

November 6, 2006

Once Safe, Public Pensions Are Now Facing Cuts

By [MARY WILLIAMS WALSH](#)

After losing a leg in the line of duty, Dan Toneck, a San Diego police officer, spent nearly a year in rehabilitation before returning to work, doing his job for another five years with an artificial limb.

Mr. Toneck, 37, was granted a disability retirement last year after 16 years on the job. Some of his fellow officers wept as he left headquarters for the last time.

Then, 10 months later, the impossible happened. San Diego cut his pension by about 10 percent, along with those of about 180 other disabled city retirees. "They're trying to pay the bills on the backs of the employees," Mr. Toneck said.

Across the country, government workers' pensions are protected by guarantees even stouter than those on pensions in the private sector. The legal promises, often backed up by union contracts, cover more than 15 million people.

Years of supporting court interpretations have enshrined the view that once a public employee has earned a pension, no one can take it away. Even during New York City's fiscal crisis 30 years ago, no existing pension promises were reduced.

But now a number of state and local governments are quietly challenging those guarantees. Financially troubled San Diego is the highest-profile example, but a handful of states, cities and smaller government bodies have also found ways to scale back existing promises and even shrink some current payments.

While still only scattered cases, these examples may be an early warning sign of what could be coming elsewhere. As local officials take stock of unexpectedly large obligations to retired public workers, some are starting to question whether service cuts, sales of government property and politically acceptable tax increases can ever go far enough to bring things into balance.

"This is a real-life problem," said Paul S. Maco, a partner in the law firm of Vinson & Elkins who advises municipalities on the disclosure of these obligations.

Mr. Toneck said that years ago, while he was still on the police force, he saw signs that San Diego was cutting corners. He recalled having to go to Kmart to buy jumper cables for his squad car. He was not surprised to learn the city had shortchanged the municipal pension fund. But he never dreamed his pension could be reduced.

"It was guaranteed, written in stone - when I retire, I make this much and they're not going to be able to touch that," he said.

His pension was set at about \$35,000 a year. But last May, he received a letter saying he would start getting about \$31,000 instead.

He and the others on disability pensions fell victim to an ambiguously written pension statute that lawyers noticed while combing through San Diego's financial records in the wake of a pension scandal. But there do not have to be accusations of wrongdoing for a government to start looking into whether its obligations to retirees can be reduced.

Some places, including Oregon, Rhode Island, Milwaukee County and several cities and towns in Texas, have already cut public workers' pensions on the basic argument that their pension funds had gone disastrously out of balance. Whether because of investment losses, faulty calculations or other factors, these places have declared that they can no longer sustain a level of benefits that had looked affordable just a few years ago.

Beyond the sheer political difficulty of removing an existing benefit, an array of legal guarantees - some in statutes, some in state constitutions, some in city charters - were supposed to prevent such reversals. But lawyers have been finding chinks in the armor.

In Texas, the pension guarantee in the state constitution has an unusual clause, giving towns and cities the chance to hold referendums on whether to opt out.

Voters in Houston made that choice after learning that pension sweeteners issued there in 2001 were allowing some people to retire in their 40s. Others, who participated in a special program that let them simultaneously work and collect pension money in high-interest accounts, got an even better deal, sometimes walking away with one-time payments of a million dollars or more on top of their regular pensions. The city raised the eligibility requirements for retirement and cut some of the biggest sweeteners.

Oregon rolled back \$6 billion worth of public pensions in 2003, but the cuts have been snarled in legal challenges. In October, a federal appellate panel affirmed that Oregon could stop paying a guaranteed rate of 8 percent a year to participants with individual accounts. But another measure, freezing some retirees' cost-of-living adjustments, is still unresolved.

"Retirees have been in a state of turmoil," said Gregory A. Hartman, a Portland lawyer representing some of them. "They don't know what their rights are. They don't know what they're entitled to."

In Rhode Island, state workers' pensions take an unusually long time to vest, so the legislature was able to cut the planned pensions of everyone with fewer than 10 years of service, about 11,300 people.

In Wisconsin, Milwaukee County has tried to avoid legal battles by working with its eight public employees' unions after a pension scandal broke in 2001. A recall election was held and angry voters ousted seven county supervisors from office after learning they had jacked up pensions, including their own.

"This was a totally corrupt, venal deal by a bunch of politicians and their friends who figured out how to loot the treasury," said Roger H. Quindel, a county supervisor.

Even so, Milwaukee County has been able to make only marginal trims so far. Money is draining out of the pension fund so fast that the county has been contemplating the sale of some parks and an airport, along with cuts in government services. And it plans to ask for pension cuts when its labor contracts come up for renegotiation in January.

"We won't survive if we don't," Mr. Quindel said.

Wisconsin's state constitution does not specifically protect public pensions, but the county's lawyers have warned that a constitutional protection of property rights may cover pensions. The supervisors asked whether the county could shed some of its pension obligations by declaring bankruptcy, as airlines, steel companies and others have sometimes done. The lawyers said no.

In the private sector, a uniform federal pension law bars companies from reducing pensions that employees have already earned. Since pensions are built up over time, this means that if a company freezes or reduces the growth of benefits at some point, workers will earn smaller benefits going forward, but they cannot be stripped of anything they earned before the change. The only way around that rule today requires a bankruptcy judge to approve a default.

In the public sector, the protections often go further. About half of the 50 states have constitutional or statutory guarantees, said Robert D. Klausner, a lawyer in Plantation, Fla., who represents state and municipal pension plans in more than 20 states. "The day you're hired, your benefits are locked in at a minimum level," he said. If a government wants to cut pensions, it cannot apply the cuts to people already in the work force, as a corporation can. It can only apply them to new hires, he said.

Governments are also studying the guarantees on retiree health benefits because of a new accounting rule that is now requiring them to calculate, for the first time, the total value of the health benefits they have promised to retirees.

The numbers now being disclosed are daunting. Mercer Human Resource Consulting estimates that when all the calculations are done, the nation's states and cities will find they have promised a total of about \$1.4 trillion, said Derek Guyton, a senior consultant.

Little, if any, money has been set aside to fulfill these obligations.

Mr. Maco, the Vinson & Elkins lawyer, said he feared that many towns and cities, particularly in places like upstate New York and along the Great Lakes, were about to discover that years of factory closings and job losses had eroded their tax bases so much that they had no realistic way to pay their full bills.

"The steel industry can shut down and close its plants, but that's hard for local governments," Mr. Maco said. After industries move away, the retired teachers and firefighters will still be there.

Pension funds can normally operate for many years with a shortfall, because they have investments to call upon and pensions are paid out slowly. But health claims, with little or no money set aside to pay them, can come due right away.

Some government agencies, like Chicago's municipal bus and rail authority, have set up a potentially explosive situation by arranging their retiree health claims to be paid directly out of their pension funds. "The taxpayers need to understand the seriousness of our situation," said Laurence Msall, president of the Civic Federation, a nonpartisan research group in Chicago. "It's not a far-off crisis."

San Diego's municipal pension fund was also responsible for retiree health care. But when the city's pension scandal broke, officials separated the health obligations.

"Now we're looking at a \$3.1 billion debt, and \$1.4 billion is health and \$1.7 billion is pension," said Michael Aguirre, the city's independent attorney.

He is now in court, leading an unusually aggressive initiative to cut the city's pension obligations, arguing that benefits granted in 1996 and 2002 were issued illegally and must be annulled.

California law protects public pensions, but Mr. Aguirre is arguing that those protections conflict with other laws that govern the actions of public officials, which he says San Diego pension trustees violated. If the court agrees with him, the benefits owed to San Diego's roughly 15,000 city workers and retirees could go back to the level before the 1996 increase - a total reduction of some \$500 million to \$700 million.

Mr. Toneck, the disabled San Diego police officer, is not directly affected by Mr. Aguirre's case. He has petitioned the San Diego city council to reverse the cut in his pension, arguing that workers disabled on the job are the last people who should pay for a mistake that was caused by an ambiguity in the law.

The council has referred his petition to Mr. Aguirre, who is busy with the broader case.

Meanwhile, Mr. Aguirre said San Diego still had not developed a plan for paying all of its obligations, whatever the courts ultimately rule. He said he might ultimately have to try bankruptcy court.

"There's no good option," he said. "It's only painful."