting Standards Board: Accounting and Financial Reporting for Pensions* 2-3 (2012). Although an imperfect measure, a retirement plan's funded percentage is used as a measure of the system's financial health. Underfunding results when the present value of promised benefits exceeds the pension plan's assets, and the so-called "annual required contribution" (ARC) represents the amounts that must be contributed to adequately fund the pension plan.

Underfunding is sometimes systematic for pension funds, as when states codify unrealistically low employer contribution rates; sometimes underfunding is episodic, as when legislators decide to cut their states' contributions to pension systems to balance the state budget during difficult fiscal times. Jack M. Beermann, *The Public Pension Crisis*, 70 Wash. & Lee L. Rev. 3, 44 (2013). In some instances, states have even withheld required pension contributions to fund tax cuts. For example, in New Jersey, in the 1990s, the state slashed its annual pension contributions in order to finance a slate of tax cuts, and recently, Governor Chris Christie withheld a $3 billion

Audit Council, *A Review of the Public Pensions Administered by the State of South Carolina* 24 (Dec. 2015), https://goo.gl/iTqdVf [hereinafter "South Carolina Report"]; The Pew Charitable Trusts, *The State Pension Funding Gap: 2015* 6, https://goo.gl/nZkd3R [hereinafter "*The State Pension Funding Gap: 2015*"]. Bad investments, poor plan structure, and intentional underfunding going back 15 years resulted in underperformance by $11 billion. South Carolina report, at 16.

Many other states that do not have fair-share requirements also suffer from similar underfunding problems. *See The State Pension Funding Gap: 2015*, *supra*, at 6 (showing Alabama funded at 67%, Arizona funded at 63%, Indiana funded at 65%, and Kansas funded at 65% as of 2015); Nat'l Council of State Legislatures, *Right to Work Resources*, https://goo.gl/JeNKML.

At the same time, states with public-sector collective bargaining and mandatory agency fees also have well-funded public pension systems. Washington State's public pension system, for example, is consistently ranked among the best-funded of any state in the country, notwithstanding the state's fair-share law. *See The State Pension Funding Gap: 2015*, *supra*, at 6; Wash. Rev. Code § 41.80.100 (2017). As of 2015, its pension system was funded at 87%. *See The State Pension Funding Gap: 2015*, *supra*, at 6. Similarly, New York State has public-sector unions and mandatory agency fees, but

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contribution to the state's pension system, while pushing for $1 billion in tax cuts. *Id.* at 44 n.151.

its public pension system was funded at 98% as of 2015. *Id.*

Pension underfunding is a complex issue, and it takes more than anecdotes to understand the causes of underfunding. As explained next, scholars who have looked at this issue find that consistent fiscal discipline, not unionization, is the key factor to understanding why some pension systems are underfunded.

3. Research Shows that Long-Term Underfunding and Outside Financial Pressures, Not Collective Bargaining, Caused Illinois' and Other States' Public Pension Challenges

Rather than unionization, the most significant factor influencing the funding status of public pension systems is whether regular, actuarially determined contributions have been made over the years. Additionally, external financial pressures such as the significant investment losses caused by the Great Recession played a large role in the current status of public pension funds.

Like the retirement savings of millions of Americans, public pensions were deeply affected by the Great Recession. Pew Center on the States, *The Widening Gap Update* 3-4 (2012). Importantly, however, public pension plans vary widely in their funding levels, and it is not true that all plans are in trouble. Munnell, *supra*, at 76. In fact, on average in 2016, pension plan funding levels reached 76.2%, up from 71.5% in 2014 and even lower in preceding years, having benefited from the rebound in the financial markets over the last several years. Nat'l Conference on Public Emp. Ret. Sys., *2016 NCPERS Public Retirement Systems Study* 4 (2016), https://goo.gl/HGs1mi.

As one of the leading scholars on public-employee pensions has shown, states with seriously underfunded plans "have behaved badly," because they "have either not made the required contributions or used inaccurate assumptions so that their contribution requirements are not meaningful." Munnell, *supra*, at 76. In other words, lack of consistent fiscal discipline by not regularly paying the full ARC and by using assumptions that tend to underestimate necessary contribution amounts, and this is true without regard to the presence of fair-share or collective-bargaining laws. Other analyses have similarly identified regular payment of the full ARC as crucial to the pension system's funding status. *See, e.g.*, State Budget Crisis Task Force, *Full Report* 36-37 (2012) (most significant reason for pension underfunding is investment earnings falling short of assumptions but "[a] very serious, non-market related, cause of pension underfunding is that some states and localities habitually have skipped or underpaid their annual required contributions"); The Pew Center on the States, *supra*, at 6 ("Keeping up with the annual required contribution is perhaps the most effective way that states can responsibly manage their long-term liabilities for public sector retirement benefits."); Fitch Ratings, *Enhancing the Analysis of U.S. State and Local Government Pension Obligations* 3 (2011), https://goo.gl/JNJdjz ("The systems that pose the greatest risks are those with significant unfunded liabilities for which the government's annual payments have been significantly less than an actuarially determined ARC over multiple years."); Jun Peng & Ilana Boivie, Nat'l Inst. on Ret. Sec., *Lessons From Well-Funded Public Pensions: An Analysis Of Six Plans That Weathered The Financial Storm* 6 (2011), https://goo.gl/CK8do2 ("The most fundamental principle in ensuring a plan achieves a 100% funding ratio is ensuring that the plan sponsors pay the entire amount of the annual required contribution (ARC) each year . . . .").

It is clear, however, that public-sector unionization is not a cause of pension underfunding. Regression analyses show that the right to collectively bargain does not have a statistically significant impact on funding or whether regular required contributions are made. Munnell, *supra*, at 83-84, 101-102. Nor does unionization have an impact on the growth in pension benefits or their generosity, although high levels of plan funding and mean reversion based on benefits provided in neighboring states can. *Id.* at 91-99.

These ideas are well illustrated by the situation in Illinois, because contrary to amici's claims, it is not public-sector collective bargaining that has caused Illinois' public pension crisis, but the repeated failure to make required contributions. Recent findings by the Illinois Supreme Court demonstrate that arguments otherwise are entirely disingenuous.

In *In Re Pension Reform Litigation*, the Illinois Supreme Court noted that inadequate funding of public pensions is not a recent experience. The problems go back nearly 100 years, to well before public employees were permitted to collectively bargain. As the court explained:

> As long ago as 1917, a report commissioned by the General Assembly characterized the condition of State and municipal pension systems as "one of insolvency" and "moving toward a crisis" because of financial provisions which were "entirely inadequate for paying the stipulated pensions when due."

In Re Pension Reform Litigation, 32 N.E.3d at 6.[4] The court also noted that the same Illinois Public Employees Pension Laws Commission sounded similar warnings in 1947, 1957, 1969, and 1970—well before collective-bargaining rights were granted in 1983. *Id.* (quoting reports that appropriations for pension funding were "below mandatory statutory requirements as expressly provided in the governing law" and "grossly insufficient"). Yet throughout this time, Illinois was funding its pensions using an approach that the United States Securities and Exchange Commission characterized as bearing "no relation to actuarial calculation," with the state's insufficient contributions being "the primary driver"

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[4] Notably, these findings do not support the proposition that "public-sector unions have helped create a situation in which the state's pension funds report a liability of more than $100 billion, at least 50% of it unfunded." *Harris v. Quinn*, 134 S. Ct. 2618, 2632 n.7 (2014) (quoting Daniel DiSalvo, *The Trouble with Public Sector Unions*, National Affairs No. 5, p. 15 (2010)).

of the increased unfunded liability. *Id.* at 8-9 (quoting *In re State of Illinois*, Securities Act Release No. 9389, 2013 WL 873208 (March 11, 2013)); *see also* Munnell, *supra*, at 117 ("Part of the problem is that Illinois got a late start on funding. Until 1981, employer contributions covered current-year pension benefits, and only employee contributions were set aside for investments.").

Nor was the concern expressed in Illinois alone. A 1979 report to Congress by the Comptroller General of the United States recounted that in Illinois, pension funding had "long been the subject of reports and recommendations" by state agencies and that "[d]espite recommendations and even statutory requirements for actuarial funding of State-level pension plans, these plans are not being funded on a full actuarial reserve basis." U.S. Gov't Accountability Office, HRD-79-66, *Funding of State and Local Pension Plans: A National Problem* 21-22 (1979).

At the same time, the funding status of the Illinois Municipal Retirement Fund (IMRF) shows that nothing about the state's pension plans is inevitable or linked to collective bargaining. In contrast to the other large Illinois pension funds, the IMRF, which covers almost 3,000 municipalities and manages approximately $35 billion in assets, is well-funded. *In Re Pension Reform Litigation*, 32 N.E.3d at 9-10 (IMRF was funded at 96.7% in 2013); *History*, Ill. Mun. Ret. Fund, https://www.imrf.org/en/about-imrf/general-information/history (last visited Jan. 15, 2018). Just like other Illinois public employees, local government workers who participate in the IMRF have collective bargaining rights, but because of consistent funding over time, it is not facing the same kind of crisis as the other major Illinois plans. Munnell, *supra*, at 5.

In their effort to blame public-sector unions for pension underfunding, amici fail to mention any of this history. Simply put, politicians in Illinois have for decades failed to properly contribute to the state's public pension systems, even though public employees continued to faithfully contribute their statutorily mandated share. The state's failure cannot be placed at the doorstep of the unions, and it certainly does not provide a reason to overturn *Abood*.

B. State and Municipal Financial Problems Are Not Due to Public-Sector Unions

1. There Is No Correlation Between Public-Sector Collective Bargaining and State Fiscal Health

It is also disingenuous for amici to claim that public-sector collective bargaining has an outsized effect on a state's budget and is therefore a burden on public entities' financial health.

Perhaps most directly, municipal bond credit ratings demonstrate that this is not the case. An analysis of municipal credit ratings found that allowing public employees to collectively bargain and charge non-members for the cost associated with union representation has no negative effect on the creditworthiness of issuers. AFSCME Dep't of

Research & Collective Bargaining Servs., *Public Sector Collective Bargaining, Fair-Share Fees and Municipal Bond Ratings* (2018), https://goo.gl/UuuYmu. In fact, the credit ratings in states with comprehensive collective bargaining laws that include fair-share fee provisions and states without such laws are essentially the same, with a slight edge in credit quality for fair-share fee states. *Id.* Moreover, the data do not suggest any meaningful effect of states' public-sector collective bargaining and fair-share fee provisions on the creditworthiness of their municipal bonds. *Id.*

Certainly there are instances in which public entities facing fiscal challenges are also jurisdictions that permit public-employee collective bargaining. However, the converse is also true, as in Kansas, which has been "right-to-work" since 1958 yet faces extreme budget shortfalls. The reality is that there is no simple story to be told that shows collective bargaining, and the authorization of agency fees, to be the cause of these financial woes.

2. The Detroit Bankruptcy Was Not Caused by Collective Bargaining

Detroit's insolvency, which amici make much of, is a clear example of how a combination of factors can build upon one another to dire effect. Although blaming the city's bankruptcy on pension obligations is attractive to those who ideologically oppose such benefits, doing so is a pretense, ignoring the complex reality of the situation. There were, in fact, multiple factors which led to Detroit's insolvency. Thomas J. Sugrue, *The Origins of the Urban Crisis: Race and Inequality in Postwar Detroit* 268-71 (2014).

First, depopulation compounded by the Great Recession caused Detroit's property and income tax revenues to plummet. Homeowners began leaving Detroit in the 1950s, and as a result Detroit's tax base steadily declined, leading to a significant revenue shortfall. *Id.* at 23. Beginning in the 1950s, the city's population fell from a high mark of nearly 2 million residents in 1950 to just 713,777 in 2010. Kate Linebaugh, *Detroit's Population Crashes*, The Wall Street Journal (Mar. 23, 2011), https://goo.gl/DMgkEb. As homeowners and jobs left the city, the city's revenue base shrunk. This came to a head during the Great Recession, and in 2008 alone the number of working Detroit residents dropped by roughly one-quarter, further diminishing the city's income tax receipts. *Id.* This decline in income tax revenue was made worse by the fact that property tax revenue declined at the same time. Detroit was hit particularly hard by the foreclosure crisis beginning around 2006, and in 2007 Detroit had a foreclosure rate of 5%, the highest foreclosure rate in the nation. Michigan State Housing Development Authority, *Michigan Foreclosure Data*, https://goo.gl/V5ZCgk. This in turn contributed to a sharp decline in property values, further diminishing property tax revenue. Lewis D. Solomon, *Detroit: Three Pathways to Revitalization* 5 (2014).

A second factor compounded the first: the state of Michigan exacerbated the problems by slashing revenue it shared with the city. At a time when the city was hardest hit, the state of Michigan cut $57 million in state revenue sharing. *Id.* These cuts accounted for nearly one third of the city's revenue losses between 2011 and 2013. Wallace C. Turbeville, Demos, *The Detroit Bankruptcy* 4 (2013). To ignore the enormous drop in revenue caused by a diminished tax base and the state of Michigan balancing its own budget at the expense of Detroit is to ignore one side of the ledger when accounting for Detroit's bankruptcy.

Being on the losing end of complex financial deals is a third factor that contributed to the bankruptcy. The biggest increase in Detroit's legacy expenses was caused by a series of complex deals it entered into in 2005 and 2006 to assume $1.4 billion in debt. *In re City of Detroit, Mich.*, 504 B.R. 97, 115 (Bankr. E.D. Mich. 2013). Instead of issuing plain general obligation bonds, the city financed its debt using certificates of participation (COPs), a financial structure that municipalities often use to get around debt restrictions. Karen Pierog, *Participants in Detroit Pension Borrowing Knew Debt Sale Was 'Iffy' – City Lawyer*, Reuters (Oct. 1, 2014), https://goo.gl/LQbGxQ. Eight hundred million dollars of these COPs carried a variable interest rate, which the city synthetically converted to a fixed rate using interest-rate swaps. The deals included provisions that allowed the banks to terminate the swaps under specified conditions and collect termination payments, which would entitle the banks to immediate payment of all projected future value of the swaps to the bank counterparties. Mary Williams Walsh, *Detroit's Casino-Tax Dollars Become Big Issue in Bankruptcy Case*, N.Y. Times, Sep. 24, 2013, at B1. The banks and insurance companies were in a far better position to understand the magnitude of these risks and they had at least an ethical duty to forbear from providing the swaps under such precarious circumstances. In the end, the banks demanded upwards of $250-350 million in swap termination payments. Curt Guyette, *Swaps, COPs, Lingering Questions in Detroit Bankruptcy*, American Civil Liberties Union of Michigan (February 05, 2014), https://goo.gl/cdyRdk. The banks exposed the city to risk it could not afford to take, furthering Detroit's insolvency.

The cost of legacy expenses was a fourth factor in the Detroit bankruptcy, and these expenses were made up of the city's debt service and financial expenses as well estimates of its future liabilities for healthcare and pension benefit payments to retirees. The city's legacy expenses increased by $62.8 million between 2008 and 2013, but a close look at these expenses reveals that the increase was driven heavily by the city's complex financial deals, not retiree benefits. Turbeville, *supra*, at 4. During that time, the city's financial expenses increased by $38.5 million, accounting for more than 60% of the total increase in legacy expenses. *Id.* Compare this to the city's pension contributions, which remained relatively flat (rising only $2 million during this time). *Id.* The city's healthcare contribution expenses increased by $24.3 million, although it should be noted that this constituted an increase of 3.25% per year. This increase came at a time when healthcare costs were rising nationally, however, and the nationwide annual increase in healthcare costs for the same period was 4%. *Id.*

In short, although no one factor alone caused Detroit's financial collapse, it is clear that Detroit's problems cannot be attributed to public pensions or collective bargaining, contrary to the claim by amici.

3. Similarly, the City of Stockton and the City of San Bernardino Did Not File for Bankruptcy Because of Collective Bargaining

The arguments attempting to blame the bankruptcies of the City of Stockton and the City of San Bernardino suffer from similar deficiencies. Amici simply cherry-picked snippets from bankruptcy records to paint a false picture of the circumstances that led to those bankruptcy filings, and then, by implication, seeks to tie those bankruptcies directly to collective bargaining and union activity. This ploy is transparent and not supported by the facts.

San Bernardino depended on property and sales taxes for its revenues and with the value of its housing stock and the disposable income of its residents both in free-fall, San Bernardino saw its revenues hemorrhage. Harold Meyerson, *Why Is San Bernardino Bankrupt?*, The American Prospect (July 13, 2012), https://goo.gl/vUenyf. In fact, commentators have noted that "[w]hat sets Stockton and San Bernardino apart is that they were at the epicenter of the California housing bubble and the California housing bust." *Id.* Indeed, "no single decision, act, group, or circumstance is entirely at fault" for Stockton's financial demise and bankruptcy. Sydney Evans, Bohdan Kosenko & Mike Polyakov, *How Stockton Went Bust: A*

California City's Decade of Policies and the Financial Crisis That Followed 2 (2012). The housing crash of 2008 exposed the City of San Bernardino to the perfect storm of devastating job losses, retail flight from the commercial center, an absentee landlord housing stock, demographics of a lower income population, and a state governor and legislature prioritizing state budget deficit reduction over local jurisdictions' budget needs. Richard Callahan & Mark Pisano, *Bankruptcy: The Divergent Cases of the City and the County of San Bernardino*, 14 Pub. Fin. and Mgmt., no. 1, 2014, at 88. Thus, amici 's attempt to place the blame for the bankruptcies of Stockton and San Bernardino on collective bargaining or pension benefits also fails.

Importantly, neither city sought, nor did the bankruptcy judges require, that either city reduce pension benefits. In Stockton, the court held that pension obligations are not impervious to impairment when a public entity files for Chapter 9 bankruptcy protection. *In re City of Stockton, Cal.*, 526 B.R. 35, 62 (Bankr. E.D. Cal. 2015). Nonetheless, the City created a bankruptcy plan which did not modify pension rights, and the bankruptcy judge deemed the plan appropriate. *Id.* Similarly, the City of San Bernardino emerged from bankruptcy without cutting pension benefits. *In re City of San Bernardino, Cal.*, 566 B.R. 46, 63 (Bankr. C.D. Cal. 2017).

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4. State and Local Governments Experience Financial Hardships and Bankruptcies for a Variety of Reasons

Because the present case is before the Court on a motion to dismiss, there is no record before the Court as to the financial effect of collective bargaining or fair-share provisions on state or local budgets. Absent a clear record, amici selectively choose data to support their conclusions, while ignoring academic research and examples from public entities that contradict their position. In reality, municipalities face financial hardship and bankruptcy for a myriad of reasons.

Moreover, public entities which do not have collective bargaining laws are no less vulnerable to financial hardship. In the case of Jefferson County, Alabama, the presence of corrupt and incompetent local officials, compounded by a credit crisis and a toxic bond system, resulted in fiscal disaster. Matthew Bigg, Melinda Dickinson, *Blame All Around For Biggest U.S. Municipal Bankruptcy*, Reuters, Nov. 10, 2011, https://goo.gl/Awme3P. As was the case in Detroit, Jefferson County fell victim to predatory lending from large financial institutions. The county borrowed $3.1 billion in 1997 from J.P. Morgan Chase and other bondholders to fund a sewage system upgrade. *Id.* In 2008, the Great Recession led to lower credit ratings for the companies that had insured the bonds, and when a deal to restructure the debt fell through, the county filed for bankruptcy. *Id.* Some of the bond deals were so corrupt that they led to twenty-one criminal convictions. *Id.* Similarly, in 2011, Boise County, Idaho sought bankruptcy protection after Developer Oaas Laney LLC won a $4 million legal judgment under the Fair Housing Act after the county placed restrictions on its attempt to build a residential treatment facility.[5] Stan Rosenberg, *Small Idaho County Files for Bankruptcy*, The Wall Street Journal, Mar. 3, 2011, https://goo.gl/Bu3uLZ. Neither of these public entities had collective bargaining laws and yet neither could escape financial ruin.

In jurisdictions that permit public-sector bargaining, unions are not the prime cause of fiscal distress. Harrisburg, Pennsylvania, for example, filed for bankruptcy after a series of fiscal disasters related to the financing of the city's trash incinerator renovation beginning in 2003. Sabrina Tavernise, *City Council In Harrisburg Files Petition Of Bankruptcy*, N.Y. Times, Oct. 12, 2011, at A17. Kansas' financial hardships are even more illustrative of this point.

Kansas, which been "right-to-work" since 1958, is currently facing extreme budget shortfalls caused by aggressive tax cuts introduced in 2012. Nat'l Council of State Legislatures, *Right to Work Resources*, https://goo.gl/RMYubt. That year, Governor Sam Brownback and the Republican majority ushered in dramatic cuts to personal income tax receipts. Russell Berman, '*You Better Learn Our Lesson*', The Atlantic, Oct. 11, 2017, https://goo.gl/MT4X5H. As part of the tax overhaul, a

[5] A bankruptcy judge rejected the filing after finding that the county failed to prove insolvency

major loophole was also introduced: taxes on companies whose owners filed their taxes as individuals were eliminated. *Id.* Thousands of businesses exploited this loophole, resulting in plummeting revenue to the state. *Id.* Since then, annual deficits have been in the range of hundreds of millions. John Hanna, *Budget Woes Have Kansas Lawmakers Struggling With Pensions*, U.S. News and World Report, March 22, 2017, https://goo.gl/9Xk2X1.

Faced with these shortfalls, Governor Brownback proposed freezing the state's annual pension contributions. *Id.* This was particularly alarming, as Kansas already had a decades-long history of shorting its contributions to meet other budget obligations, creating a long-term shortfall in funding for promised benefits. *Id.*; *see also The State Pension Funding Gap: 2015*, *supra*, at 6 (reporting Kansas total pension funding ratio of 65%). Finally, in June 2017, legislators overrode Brownback's veto of a large tax increase which was projected to generate more than $1.2 billion for the state over the next two years. Jonathan Shorman & Daniel Salazar, *Lawmakers Override Brownback Veto of Tax Increases, Rolling Back 2012 Cuts*, The Wichita Eagle, June 6, 2017, https://goo.gl/FZP5z7.

The Kansas example highlights that it is not only incorrect to blame public-sector collective bargaining or public pensions for fiscal peril, but that very often the reverse is true, and fiscal problems result in state and local governments refusing to make required contributions. Yet Kansas' present fiscal woes certainly cannot be attributed to public-sector unions or mandatory agency fees.

II. The Same Debates Over Public-Employee Pensions and Their Funding Existed at the Time of *Abood*

If this Court ends up overturning *Abood*, it should not be on the erroneous ground that we have somehow learned something new about public pensions or the impact of public-sector collective bargaining since then. This is particularly true since the *Abood* court directly considered the impact of public pensions and collective bargaining but nevertheless upheld fair-share laws. *See Abood*, 431 U.S. at 263 n.16 (Justice Powell, concurring, finding that pension issues presented "relatively insignificant" First Amendment concerns).

In fact, when Congress enacted Employee Retirement Income Security Act (ERISA) in 1974, it debated including state and local government plans within its scope, in part because of funding concerns. Munnell, *supra*, at 13. Multiple lawmakers voiced concerns when public pensions were exempted from ERISA. *See, e.g.,* H.R. Rep. No. 93-533, at 43-44 (1973) (additional view of Representative Erlenborn, stating that "public plans are notorious for their pay-as-you-go, or worse, funding" and describing lawsuits brought by teachers to address $1.7 billion in unfunded liabilities in Illinois).

ERISA did require the federal government to study the issue, and one year after *Abood* was decided, the House of Representatives Committee on Education and Labor issued a comprehensive report on public-employee retirement systems throughout the country. Noting that public-employee pensions involve "a fundamental national interest affecting the well-being and security of millions of workers and their families," the Committee found that the "alarm has been sounded on many occasions as to the inadequate funding of some public employee retirement systems." *Task Force Report* at 2, 143.

According to the Committee, even in the 1950s, concerns had been expressed about the "considerable degree of cost blindness existing in many pension plans for government employees," and the Advisory Commission on Intergovernmental Relations had likewise concluded in 1973 that "underfunded, locally administered retirement systems pose an emerging threat to the financial health of local governments." *Id.* at 143 (citations omitted); *see also* U.S. Gov't Accountability Office, *supra*, at 12 ("Funding of public pension benefits has aroused widespread interest and controversy in recent years. Much has been written on the subject.").

As Congress found, and as the above discussion about Illinois also illustrates, the same claims raised now about public-employee pensions and the fiscal health of state and local governments were part of the public consciousness and debate at the time of *Abood*. Amici are incorrect when they assert that the issues facing state and local governments are qualitatively different today, or that we have somehow learned something new since *Abood*—an error that was similarly repeated in *Harris*, 134 S. Ct. at 2632 n.7.

In fact, the problems were in many ways worse at the time of *Abood*. Public pensions did not have the consistent obligations or standards for reporting funding levels that exist now under the Governmental Accounting Standards Board, and they varied widely in their approach to funding and accounting. Seventeen percent of all public pension plans operated on a pay-as-you-go basis, without prefunding at all. *Task Force Report* at 147. Twenty-four percent of plans had never had an actuarial valuation to estimate the cost of benefits or had not done so for at least ten years. *Id.* at 144. Even among plans prefunding benefits, nearly 30% did not do so on an actuarial basis. *See id.* at 152. For instance, CalSTRS, the largest teacher pension system in the country, operated on a pay-as-you-go basis from its inception in 1913 until 1972, and it was 30% funded with \$7.8 billion in liability in 1975. CalSTRS, *The History of the CalSTRS Investment Program* 2 (2011) (presentation to the CalSTRS Investment Committee); see also U.S. Gov't Accountability Office, *supra*, at 11 (estimating that CalSTRS had \$8.6 billion in unfunded liability as of 1977).

In short, the *Abood* court was not blind to these issues: the arguments raised by Petitioners and their amici are the same here as they were then. But *Abood* found that the difference between public- and private-sector collective bargaining was not significant enough to prohibit mandatory agency fees. *Abood*, 431 U.S. at 232. Even Justice Powell noted in his concurrence that "on some narrowly defined economic issues—teachers' salaries and pension benefits, for example—the case for requiring teachers to speak through a single representative would be quite strong, while the concomitant limitation of First Amendment rights would be relatively insignificant." *Id.* at 263 n.16. If anything, public pensions have seen significant improvements in their funding and management since the time of *Abood*, and there has not been the kind of unforeseen change that amici claim.

CONCLUSION

Neither public-sector collective bargaining nor fair-share laws are responsible for the present financial situation state and local governments or their pension systems face. The insinuation that public employees or their unions are the cause of these problems is baseless, and amici's conflation of the issues obscures genuine issues that should be addressed, such as some plans' lack of fiscal discipline and the failure to make regular actuarially determined contributions. Particularly when so many working Americans lack any retirement savings and struggle with retirement insecurity, attacking public-sector workers and unions for funding problems they did not create is short-sighted and a poor reason for overturning decades of precedent. *See* Nari Rhee, Nat'l Inst. on Ret. Sec., *The Retirement Savings Crisis: Is It Worse Than We Think?* (2013).

Nor are these concerns a new phenomenon—they were debated and discussed well before *Abood* and even before state and local government employees could collectively bargain. If the Court overturns *Abood*, it should not be because of the erroneous notion that public-sector collective bargaining presents new concerns that were unforeseen at that time.

Respectfully submitted,

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