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A SKUNK AT A GARDEN PARTY: REMEDIES FOR PARTICIPANTS IN STATE AND LOCAL PENSION PLANS

RIDGELEY A. SCOTT*

I. INTRODUCTION

Legislators who want to spend more money than is available prefer to obtain the difference by a method other than raising taxes.[1] Pension trusts for public employees are especially inviting because they frequently have substantial assets.[2] When legislators remove funds from pension trusts,[3] they leave the trusts in a weakened condition, forcing fund administrators to make suspect loans.[4]

The current trend is to make indirect removals.[5] Approaches include terminating all[6] or part[7] of the plan; reducing benefits;[8] and, suspending,[9] postponing[10] or reducing[11] contributions by the employer. Legislators may also increase contributions by participants.[12] While some of the activities are accompanied by an explanation, other legislative bodies do not attempt to justify the action.[13]

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1. Dadisman v. Moore, 384 S.E.2d 816, 828-29 (W. Va. 1988).

2. Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 799 (1993).

3. Sklodowski v. Illinois, 642 N.E.2d 1180, 1181-83 (Ill. 1994); *Dadisman*, 384 S.E.2d at 826; I.R.S. and N.J., Agreement as to Final Determination of Tax Liability and Specific Matters (Mar. 22, 1996) (on file with author) [hereinafter I.R.S. and N.J.]; *A Wobbly California Giant*, ECONOMIST, May 30, 1992, at 75.

4. Withers v. Teachers' Retirement Sys., 447 F. Supp. 1248, 1255-56 (S.D.N.Y. 1978), *aff'd without op.*, 595 F.2d 1210 (2d Cir. 1979); Philadelphia Lodge No. 5, Fraternal Order of Police v. Philadelphia Bd. of Pensions and Retirement, No. 5224 slip op. at 9 (Dec. Term, 1990), *appeal denied*, 606 A.2d 603 (Pa. Commw. Ct. 1992).

5. Romano, *supra* note 2, at 802-03.

6. Pennie v. Reis., 132 U.S. 464, 471 (1889); *A Wobbly California Giant*, *supra* note 3.

7. Calabro v. City of Omaha, 531 N.W.2d 541, 551 (Neb. 1995).

8. Dodge v. Board of Educ., 302 U.S. 74, 75 (1937); Alston v. City of Camden, 471 S.E.2d 174, 176 (S.C. 1996); *A Wobbly California Giant*, *supra* note 3.

9. Dadisman v. Moore, 384 S.E.2d 816, 822-23 (W. Va. 1988).

10. Board of Admin. of the Pub. Employees' Retirement Sys. v. Wilson, 61 Cal. Rptr. 2d 207, 213-16 (Cal. Ct. App. 1997).

11. McDermott v. Regan, 624 N.E.2d 985, 986-88 (N.Y. 1993); Kleinfeldt v. New York City Employees' Retirement Sys., 324 N.E.2d 865, 868-69 (N.Y. 1975); *A Wobbly California Giant*, *supra* note 3.

12. Pennsylvania Fed'n of Teachers v. School Dist., 484 A.2d 751, 752-53 (Pa. 1984).

13. *See Dadisman*, 384 S.E.2d at 822-23.

The availability of remedies for participants is uncertain. Where contributions have been reduced or eliminated, the question is whether the government has an enforceable obligation to make contributions in an ascertainable amount. In states which provide express constitutional protection for pensions,[14] some courts will enforce the obligation.[15]

State and local governments generally are liable for their agreements under the obligations of the Contracts Clause.[16] Some courts find there is an enforceable agreement.[17] Others have focused on the idea of permitting legislators to do whatever they would prefer, and go out of their way to avoid finding a contract.[18]

The government cannot take property without due process.[19] Where there is no contract, the courts usually conclude that participants have a property interest in the plan. This approach does not provide much comfort to participants since most courts conclude that the only requirements for modifying an interest in a plan is notice and an opportunity to be heard on a proposed change.[20]

Money damages is the usual remedy for a breach of contract or a taking of property without due process.[21] Equitable remedies are available if money damages are an inadequate remedy.[22] Executive and legislative authorities have been ordered to make the contributions necessary to satisfy actuarial standards.[23]

The remaining question is the relationship of the participant to trust funds. Governments frequently argue that they own trust assets because they contributed the money.[24] This position is nonsense unless the trust agreement contains an express reservation which permits the government to recover the funds.[25]

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14. *See* N.Y. CONST. art. V, § 7.

15. *Kleinfeldt*, 324 N.E.2d at 868-69; *McDermott*, 624 N.E.2d at 986-90.

16. United States Trust Co. v. New Jersey, 431 U.S. 1, 17-18 (1977).

17. Board of Admin. of the Pub. Employees Retirement Sys. v. Wilson, 61 Cal. Rptr. 2d 207, 226 (Cal. Ct. App. 1997).

18. Spiller v. State, 627 A.2d 513, 516-17 (Me. 1993); Pierce v. State, 910 P.2d 288, 304-05 (N.M. 1995).

19. U.S. CONST. amend. XIV, § 1.

20. *Pierce*, 910 P.2d at 304.

21. E. ALLAN FARNSWORTH, CONTRACTS § 12.4, 850 (2d ed. 1990).

22. *Id.*

23. Dadisman v. Moore, 384 S.E.2d 816, 828-29 (W. Va. 1988); *see also* Board of Admin. of the Pub. Employees Retirement Sys. v. Wilson, 61 Cal. Rptr. 2d 207, 216 (Cal. Ct. App. 1997); Kleinfeldt v. New York City Employees' Retirement Sys., 324 N.E.2d 865, 868-69 (N.Y. 1975).

24. *See, e.g.*, I.R.S. and N.J., *supra* note 3.

25. GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS & TRUSTEES § 42, at 431-33 (2d ed. 1984). *See, e.g., Dadisman* 384 S.E.2d at 825-26.

The right to use trust assets is a related problem. Governments may seek to borrow trust funds because they are unable to borrow elsewhere.[26] An alternative is making loans available to others. Governments may establish programs to develop the local economy[27] and for other socially conscious reasons.[28] However, if the funds do not belong to the government, the government is not entitled to a preferred status for obtaining loans, or for making loans available to others.

Government plans that desire the benefits of qualification for tax purposes must satisfy the pre-Employee Retirement Income Security Act (ERISA) qualification requirements. If the government has the right to modify fund components such as benefits and contributions, the plan does not qualify since it fails the definiteness requirement.[29] Hence, the plan is subject to tax on its income,[30] and holders of vested interests receive income each time the government makes a contribution to the plan.[31]

Qualified plans are subject to prohibited transaction rules. The plan loses its tax exemption[32] if loans to the government do not satisfy the rules. The loan must be based on a bona fide debtor-creditor relationship, bear a reasonable rate of interest, and be backed by adequate security.[33]

The utility of the qualification rules is uncertain because the IRS usually avoids enforcement actions against government plans.[34] Participants can sue for a declaration that the plan is not qualified.[35] If the IRS does not enforce a declaration, participants might be able to force it to perform its duty.[36] The greatest prospect of success may be political pres-

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26. *See, e.g.*, Withers v. Teacher's Retirement Sys., 447 F. Supp. 1248, 1255-56 (S.D.N.Y. 1978), *aff'd without op.*, 595 F.2d 1210 (2d Cir. 1979); Philadelphia Lodge No. 5, Fraternal Order of Police v. Philadelphia Bd. of Pensions and Retirement, No. 5224 slip op. at 9 (Dec. Term, 1990), *appeal denied*, 606 A.2d 603 (Pa. Commw. Ct. 1992).

27. James A. White, *Picking Losers, Back-Yard Investing Yields Big Losses, Roils Kansas Pension System—But Idea of Using Such Funds to Help Local Industries Still Intrigues Politicians—Now a Steel Mill is Sitting*, WALL ST. J., Aug. 21, 1991, at A1. The idea appealed to the S.B.A., which commissioned a report. M&R Assoc., Pension Funds and Small Firm Financing (1995) (on file with author).

28. Romano, *supra* note 2, at 810-12; Cindy Skrzycki, *The Regulators: Targeting a Pension Policy To GOP, 'Targeted Investments' Are Just Retiree Robbery*, WASH. POST, June 2, 1995, at F1; Jim Saxton, *A Raid on America's Pension Funds*, WALL ST. J., Sept. 29, 1994, at A12.

29. South Texas Commercial Nat'l Bank v. Commissioner, 7 T.C. 764, 767 (1946), *aff'd*, 162 F.2d 462 (5th Cir. 1947).

30. I.R.C. § 501(a) (1994).

31. Treas. Reg. § 1.402(b)-1(a)(1) (1978).

32. I.R.C. § 503(a)(1)(B) (1994).

33. I.R.C. § 503(b)(1) (1994).

34. *Public Employee Pension Benefit Plans: Joint Hearing Before the House Subcomm. on Oversight of the House Comm. on Ways and Means and the Subcomm. on Labor-Management Relations of the House Comm. on Educ. & Labor*, 98th Cong. 165 (1983) (statement of S. Allen Winborne, Ass't Commissioner of Internal Revenue) [hereinafter *Joint Hearing*].

35. I.R.C. § 7476 (1994).

36. *See, e.g.*, Vishnevsky v. United States, 581 F.2d 1249 (7th Cir. 1978).

sure generated by the possibility that participants will pay taxes on contributions.

The probability that financially troubled governments will continue to try to solve their problems by reducing or eliminating financial support for pension programs combined with the uncertainty of enforcement of those programs underline the need for legislation. Proposals designed to subject plans to a modest set of definite rules[37] have been defeated by intense lobbying of state and local governments.[38]

The principal theme has been that the requirements would unnecessarily increase the cost of providing pensions.[39] That argument is difficult to accept since many state and local governments have not taken the trouble to determine what the cost of their programs might be.[40] A much more likely explanation is that legislators do not like the idea of being forced to make unexpectedly large payments to deliver benefits which have been promised. Legislators also want to retain the ability to reduce benefits in order to deal with financial problems.

This article covers the possibilities for enforcement of pension promises against state and local governments. The discussion begins with state law actions, continues with tax rules, and ends with the possibility for legislation analogous to ERISA. The conclusion argues that legislation is the only way to force many governments to reasonably honor their commitments.

II. DIRECT REMEDIES

A. *Introduction*

Employees of state and local governments expect pensions because of their common use as one of the inducements used to attract and retain employees.[41] Enforcement of the expectation is another matter. State law frequently is silent about the nature of the interest held by participants,[42] and many courts are reluctant to find enforceable rights.[43]

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37. *See, e.g.*, H.R. 14138, 95th Cong. (1978).

38. Ridgeley A. Scott, *Misuse of Public Pension Assets: White Collar Crimes and Other Offenses*, 26 IND. L. REV. 589, 590 (1993).

39. *Id.*

40. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEM 63-64, 180-81 (Comm. Print 1978).

41. Hammon v. Hoffbeck, 627 P.2d 1052, 1056-57 (Alaska 1981); Calabro v. City of Omaha, 531 N.W.2d 541, 548-49 (Neb. 1995); Jaennont v. New Hampshire Personnel Comm'n, 392 A.2d 1193, 1196 (N.H. 1978).

42. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 80 (Comm. Print 1978).

43. *See* Spiller v. State, 627 A.2d 513 (Me. 1993); Pierce v. State, 910 P.2d 288 (N.M. 1995).

The classification of pension rights generally is a matter of state law.[44] Some courts find that pension legislation creates contracts,[45] while others conclude that interests in receiving benefits are property rights.[46] Enforcement of property rights may be more uncertain than enforcement of contract rights.[47]

Politics is the reason for the lack of agreement over the nature and extent of the interest of a participant.[48] Judges who conclude that there is an agreement which cannot be unilaterally altered[49] are not be sympathetic to legislative problems. Those who find there is no enforceable right[50] are not be concerned with the needs of participants. Intermediate positions reflect attempts to reconcile the competing interests.

The availability of remedies usually is governed by the nature of the right. The enforcement of contract and property rights generally is limited to money damages, although circumstances may justify extraordinary remedies such as an injunction.[51] The availability of remedies also may be affected by the fact that the defendant is a government.[52]

B. *Plans*

There are three general categories of pension rights. One is the terms and conditions of the plan prior to retirement, which includes the amount of contributions by the employer and the participant, requirements for receipt of benefits, and the amount of benefits.[53] Another is the terms and conditions of the plan after retirement, which includes the amount of

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44. *See* Bishop v. Wood, 426 U.S. 341, 344-47 (1976); *see also* Alston v. City of Camden, 471 S.E.2d 174, 177-78 (S.C. 1996).

45. *Calabro*, 531 N.W.2d at 551-52.

46. *Pierce*, 910 P.2d at 299.

47. *Id.* at 299-304; *Spiller*, 627 A.2d at 515-17; Peter Rehon, *The Pension Expectation as Constitutional Property*, 8 HASTINGS CONST. L.Q. 153, 163-67 (1980); Note, *Public Employee Pensions in Times of Fiscal Distress*, 90 HARV. L. REV. 992, 1002-03 (1977) [hereinafter Note, *Public Employee Pensions*].

48. Kosa v. Treasurer of the State, 292 N.W.2d 452, 454-55 (Mich. 1980); *see also* Dadisman v. Moore, 384 S.E.2d 816, 828 (W. Va. 1989).

49. Yeazell v. Copins, 402 P.2d 541, 546 (Ariz. 1965); *see also* Pennsylvania Fed'n of Teachers v. School Dist., 484 A.2d 751, 753-54 (Pa. 1984).

50. *See* Board of Trustees of Firemen's Pension v. Behrman, 203 P.2d 490, 492-93 (Colo. 1949), *overruled in part*, Police Pension and Relief Bd. v. McPhail, 338 P.2d 694 (Colo. 1959).

51. *See Dadisman*, 384 S.E.2d at 829, 832.

52. Musselman v. Governor, 533 N.W.2d 237, 245-46 (Mich. 1995), *reh'g granted*, 535 N.W.2d 346 (1995), *on reh'g*, 545 N.W.2d 346 (1996).

53. *See* STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 43-46 (Comm. Print 1978); 3 EUGENE MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS §§ 12.141-12.172 (3d ed. 1990) (discussing pensions, benefits, and insurance); Rubin G. Cohn, *Public Employee Retirement Plans—The Nature of the Employees' Rights*, 1968 U. ILL. L.F. 32 (1968) (criticizing courts' willingness to apply labels in analyzing pension fund situations); Deborah Kemp, *Public Pension Plans: The Need for Federal Regulation*, 10 HAMLINE L. REV. 27, 47-52 (1987) (outlining the characteristics of Public Employee Retirement Systems).

contributions by the employer, the amount of benefits, and limitations on the right to continue receiving benefits.[54]

The third category is rights in plan assets.[55] Participants own a property right in the assets held in trust.[56] While this right may achieve protection of trust assets,[57] it usually is not a ground to force the government to make adequate contributions.[58] Sometimes the circumstances obligate the trustees to take legal action to obtain adequate contributions.[59]

C. *Expectations of the Parties*

When state and local governments seek to attract prospective employees, one of the inducements offered is pension benefits.[60] Recruitment materials often describe pensions in terms of the monthly amount which participants can expect after a certain number of years on the job.[61] This leads participants to think that the benefit is part of the compensation for work performed.[62]

Employment contracts confirm the impression that pension benefits are compensation.[63] Many contracts go further by requiring employee contributions as one source of funding retirement benefits.[64] Materials furnished by the employer to supplement the contracts frequently outline the terms of the plan including a description of the monthly amount which participants can expect after a certain number of years on the job.[65]

Legislators have a different viewpoint. There is little or no advance planning devoted to the establishment or modification of most retirement programs.[66] The atmosphere is political, and problems such as how to pay the costs or who will pay the costs are not carefully considered.

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54. *See* Lea E. Selleck, *Post-Retirement Employment Restrictions on Public Employees in Kansas*, 5 KAN. J.L. & PUB. POL'Y 199 (1996).

55. New Jersey claimed it was the owner of the corpus of pension trusts and had the right to remove assets. I.R.S. and N.J., *supra* note 3; Scott, *supra* note 38, at 589.

56. Scott, *supra* note 38, at 597.

57. BOGERT & BOGERT, *supra* note 25, § 42.

58. *See* Rehon, *supra* note 47.

59. Dadisman v. Moore, 384 S.E.2d 816, 825-26 (W. Va. 1988).

60. Kern v. City of Long Beach, 179 P.2d 799, 803 (Cal. 1947).

61. *See* Hammond v. Hoffbeck, 627 P.2d 1052, 1056-57 (Alaska 1981); Jaennont v. New Hampshire Personnel Comm'n, 392 A.2d 1193, 1195-96 (N.H. 1978).

62. Nash v. Boise City Fire Dept., 663 P.2d 1105, 1107 (Idaho 1983); Duella v. Massachusetts Bay Transp. Auth., 421 N.E.2d 1228, 1233 n.9 (Mass. App. Ct. 1981).

63. Police Pension and Relief Bd. v. McPhail, 338 P.2d 694, 698-99 (Colo. 1959); *Hammond*, 627 P.2d at 1056-57; *Dadisman*, 384 S.E.2d at 829.

64. Pennsylvania Fed'n of Teachers v. School Dist., 484 A.2d 751, 753 (Pa. 1984); *McPhail*, 338 P.2d at 698-99.

65. Information of this sort frequently is repeated and embellished by benefits officials. *See* Alston v. City of Camden, 471 S.E.2d 174, 179 (S.C. 1996).

66. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG. PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 80 (Comm. Print 1978).

Legislators even seem to be unaware of the fact that if one program is made more generous, participants in other programs will seek similar terms.[67]

Legislative programs generally can be modified at any time.[68] Legislators usually avoid expressly committing their successors to continue a definite program,[69] and they feel free to change their spending priorities at any time. There may be no legal remedy available to those who lose all or some of what they were entitled to receive under an existing program.[70] Faced with budget shortfalls, many legislative bodies have reduced contributions[71] or removed assets from plans to balance their budgets.[72]

D. *Gifts*

Early decisions relied on the feudal doctrine that a pension was a gift from the king[73] which could be modified or terminated at any time.[74] After the Supreme Court suggested that participants acquired a vested interest when payments became due,[75] many courts concluded there was a mere expectancy prior to retirement.[76]

Gift classification may make the plan illegal where gifts of public money are prohibited.[77] One court avoided the problem by concluding that pension contributions were payments for services even though the legislature could modify or terminate the plan at any time.[78] Another found

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67. *Id.* at 63-64.

68. Spina v. Consolidated Police & Firemen's Pension Fund Comm'n, 197 A.2d 169, 172-73 (N.J. 1964); *Alston*, 471 S.E.2d at 177-78.

69. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 80 (Comm. Print 1978).

70. City of Dallas v. Trammell, 101 S.W.2d 1009, 1013 (Tex. 1937). *See* STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 80 (Comm. Print 1978).

71. Governor Whitman's plan to balance the New Jersey budget and reduce state income taxes included substantial reductions in state contributions. Bob Herbert, *Whitman Steals the Future*, N.Y. TIMES, Feb. 22, 1995, at A19.

72. Governor Florio removed assets from the New Jersey plan to balance the budget. I.R.S. and N.J., *supra* note 3.

73. Hickey v. Pension Bd., 106 A.2d 233, 235 (Pa. 1954). *See also* Nash v. Boise City Fire Dep't, 663 P.2d 1105, 1106 (Idaho 1983); *see* Note, *Public Employee Pensions*, *supra* note 47, at 992. The idea is so fantastic that one court observed that the "label 'gratuity' could never have been taken with sober literalness." Opinion of the Justices, 303 N.E.2d 320, 327 (Mass. 1973).

74. Pecoy v. City of Chicago, 106 N.E. 435, 436 (Ill. 1914).

75. Dodge v. Board of Educ., 302 U.S. 74, 80-81 (1937); Pennie v. Reis., 132 U.S. 464, 471 (1889); *see* Flemming v. Nestor, 363 U.S. 603 (1960).

76. Haverstock v. Public Employees' Retirement Fund, 490 N.E.2d 357, 361 (Ind. Ct. App. 1986); Cook v. Employees' Retirement Sys., 514 S.W.2d 329, 331 (Tex. Civ. App. 1974, writ ref'd n.r.e.).

77. *See* ARIZ. CONST. art. IX, § 7; N.J. CONST. art. VIII, § 3, ¶3.

78. Spina v. Consolidated Police and Firemen's Pension Fund Comm'n, 197 A.2d 169, 175 (N.J. 1964).

that contributions were not donations because they induced state employees to remain on the job.[79]

E. *State Constitutions*

Five states provide express protection for public pension obligations.[80] After the New York courts concluded they could be modified or terminated at any time,[81] the state constitution was amended to protect pension rights.[82] Since an employee received an enforceable right at the moment he became a participant,[83] the constitution provided that the legislature could not reduce benefits[84] and contributions,[85] remove funds from the trust, or order the trust to make loans to the government.[86] On the other hand, a federal court approved a trustee's decision to make suspect loans because failure to make the loans might cause termination of the plan.[87] This approval may have been a political decision.[88]

Interpretation of the other constitutions is not uniform. The Illinois provision was modeled after the New York rule,[89] and the courts found that the legislature cannot reduce benefits.[90] However, the amount of protection

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79. The payments were not classified as payments for services. Fraternal Order of Firemen v. Shaw, 196 A.2d 734, 736 (Del. 1963).

80. *See* Darryl B. Simko, *Emerging Issues in State Constitutional Law of Public Pensions, State Constitutional Contract Protection, and Fiscal Constraint*, 69 TEMPLE L. REV. 1059 (1996).

81. Roddy v. Valentine, 197 N.E. 260, 262 (N.Y. 1935).

82. N.Y. CONST. art. V, § 7; *see* McDermott v. McDermott, 507 N.Y.S.2d 390, 396 (N.Y. App. Div. 1986).

83. Birnbaum v. New York State Teachers' Retirement Sys., 152 N.E.2d 241, 245 (N.Y. 1958).

84. *McDermott*, 507 N.Y.S.2d at 398-99; Kleinfeldt v. New York City Employees' Retirement Sys., 324 N.E.2d 865, 868-69 (N.Y. 1975).

85. McDermott v. Regan, 624 N.E.2d 985, 987 (N.Y. 1993).

86. Sgaglione v. Levitt, 337 N.E.2d 592, 594 (N.Y. 1975).

87. Withers v. Teachers' Retirement Sys., 447 F. Supp. 1248, 1259 (S.D.N.Y. 1978), *aff'd without op.*, 595 F.2d 1210 (2d Cir. 1979). The Pennsylvania courts reached the same decision when Philadelphia was on the edge of bankruptcy. *See generally* Scott, *supra* note 38, at 603 (discussing Philadelphia's fiscal crisis during Mayor Wilson Goode's administration).

88. Marc Gertner, *Fiduciary Responsibility of Public Employee and Employer Representatives*, 6 J. OF PENSION PLANNING & COMPLIANCE 83, 94 (1980).

89. *Compare* ILL. CONST. art. XIII, § 5 (stating that membership in a pension or retirement system of "the State, any unit of local government or school district, or any agency or instrumentality thereof" shall be an "enforceable contract"), *with* N.Y. CONST. art. V, § 7 (stating that membership in a pension or retirement system of "the state or of a civil division thereof" shall be a "contractual relationship"), People *ex rel.* Sklodowski v. State, 642 N.E.2d 1180, 1193 (Ill. 1994) (recognizing that New York courts consistently interpreted the protections to "shield the source of funds for benefits not yet realized"), Kraus v. Board of Trustees of the Police Pension Fund, 390 N.E.2d 1281, 1288 (Ill. App. Ct. 1979) (recognizing that the Illinois legislature was aware of New York's comparable constitutional provision, but that even then, some legislators were unsure of the provision's implications). *See* Loren Oury, Comment, *Public Employee Pension Rights and the 1970 Illinois Constitution: Does Article XIII, Section 5 Guarantee Increased Protection?*, 9 J. MARSHALL J. OF PRACTICE & PROCEDURE 440 (1976).

90. *See, e.g.*, Felt v. Board of Trustees of the Judges Retirement Sys., 481 N.E.2d 698, 699-700 (Ill. 1985).

is smaller because the funding needed to provide actuarial soundness is not required,[91] and funds can be removed from a pension trust to balance the budget.[92] Hence, the Illinois courts are willing to let political expediency override the constitution.[93]

While the Alaska, Hawaii and Michigan constitutions[94] protect accrued benefits, their courts sometimes permit modifications of conditions for future benefits.[95] Although Michigan cities must provide adequate funding,[96] the requirement is not enforceable against the state because the courts would not order the legislature to appropriate money.[97] On the other hand, Michigan could not transfer funds from a trust to balance the budget.[98] There are no reported Alaska or Hawaii decisions on the funding issue.

The decisions give the distinct impression that the courts are hostile to the rules. Most courts are unwilling to force politicians to honor their commitments even where state constitutions establish substantive rights.[99]

F. *Statute or Ordinance*

Rights may be contained in various sorts of legislation.[100] Funding provisions have been upheld where a statute required the governor to keep a plan financially sound,[101] and a home rule charter required a city to keep a plan actuarially sound.[102]

Courts also may enforce funding requirements appearing in the legislation creating the plan. One statute contractually obligated the legislature to make monthly payments to the plan,[103] and another called for contributions needed to maintain actuarial soundness.[104]

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91. *See* People *ex rel.* Illinois Federation of Teachers v. Lindberg, 326 N.E.2d 749 (Ill. 1975).

92. *See generally Sklodowski*, 642 N.E.2d at 1180 (allowing state officials to transfer money from pension funds to the state's general revenue fund by refusing to grant beneficiaries' motions and denying appeal).

93. *Id.* at 1194.

94. ALASKA CONST. art. XII, § 7; HAW. CONST. art. XVI, § 2; MICH. CONST. art. IX, § 24.

95. *See* Hammond v. Hoffbeck, 627 P.2d 1052, 1057 (Alaska 1981); Chun v. Employees' Retirement Sys., 607 P.2d 415, 421 (Haw. 1980); *In re* Enrolled Senate Bill 1269, 209 N.W.2d 200, 202-03 (Mich. 1973).

96. *See* Shelby Township Police and Fire Retirement Bd. v. Charter Township of Shelby, 475 N.W.2d 249, 250 (Mich. 1991).

97. Musselman v. Governor, 553 N.W.2d 237, 246 (Mich. 1995). *See generally* Allison Weathersby, *Government Law*, 42 WAYNE L. REV. 955, 977-85 (1996) (discussing *Musselman*).

98. *Musselman*, 533 N.W.2d at 246.

99. *Id.*; Withers v. Teachers' Retirement Sys., 447 F. Supp. 1248, 1260 (S.D.N.Y. 1978), *aff'd without op.*, 595 F.2d 1210 (2d Cir. 1979); Gertner, *supra* note 88, at 94.

100. *See generally* Kemp, *supra* note 53 (discussing differences in pension plan benefits).

101. Weaver v. Evans, 495 P.2d 639, 649-50 (Wash. 1972).

102. Dombrowski v. City of Philadelphia, 245 A.2d 238 (Pa. 1968).

103. Board of Admin. of the Pub. Employees' Retirement Sys. v. Wilson, 61 Cal. Rptr. 2d 207 (Cal. Ct. App. 1997); Valdes v. Cory, 189 Cal. Rptr. 212, 223 (Cal. Ct. App. 1983).

104. Dadisman v. Moore, 384 S.E.2d 816 (W. Va. 1989).

Either type of right may be illusory since elected officials may change legislation without any obligation to continue a former program, or to continue it on the same terms. Hence, enforcement of a plan may be denied if the legislature modified or repealed the legislation.

Legislation may create an obligation that cannot be unilaterally altered. The legislation creates this obligation if there is either an express contract requiring maintenance of the plan,[105] or the circumstances are sufficient to constitute a contract.[106] For example, where an employee has the choice to enter the system, most courts find that this consent creates a contract right which vests at the time of entry.[107] Where the plan requires participation, many courts conclude there is a mere expectancy prior to retirement.[108]

The rights under a contract may be less than one might expect. One court found that the term "contract" was a label meaning that the material expectations of the employees should in substance be respected.[109] The court suggested that retirement plans for public employees do not readily submit themselves to analysis under accepted principles of contract law, which typically require mutually assenting individuals to form a specific bargain.[110] One of the accepted principles of contract law involves continuing unilateral offers. An enforceable contract arises between the person who made the offer and everyone who satisfies the conditions and accepts the offer.[111]

The distinction between voluntary and mandatory participation is difficult to justify. Prospective employers typically offer employment on specified terms and conditions. If participation in a mandatory pension plan is part of the arrangement, acceptance of employment constitutes

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105. The contract might be an individual employment agreement or a collectively bargained arrangement for a group of people.

106. Weaver v. Evans, 495 P.2d 639, 648 (Wash. 1972). *See generally* David Kopilak, Recent Development, Hughes v. State*: Breaching Statutory Contracts Without Violating Oregon's Contract Clause*, 72 OR. L. REV. 487 (1993) (discussing *Hughes*, where the Oregon Supreme Court held that PERS was a binding contract between the state and its employees and that such contract included a statutory state tax exemption).

107. Barden v. Board of Trustees of Judges Retirement Sys., 174 N.E.2d 168, 170 (Ill. 1961). *But see* Haverstock v. State Pub. Employees Retirement Fund, 490 N.E.2d 357, 360-61 (Ind. Ct. App. 1986).

108. Pierce v. State, 910 P.2d 288, 297 (N.M. 1995). The fact that the employee was required to contribute to the plan did not change the result. *Haverstock*, 490 N.E.2d at 360-61.

109. Opinion of the Justices, 303 N.E.2d 320, 327-28 (Mass. 1973).

110. *Id.*; *see* Spina v. Consolidated Police and Firemen's Pension Fund Comm'n, 197 A.2d 169, 176 (N.J. 1963) (finding the concept of contract was inadequate and concluding that a pension plan was merely legislative policy).

111. Oregon State Police Officers' Ass'n v. State, 918 P.2d 765, 773-74 (Or. 1996); 1 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 3.9 (Joseph M. Perillo ed., rev. ed. 1993); SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 6:31 (Richard A. Lord ed., 4th ed. 1991).

agreement to the burdens and benefits of the plan. Hence, the transaction certainly has the appearance of assent to a specific pension bargain.[112]

Requiring employee contributions[113] is an additional ground for concluding that there is a contract. Where the employee's consent to join the plan includes an agreement to place part of his pay in the plan, he has good reason to expect a pension in return for his investment in the plan.[114]

Suggesting that employee contributions are not contributions because money is merely transferred from one public account to another[115] does not withstand analysis. Since the transaction would not occur but for the employee's services, the employee earned the money. The fact that the plan requires contributions and the money never comes into the possession of the employee does not change the fact that the employee contributed part of the compensation to his plan.[116]

Pension plans usually give a participant credit for his contributions.[117] It would be especially difficult to argue that the employee did not make a contribution if the plan confirms the existence of a benefit to the employee from his mandatory contributions.[118]

The general nature of the transaction leads to the same conclusion. Federal[119] and state[120] tax laws agree that mandatory contributions constitute compensation, which is taxable to the employee. Several cases involve federal employees whose wages were reduced by contributions. The fact the contributions were mandatory and the money was merely transferred from one public account to another did not alter the government's conclusion that employees received the contributions for state income tax purposes.[121]

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112. Dryden v. Board of Pension Comm'rs, 59 P.2d 104, 106 (Cal. 1936); Calaboro v. City of Omaha, 531 N.W.2d 541, 548-49 (Neb. 1995); *Oregon State Police Officer's Ass'n.*, 918 P.2d at 773.

113. Eighty-five percent of employees are required to make contributions. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 138 (Comm. Print 1978).

114. Hogan v. United States, 513 F.2d 170, 174 (6th Cir. 1975); Police Pension and Relief Board v. McPhail, 338 P.2d 694, 699-701 (Colo. 1959); Witte v. Director of Revenue, 829 S.W.2d 436, 441 (Mo. 1992).

115. Pennie v. Reis., 132 U.S. 464, 471-72 (1889).

116. *McPhail*, 338 P.2d at 698-701; *Hogan*, 513 F.2d at 174; *Witte*, 829 S.W.2d at 441.

117. An interest in an ERISA plan must always be 100% vested for accrued benefits from employee contributions, while benefits from employer contributions may be less than 100% vested. I.R.C. § 411(a)(1)-(2) (1994).

118. Zwiener v. Commissioner, 743 F.2d 273, 275-76 (5th Cir. 1984); Feistmen v. Commissioner, 63 T.C. 129, 133-34 (1974), *appeal dismissed on procedural grounds*, 587 F.2d 941 (9th Cir. 1978).

119. *Zwiener*, 743 F.2d at 274-75; Cohen v. Commissioner, 543 F.2d 725 (9th Cir. 1976).

120. Borthwick v. Veatch, 38 Haw. 188 (1948).

121. Bernknopf v. Commonwealth, 425 A.2d 880, 882 (Pa. Commw. Ct. 1981); Kjer v. Wisconsin Dept. of Taxation, 24 N.W.2d 604, 606 (Wis. 1946).

Economic benefit is the justification for the income tax rule.[122] Even if the employee can never acquire possession of the money,[123] receipt of a benefit such as an increase in pension rights[124] is a sufficient receipt to justify a tax.

The effect of tax motivated arrangements is unclear. Under a salary reduction agreement, the participant agrees to a salary reduction in exchange for the employer's payment of a contribution in order to avoid income tax withholding.[125] A pick up arrangement reaches the same result because there is no withholding when the employer pays the employee's contribution.[126]

The argument that the employee does not make a contribution is not convincing. While the agreements are effective to avoid current withholding[127] and income[128] taxes under special statutes, the receipt is taxable under the general rules.[129] Since it is clear that the employer agreed to make the contribution for the employee, the payment should be treated as received by the employee.

G. *Contract*

Where a plan creates contract rights, the question is the extent to which enforcement is available.[130] States which find that plans constitute contracts but deny enforcement[131] probably do so to avoid the prohibition on gifts of state money while also avoiding enforcement.

Other states go to the opposite extreme by prohibiting any change. A typical situation involves an increase in mandatory employee contributions and a decrease in benefits after an employee commences participation. In one case, the court concluded that the terms of the pension

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122. Canron Corp. v. City of New York, 674 N.E.2d 1117, 1121 (N.Y. 1996); Humble Oil & Refining Co. v. Calvert, 478 S.W.2d 926, 930 (Tex. 1972).

123. Old Colony Trust Co. v. Commissioner, 279 U.S. 716 (1929).

124. *Zwiener*, 743 F.2d at 275-76; Feistmen v. Commissioner, 63 T.C. 129, 133-34 (1974), *appeal dismissed on procedural grounds*, 587 F.2d 941 (9th Cir. 1978); Witte v. Director of Revenue, 829 S.W.2d 436, 441 (Mo. 1992); *Kjer*, 24 N.W.2d at 606; *Bernknopf*, 425 A.2d at 882.

125. I.R.C. § 3401(a)(12)(A) (1994); University of N.D. v. United States, 603 F.2d 702, 703 (8th Cir. 1979).

126. I.R.C. § 414(h)(2), § 3401(a)(12)(A) (1994); Rev. Rul. 77-462, 1977-2 C.B. 358.

127. I.R.C. § 414(h)(2), § 3401(a)(12)(A) (1994); *University of N.D.*, 603 F.2d at 703-06; Rev. Rul. 77-462, 1977-2 C.B. 358.

128. I.R.C. § 402(a) (1994); Rev. Rul. 77-462, 1977-2 C.B. 358.

129. A contribution to a vested account in a nonexempt pension trust is taxable. I.R.C. § 402(b)(1) (1994); *Zwiener*, 743 F.2d at 275-76; *Feistmen*, 63 T.C. at 133; *Witte*, 829 S.W.2d at 441; *Bernknopf*, 425 A.2d at 882; *Kjer*, 24 N.W.2d at 606.

130. *See generally* Note, *Public Employee Pensions*, *supra* note 47, at 998-1003 (arguing that contract doctrine offers limited guidance to courts in accommodating the interests of pensioners and the government).

131. City of Dallas v. Trammell, 101 S.W.2d 1009, 1013-14 (Tex. 1937). Refusing to provide a remedy probably is an improper impairment of the obligation of contract. United States Trust Co. v. New Jersey, 431 U.S. 1, 19 n.17 (1977).

were established when participation began and they could not be unilaterally modified. [132] This interpretation entitles the employee to receive pension payments based on the benefit formula in force when the employee commenced participation.[133]

There are intermediate positions which attempt to compromise between the contractual rights of employees and the desire for flexibility. The California version grants limited contractual rights at the moment a participant enters the system.[134] The right prevents repeal, and modifications are permitted[135] if they are reasonable.[136] A modification is reasonable if it has a material relationship to the operation of the pension system[137] and any disadvantage to participants is accompanied by significant new advantages.[138]

H. *Contract Clause*

Cases construing the Contract Clause[139] generally permit legislation to be changed. The Supreme Court concluded that legislative programs usually can be repealed or modified[140] because state and local governments typically have the sovereign right to change their spending priorities at any time. The right to change financial arrangements is limited if a statute is considered a contract between the government and private interests.[141]

Impairments are upheld if they are reasonable and serve an important public purpose. However, the mere fact that a government would prefer to spend the money for the public good does not justify an impairment of its financial obligations. The impairment must be compared with other means

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132. The court concluded that pension rights "vest" at the moment a participant receives a legally protected interest. Calabro v. City of Omaha, 531 N.W.2d 541, 550 (Neb. 1995).

133. Yeazell v. Copins, 402 P.2d 541, 546 (Ariz. 1965); Pennsylvania Fed'n of Teachers v. School Dist., 484 A.2d 751, 752-53 (Pa. 1984).

134. Board of Admin. of the Pub. Employees' Retirement Sys. v. Wilson, 61 Cal. Rptr. 2d 207, 230 (Cal. 1997); Dryden v. Board of Pension Comm'rs, 59 P.2d 104, 105-06 (Cal. 1936).

135. One opinion suggested that the pension statute included an implied right to make reasonable modifications. Kern v. City of Long Beach, 179 P.2d 799, 802-03 (Cal. 1947). Another concluded that the employee contracted for a substantial pension, and he was presumed to have acquiesced to reasonable modifications. Bakenhus v. City of Seattle, 296 P.2d 536, 540 (Wash. 1956).

136. Wallace v. City of Fresno, 265 P.2d 884, 886 (Cal. 1954).

137. Allen v. City of Long Beach, 287 P.2d 765, 767 (Cal. 1955).

138. Abbott v. City of Los Angeles, 326 P.2d 484, 488-89 (Cal. 1958).

139. "No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ." U.S. CONST. art. I, § 10, cl. 1; *see* G. Richard Shell, *Contracts in the Modern Supreme Court*, 81 CAL. L. REV. 433 (1993); Barton H. Thompson, *The History of the Judicial Impairment "Doctrine" and Its Lessons for the Contract Clause*, 44 STAN. L. REV. 1373 (1992).

140. Flemming v. Nestor, 363 U.S. 603 (1960); Pennie v. Reis., 132 U.S. 464 (1889).

141. National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co., 470 U.S. 451, 465-66 (1985); United States Trust Co. v. New Jersey, 431 U.S. 1, 21-25 (1977).

of serving the public purpose, and any benefits received by the other party to the contract.[142]

One court applied the impairment criterion to a pension plan where a state changed the timing of contributions from monthly to annually 12 months in arrears.[143] The court determined that the state financial problems did not justify the arrears approach to contributions.[144] In another case, a city repealed part of a plan because of financial problems.[145] The repeal was rejected because the city failed to provide any evidence that a less drastic measure would not deal with the financial problem, and the disadvantage was not offset by another benefit.[146]

I. *Detrimental Reliance*

A contract sometimes will be implied from the circumstances. The party to be charged must have made a promise that a reasonable person would expect to induce action or forbearance. A contract arises if it does induce the action or forbearance and enforcement is necessary to avoid injustice.[147] Reasonable people can differ about whether particular circumstances are adequate to justify application of the doctrine.

One case involved an employee who elected to join a municipal pension plan, and retired with 23 years of service.[148] Payments were suspended after the state enacted a minimum age requirement.[149] The court observed that a pension was promised without mention of a minimum age requirement, and that the employee relied on the promise when he elected to join the plan.[150] Once he elected to become eligible for benefits, the state was estopped to deny his right to those benefits.[151]

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142. *United States Trust Co.*, 431 U.S. at 28-32; Board of Admin. of the Public Employees' Retirement Sys. v. Wilson, 61 Cal. Rptr. 2d 207 (Cal. Ct. App. 1997); *see* Stephen F. Befort, *Public Sector Bargaining: Fiscal Crises and Unilateral Change*, 69 MINN. L. REV. 1221 (1985); Stewart E. Sterk, *The Continuity of Legislatures: Of Contracts and the Contracts Clause*, 88 COLUM. L. REV. 647 (1988); Recent Case, *Constitutional Law—Contract Clause—Fourth Circuit Upholds City's Payroll Reduction Plan As a Reasonable and Necessary Impairment of Public Contract*—Baltimore Teachers Union v. Mayor, 107 HARV. L. REV. 949 (1994).

143. *Wilson*, 61 Cal. Rptr. 2d at 213.

144. *Id.* at 242. Similar ploys have been rejected by other states. *See* McDermott v. Regan, 624 N.E.2d 985 (N.Y. 1993).

145. Calabro v. City of Omaha, 531 N.W.2d 541 (Neb. 1995).

146. *Id.* at 551-52.

147. RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981).

148. Christensen v. Minneapolis Mun. Employees' Retirement Bd., 331 N.W.2d 740, 742 (Minn. 1983).

149. *Id.* at 742-43.

150. *Id.* at 749.

151. *Id.*; *see also* Law Enforcement Labor Servs., Inc. v. County of Mower, 483 N.W.2d 696, 701 (Minn. 1992). On the other hand, reliance on reemployment criterion in effect at the time of retirement did not create an implied contract. Retired Adjunct Professors v. Almond, 690 A.2d 1342, 1345 (R.I. 1997). *See generally* Case Note, *Public Employee Pension Benefits—A Promissory Estoppel Approach*, 10 WM. MITCHELL L. REV. 287 (1984) (discussing Christensen v. Minneapolis

J. *Property*

Since a participant has a right to benefits,[152] his interest in a pension plan is a property right[153] which cannot be taken without due process.[154] State courts have concluded that due process is satisfied by notice and an opportunity to be heard on proposed changes to pension arrangements.[155]

Whether due process[156] requires compensation is unclear. Elimination or reduction of a pension right certainly appears to be a taking of property for use by the government. If the change is not an actual taking, the issue is whether governmental action amounted to a taking.[157] Although regulations which prevent all economically viable use is a deemed taking of land, the Supreme Court suggested that a change which renders personal property less valuable or even worthless usually does not require compensation.[158]

Perhaps the distinction can be justified by the differences between real and personal property. Because most parcels of land are capable of many types of productive use, the fact that one or more uses are prohibited usually does not render a parcel economically useless. If personal property has only one use, prohibition of that use renders it economically useless. The expense of requiring compensation for that sort of prohibition might frustrate many otherwise appropriate regulations.

The fact that the Due Process Clause applies to private property suggests that all property should be given the same treatment.[159] Attempts to explain the distinction have produced discussions of issues such as social

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Employees' Retirement Bd., 331 N.W.2d 740 (Minn. 1983), where the court reconciled the gratuity and contract theory approaches to public employee pension rights).

152. Pierce v. State, 910 P.2d 288, 301 (N.M. 1995).

153. Rehon, *supra* note 47, at 163-67; Note, *Public Employee Pensions*, *supra* note 47, at 1003-05.

154. The Due Process Clause provides that "nor shall private property be taken for public use, without just compensation." U.S. CONST. amend. V. What constitutes property generally is a matter of state law. D. Benjamin Barros, *Defining "Property" in the Just Compensation Clause*, 63 FORDHAM L. REV. 1853, 1865-82 (1995).

155. *Pierce*, 910 P.2d at 304-05.

156. *See* Roger Clegg, *Reclaiming the Text of the Takings Clause*, 46 S.C. L. REV. 531 (1995); Richard A. Epstein, Lucas v. South Carolina Coastal Council: *A Tangled Web of Expectations*, 45 STAN. L. REV. 1369 (1993); Richard A. Epstein, *The Seven Deadly Sins of Takings Law*, 26 LOY. L.A. L. REV. 955 (1993); Joseph L. Sax, *Property Rights and the Economy of Nature*, 45 STAN. L. REV. 1433 (1993).

157. Molly S. McUsic, *The Ghost of* Lochner*: Modern Takings Doctrine and Its Impact on Economic Legislation*, 76 B.U. L. REV. 605, 655-56 (1996). *See generally* Margaret Jane Radin, *Property and Personhood*, 34 STAN. L. REV. 957, 991-1008 (1982) (discussing takings issues by using the "rough dichotomy between personal and fungible property").

158. Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1027-28 (1992); *see* Susan A. Austin, Comment, *Tradeable Emissions Programs: Implications Under the Takings Clause*, 26 ENVTL. L. 323, 336, 346 (1996); McUsic, *supra* note 157, at 655 n.214.

159. Clegg, *supra* note 156, at 533-34; Glynn S. Lunney, Jr., *Responsibility, Causation, and the Harm-Benefit Line in Takings Jurisprudence*, 6 FORDHAM ENVTL. L.J. 433, 468 n.178 (1995).

contract and the expectations of owners,[160] forfeitures as a means of preventing undesirable uses,[161] and cases involving endangered species.[162] Several commentators concluded that there is no reasonable basis for distinguishing real and personal property for due process purposes.[163]

K. *Trust*

A trust is created whenever a person intends[164] that the property will be held for the benefit of one or more persons.[165] The existence and continuation of a trust is not affected by the lack of involvement of the beneficiary in the creation and operation of the trust.[166] Hence, the fact that the beneficiary did not know of a proposed trust,[167] did not contribute to it,[168] and did not accept benefits, does not affect the trust.[169] Since the identity of the trustee is irrelevant, the trustee may be the settlor, or his officials or employees.[170]

Rights to trust property[171] are determined by the trust instrument.[172] The settlor has no further interest in anything conveyed to the trust except to the extent of expressly reserved rights.[173] If nothing has been reserved, the settlor is not entitled to remove assets from the trust,[174] and has no right to use trust assets. If the settlor is permitted to use trust assets, it must be the result of an arm's length transaction.[175]

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160. Richard J. Lazarus, *Putting the Correct "Spin" on* Lucas, 45 STAN. L. REV. 1411, 1423-25 (1993); William W. Fisher III, *The Trouble with* Lucas, 45 STAN. L. REV. 1393, 1399-1400 (1993).

161. John A. Humbach, *Evolving Thresholds of Nuisance and the Takings Clause*, 18 COLUM. J. ENVTL. L. 1, 3-4 (1993).

162. Barton H. Thompson, Jr., *The Endangered Species Act: A Case Study in Takings and Incentives*, 49 STAN. L. REV. 305, 328-35 (1997).

163. MARK L. POLLOT, GRAND THEFT AND PETIT LARCENY: PROPERTY RIGHTS IN AMERICA 194-95 (1993); Lynda J. Oswald, *Cornering the Quark: Investment-Backed Expectations and Economically Viable Uses in Takings Analysis*, 70 WASH. L. REV. 91, 128, 130-31 (1995).

164. AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, THE LAW OF TRUSTS § 23 (4th ed. 1987); BOGERT & BOGERT, *supra* note 25, § 46.

165. SCOTT & FRATCHER, *supra* note 164, § 2.3; BOGERT & BOGERT, *supra* note 25, § 1.

166. *See* SCOTT & FRATCHER, *supra* note 164, § 14, at 185.

167. *See id.* § 36, at 385.

168. *Id.* § 29.

169. *Id.* § 36.1, at 389-92.

170. *Id.* § 32.5; *see* Dadisman v. Moore, 384 S.E.2d 816, 820 n.1, 825-26 (W. Va. 1989).

171. The word property may be defined as a "bundle of rights" associated with a physical thing. *See, e.g.*, Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1027 (1992).

172. A statute expressly creating a trust presumably will be considered a trust instrument. Where there is no express trust, the terms of the trust should be inferred from circumstances such as the statute creating the plan.

173. BOGERT & BOGERT, *supra* note 25, § 42.

174. *Dadisman*, 384 S.E.2d at 827.

175. *Compare* 29 U.S.C.A § 1103(c) (Supp. 1997), *with* 29 C.F.R. § 2550.408b-2 (1996). *See* Note, *Public Employee Pensions*, *supra* note 47, at 1005-16.

The ability of beneficiaries to obtain distributions is also determined by the trust instrument.[176] Most jurisdictions conclude that a participant who has retired has an absolute right to accrued payments. However, the right to any payment due in the future frequently can be modified at any time before the payment becomes due.[177] The trust arrangement may be modified to the extent permitted by the contract, or due process principles.

Any beneficiary is entitled to protect his interest by preventing misuse of trust assets by the employer.[178] Hence, a participant can maintain an action to prevent an employer from removing assets, require the employer to return assets,[179] and block other actions such as improper borrowing.[180] The duty to preserve trust assets for the beneficiaries may obligate the trustees to sue to prevent misuse of trust assets.[181]

The circumstances may justify relief that goes beyond protecting assets in the plan. One plan created contractual rights in the beneficiaries, and the state was obligated to make adequate quarterly contributions.[182] The court found the trustees had a duty to sue the state for failure to make the contributions and ordered restoration of past contributions as well as adequate future contributions.[183] Inadequate protection for the interests of participants led to suggestions of a need for federal regulation of the trustee's conduct.[184]

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176. One court observed that each beneficiary held a "contractually vested property right." *Dadisman*, 384 S.E.2d at 827.

177. *See generally* Selleck, *supra* note 54, at 205-08 (discussing matters to consider before making changes in pension benefits).

178. GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS & TRUSTEES § 541, at 167 (2d ed. 1993); *id.* § 543, at 217; *see* Board of Trustees of the Employees' Retirement Sys. v. Mayor and City Council of Baltimore City, 562 A.2d 720 (Md. 1989); PETER DRUCKER, POST-CAPITALIST SOCIETY 75 (1993).

179. *Dadisman*, 384 S.E.2d at 831. Some courts do permit the employer to remove assets to balance the budget. *See, e.g.*, People *ex rel.* Sklodowski v. State, 642 N.E.2d 1180 (Ill. 1994).

180. Sgaglione v. Levitt, 337 N.E.2d 592, 596 (N.Y. 1975).

181. *Dadisman*, 384 S.E.2d at 825 n.12. *See generally* Maria O'Brien Hylton, *"Socially Responsible" Investing: Doing Good Versus Doing Well in an Inefficient Market*, 42 AM. U. L. REV. 1 (1992) (focusing on socially responsible investing as practiced by pension funds); Marcia Gaughan Murphy, *Regulating Public Employee Retirement Systems for Portfolio Efficiency*, 67 MINN. L. REV. 211 (1980) (proposing a model regulatory scheme for public employee retirement systems); Romano, *supra* note 2 (underscoring investment conflicts faced by public pension fund managers).

182. *Dadisman*, 384 S.E.2d at 832-33.

183. *Id.* at 825 n.12, 826.

184. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 187-88, 197-98 (Comm. Print 1978); Kathleen Paisley, *Public Pension Funds: The Need for Federal Regulation of Trustee Investment Decisions*, 4 YALE L. & POL'Y REV. 188, 196-206 (1985). *See generally* DRUCKER, *supra* note 178, at 75.

L. *Reappraisal*

Using state law to require a government to honor an apparent pension promise may be impossible. Plans established by private employers are unenforceable if the circumstances do not justify finding either a contract or application of the doctrine of detrimental reliance. Government plans are subject to the same uncertainties as well as the additional consideration of politics.

Legislative bodies have a duty to represent all their constituents by doing whatever is needed for the public good as determined by a majority of the legislators at any particular time. The statement that "a week is a long time in politics"[185] suggests that politicians should be free to respond to the perceived needs of the community at any moment.

While it is desirable that the political system is able to adequately respond to changes in circumstances, discretion should not be completely unlimited. Benefits to society in general or to a group of people should not unfairly burden particular segments of the community. One commentator characterizes the use of pension funds for other purposes as looting.[186]

III. INDIRECT REMEDIES

A. *Introduction*

Pension plans are not subject to the qualification rules unless the plan is set up to derive tax benefits. A qualified plan is not subject to tax on its income,[187] and participants are not taxed on employer contributions until after retirement.[188] However, many plans and participants claim the benefits even though the plan does not satisfy the requirements for qualification.[189]

The pre-ERISA qualification rules apply to government plans.[190] Requirements include[191] a plan,[192] funding,[193] and holding plan assets in a

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185. The statement was made by Prime Minister Harold Wilson. DANIEL YERGIN, THE PRIZE 670 (1992).

186. David L. Gregory, *The Problematic Status of Employee Compensation and Retiree Pension Security: Resisting the State, Reforming the Corporation*, 5 B.U. PUB. INT. L.J. 37, 40 (1995); *Dadisman*, 384 S.E.2d at 829.

187. I.R.C. § 501(a) (1994).

188. *Id.* § 402(a) (1974).

189. *See, e.g.*, I.R.S. and N.J., *supra* note 3.

190. H.R. Rep. No. 93-779, at 5 (1974), *reprinted in* 1974-3 C.B. 248.

191. Additional rules address topics such as the adequacy of participation and vesting, and prohibit discrimination in contributions or benefits. I.R.C. § 401(a)(3)-(4), (7) (1974).

192. *Id.* § 401(a)(1).

193. I.R.S. Publication 778, pt. 2(b) (Feb. 1972), *reprinted in* 3 STAND. FED. TAX REP. (CCH) § 2605.70 (1973), *replacing* Rev. Rul. 69-421, pt. 2(b), 1969-2 C.B. 59.

trust[194] which expressly prohibits diversion of assets for an improper purpose.[195] Certain transactions between the trust and the employer are prohibited.[196] The IRS does not require an advance determination[197] that a new plan or an amendment to an existing plan satisfies the qualification rules.[198] The consequences of failure to qualify are so drastic that most employers want advance approval.[199] The fact that many officials have little or no idea of what the rules are[200] suggests that most state and local plans do not consider obtaining approval.

The principal problem with qualification rules is lack of enforcement. The IRS has shown little interest in enforcing the qualification rules.[201] The fact that participants are permitted to obtain a judicial declaration of whether the plan is qualified[202] may not be helpful since there is no reasonably reliable method for enforcing a declaration. Political pressure to obtain the tax benefits of qualification may produce the desired result.

B. *Government Plans*

Government plans are exempt from the labor portion of ERISA,[203] and are subject to the pre-ERISA tax qualification rules.[204] The plan must be "established" or "maintained"[205] by a government[206] for its employees.[207]

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194. Treas. Reg. § 1.401-1(a)(1) (1972).

195. *Id.* § 1.401-2(a)(2) (1964).

196. I.R.C. § 503(b) (1974).

197. Treas. Reg. § 1.401-1(e)(1) (1972); Tech. Info. Rel. 1195 (Aug. 24, 1972), *reprinted in* 7 STAND. FED. TAX REP. (CCH) § 6902 (1973).

198. Treas. Reg. § 601.201(o) (1997). Determination letters on qualified plans are sufficiently important to rate a separate set of instructions which are updated annually. *See, e.g.*, Rev. Proc. 97-4, 1997-1 I.R.B. 96.

199. 2 BORIS BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES & GIFTS § 61-11 to -12 (2d ed. 1990).

200. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 77-78 (Comm. Print 1978); I.R.S. and N.J., *supra* note 3.

201. *Joint Hearing*, *supra* note 34, at 165; STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 33-35 (Comm. Print 1978); *see* S. REP. NO. 92-634, at 97 (1972).

202. I.R.C. § 7476(a) (1994).

203. 29 U.S.C. § 1003(b)(1) (1994).

204. H.R. REP. NO. 93-779, at 5 (1974), *reprinted in* 1974-3 C.B. 248. A few of the original ERISA qualification rules apply to government plans. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 30-35 (Comm. Print 1978); *see* S. REP. NO. 92-634 (1972). Some ERISA modifications apply to government plans. *See* I.R.C. § 401(a)(26) (1994).

205. 29 U.S.C. § 1002(32) (1994). Although the tax definition requires that the plan be established *and* maintained, the IRS apparently has concluded that the requirement is satisfied if the plan is established *or* maintained. Feinstein v. Lewis, 477 F. Supp. 1256, 1260 (S.D.N.Y. 1979), *aff'd*, 622 F.2d 573 (2d Cir. 1980); I.R.C. § 414(d) (1994); Priv. Ltr. Rul. 79-09-037 (Nov. 28, 1978), *modified*, Priv. Ltr. Rul. 79-35-040 (May 29, 1979); *see* Priv. Ltr. Rul. 91-10-048 (Dec. 12, 1990); Priv. Ltr. Rul. 97-10-029 (Dec. 9, 1996).

Administrators do not have a consistent approach to applying the "established" or "maintained" requirement.[208] The Labor Department feels it is satisfied if the employer either contributes funds to the plan or has a significant involvement in the administration of the plan.[209] The IRS considered several enumerated criteria and other relevant factors, and has indicated that one of the most important factors is the degree of control the government has over the everyday operations of the plan.[210]

If the government establishes the plan and there is no change in the circumstances, the plan is always a government plan.[211] Governments frequently hire private concerns such as insurance companies to operate plans. If the government remains in overall control, it is still a government plan.[212] If a private plan becomes the responsibility of a government, it becomes a government plan at the moment of the change.[213] Similarly, a government plan becomes a private plan at the moment it becomes the responsibility of a private corporation.[214]

C. *Definiteness*

1. The Plan

The plan must be in writing which expressly sets forth the terms and conditions of the essential features such as benefits.[215] The terms and

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206. The term "government" means a state, a political subdivision of a state, or an agency or instrumentality of a state or political subdivision. 29 U.S.C. § 1002(32) (1994); I.R.C. § 414(d) (1994); Rose v. Long Island R.R. Pension Plan, 828 F.2d 910, 917-18 (2d Cir. 1987). *Compare* Rev. Rul. 89-49, 1989-1 C.B. 117, *with* Priv. Ltr. Rul. 95-41-040 (July 20, 1995).

207. 29 U.S.C. § 1002(32) (1994); I.R.C. § 414(d) (1994). *Compare* DOL Advisory Op. 80-50A (1980), *with* DOL Advisory Op. 86-24A (1986), *and* Rev. Rul. 89-49, 1989-1 C.B. 117 (stating that a governmental plan may be defined as one established pursuant to a collective bargaining agreement).

208. Commentators have suggested a need for more definite criteria for identifying when an organization is a government. *See* Ellen P. Aprill, *Excluding the Income of State and Local Governments: The Need for Congressional Action*, 26 GA. L. REV. 421, 480-87 (1992); Phillip Marchesiello, Note, *Federal Tax Immunity for State-Related Organizations:* Michigan v. United States, 49 TAX LAW. 429, 437-42 (1996).

209. DOL Advisory Op. 79-83A (1979). *Compare* DOL Advisory Op. 80-16A (1980), *with* DOL Advisory Op. 86-23A (1986). Application of the criterion to multi-employer plans is more complicated. *See* DOL Advisory Op. 83-36A (1983), *revoked by* DOL Advisory Op. 85-03A (1985).

210. *Compare* Rev. Rul. 89-49, 1989-1 C.B. 117, *with* Priv. Ltr. Rul. 97-05-027 (Nov. 5, 1996), *and* Priv. Ltr. Rul. 95-41-040 (July 20, 1995), *and* Priv. Ltr. Rul. 95-29-038 (April 27, 1995).

211. Rose v. Long Island R.R. Pension Plan, 828 F.2d 910, 917-18 (2d Cir. 1987).

212. Roy v. Teachers Ins. & Annuity Ass'n, 878 F.2d 47, 50 (2d Cir. 1989). *See generally* Silvera v. Mutual Life Ins. Co., 884 F.2d 423 (9th Cir. 1989) (holding that a group benefits policy purchased by the city for employees was a "governmental plan," although the plan was offered and administered by a private insurer).

213. Priv. Ltr. Rul. 79-09-037 (Nov. 28, 1978), *modified by* Priv. Ltr. Rul. 79-35-040 (May 29, 1979); *see also* Priv. Ltr. Rul. 97-10-029 (Dec. 9, 1996); Priv. Ltr. Rul. 91-10-048 (Dec. 12, 1990).

214. Hightower v. Texas Hosp. Ass'n, 65 F.3d 443, 449-51 (5th Cir. 1995).

215. Engineered Timber Sales, Inc. v. Commissioner, 74 T.C. 808, 827 (1980); Rev. Rul. 74-466, 1974-2 C.B. 131; I.R.S. Publication 778, pt. 2(f) (Feb. 1972), *reprinted in* 3 STAND. FED. TAX REP. (CCH) ¶2605.70 (1973), *replacing* Rev. Rul. 69-421, pt. 2(f), 1969-2 C.B. 59 at 63.

conditions must be communicated to the employees[216] so that they understand their relationship to the plan as well as to ensure that the plan is enforceable.[217]

The exact extent to which the plan must be enforceable is unclear. The possibility that a right to terminate the plan will be exercised usually does not affect the qualification of the plan.[218] However, alteration of the essential features of the plan is another matter. Since the employer may not retain the right to modify the essential features,[219] the employer cannot make a change that is less favorable to participants. The IRS and participants presumably would not object to amendments that are favorable to participants.

Several recent decisions conclude that state and local governments may retroactively modify the essential features of plans.[220] The existence of this power means the plan is not qualified because it fails the definiteness requirement.[221]

2. Pension Benefits

A pension plan[222] must provide definitely ascertainable retirement benefits.[223] Benefits are not definitely ascertainable if they are subject to the discretion of the employer.[224] Some recent decisions conclude that legislative bodies may reduce benefits whenever they choose to do so.[225] If legislatures can reduce benefits to suit political expediency,[226] they are not definitely ascertainable.

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216. Treas. Reg. § 1.401-1(a)(2) (1972); Rev. Rul. 72-509, 1972-2 C.B. 221; Rev. Rul. 71-90, 1971-1 C.B. 115.

217. G & W Leach Co. v. Commissioner, 41 T.C.M. (P-H) 988, 990, 992 (1981); *Engineered*, 74 T.C. at 827.

218. The possibility of termination does affect the qualification of the plan if the circumstances suggest that the employer did not expect the plan to be permanent. *Engineered*, 74 T.C. at 822; Treas. Reg. § 1.401-1(b)(2) (1972).

219. Lichter v. Commissioner, 17 T.C. 1111, 1118-20 (1952), *acq.*, 1952-1 C.B. 3, *aff'd per curiam*, 201 F.2d 49 (6th Cir. 1952); South Tex. Commercial Nat'l Bank v. Commissioner, 7 T.C. 764, 767-68 (1946), *aff'd*, 162 F.2d 462 (5th Cir. 1947).

220. *See* Spiller v. State, 627 A.2d 513 (Me. 1993).

221. *Lichter*, 17 T.C. at 1118-20; *South Texas*, 7 T.C. at 767-68.

222. Any plan is considered a pension plan if benefits are to be paid over a period of years after retirement, and contributions can be determined either actuarially, or are fixed without being geared to profits. Treas. Reg. § 1.401-1(b)(1)(i)-(ii) (1972).

223. *Id.* § 1.401-1(b)(1)(i); Rev. Rul. 71-24, 1971-1 C.B. 114.

224. I.R.C. § 401(a)(25) (1994); Rev. Rul. 74-385, 1974-2 C.B. 130.

225. *See Spiller*, 627 A.2d at 513.

226. Leslie Scism, *Coming Up Short: Public Pension Plans Are So Underfunded That Trouble is Likely: Many States and Localities May Have to Cut Benefits or Raise Taxes Sharply: Some People Delay Retiring*, WALL. ST. J., April 6, 1994, at A1.

3. Funding

Unfunded plans have never satisfied the requirements for qualification.[227] Hence, a promise that the employer will pay benefits directly to the employee fails the funding requirement.[228] The employer must make regular and substantial contributions[229] to a fund in an amount needed to pay current and near future benefit payments.[230]

A plan may be considered terminated if the employer suspends or reduces contributions. Unless the plan satisfies objective criteria, whether termination has occurred is to be determined by examining the facts and circumstances.[231] A suspension of contributions is not a discontinuance if the amount of benefits are never affected, and a minimum funding standard is satisfied.[232] It usually is satisfied by contributions equal to the present cost of future benefits earned during the year plus interest on the past service cost.[233]

Continuing problems led to several statements that funding should be required,[234] and the requirement was upheld.[235] The fact that IRS enforcement practices were inadequate[236] was underlined by the mass loss of benefits when the underfunded Studebaker plan was terminated.[237] The

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227. Trebotich v. Commissioner, 57 T.C. 326, 333-36 (1971), *aff'd*, 492 F.2d 1018 (9th Cir. 1974); S. REP. NO. 70-960, at 21-22 (1928), *reprinted in* 1939-1 (pt. 2) C.B. 423-24; H.R. CONFR. REP. NO. 70-1882, at 12 (1928), *reprinted in* 1939-1 (pt. 2) C.B. 445-46.

228. Rev. Rul. 71-91, 1971-1 C.B. 116 (1971).

229. *See* Treas. Reg. § 1.401-1(b)(2) (1972).

230. *Compare* Gen. Couns. Mem. 36,813 (Aug. 16, 1976), *with Trebotich*, 57 T.C. at 334-36.

231. Treas. Reg. § 1.401-6(c)(1) (1963).

232. *Id.* § 1.401-6(c)(2)(i). The unfunded past service cost never exceeds the unfunded past service cost as of the date the plan was established, plus any additional past service or supplemental costs added by amendment. *Id.* § 1.401-6(c)(2)(ii).

233. PRESIDENT'S COMM. ON CORPORATE PENSION FUNDS, PUBLIC POLICY & PRIVATE PENSION PROGRAMS 49-50 (1965); Regina T. Jefferson, *Defined Benefit Funding: How Much Is Too Much?*, 44 CASE W. RES. L. REV. 1, 8 n.35 (1993).

234. Funding was not a distinct topic in the formal IRS qualification guides issued prior to 1961. Funding was a separately stated requirement beginning in 1961. I.R.S. Publication 778, pt. 2(b) (Feb. 1972), *reprinted in* 3 STAND. FED. TAX REP. (CCH) ¶ 2605.70 (1973) *replacing* Rev. Rul. 69-421, pt. 2(b), 1969-2 C.B. 59, at 62, *replacing* Rev. Rul. 65-178, pt. 2(b), 1965-2 C.B. 94, at 98-99, *replacing* Rev. Rul. 61-121, pt. 2(f), 1961-2 C.B. 65, at 72, *replacing* Rev. Rul. 57-163, 1957-1 C.B. 128. A funding safe harbor was added to the regulations in 1963. Treas. Reg. § 1.401-6(c)(2) (1963).

235. *Trebotich*, 57 T.C. at 332-34.

236. PRESIDENT'S COMM. ON CORPORATE PENSION FUNDS, PUBLIC POLICY & PRIVATE PENSION PROGRAMS 51 (1965).

237. H.R. REP. NO. 93-807, at 13 (1973), *reprinted in* 1974-3 (Supp.) C.B. 248; S. REP. NO. 92-634, at 71-72, 75 (1972); Leigh Allyson Wolfe, *Is Your Pension Safe? A Call For Reform of the Pension Benefit Guaranty Corporation and Protection of Pension Benefits*, 24 SW. U. L. REV. 145, 145-46 (1994).

Studebaker episode was one of the major causes for the enactment of ERISA.[238]

Political pressure motivated Congress to exempt government plans from the ERISA funding rules.[239] Although governments argued that the taxing power was a functional substitute for the funding rules, several congressional reports note instances where taxes probably could not be raised enough to pay the promised benefits.[240]

Congress compromised by exempting government plans and ordering a study. Congress went even further by emphasizing that the termination safe harbors were not to become requirements for governmental plans.[241] Hence, those that do not satisfy the safe harbor are to be judged under the facts and circumstances.[242] Although the study concluded that funding rules were needed,[243] state and local governments successfully lobbied against them.[244]

D. *Trust*

Contributions and other assets of the plan must be held in a trust.[245] Government plans frequently do not satisfy this requirement because the mere holding of assets in an employer's account is unsatisfactory.[246] The assets must be held by an organization which is independent of the employer.[247] Some cases conclude that the trust requirement is satisfied if assets are held by an organization such as an independent corporation.[248]

The assets must be the property of the trust at least to the extent needed to satisfy all of its liabilities.[249] The trust instrument[250] must provide

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238. George Lee Flint, Jr., *ERISA: Reformulating the Federal Common Law for Plan Interpretation*, 32 SAN DIEGO L. REV. 955, 975 (1995).

239. H.R. REP. NO. 93-779, at 90, 163 (1974), *reprinted in* 1974-3 C.B. 333, 406; H.R. CONF. REP. NO. 93-1280, at 291 (1974), *reprinted in* 1974-3 C.B. 452; S. REP. NO. 93-383, at 67 (1973), *reprinted in* 1974-3 (Supp.) C.B. 146.

240. H.R. REP. NO. 93-779, at 90.

241. H.R. CONF. REP. NO. 93-1280, at 291.

242. *Id.*

243. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 179-81 (Comm. Print 1978).

244. *See generally Public Employee Pension Benefit Plan: Hearings Before the Ways & Means Comm.*, 98th Cong. 1138 (1984) (presenting the statement of Mr. Hawkins of the Committee on Education and Labor).

245. Treas. Reg. § 1.401-1(a)(1) (1972); Rev. Rul. 72-14, 1972-1 C.B. 106. *See* I.T. 4102, 1952-2 C.B. 173, 174 (treating civil service retirement and disability fund as a qualified trust).

246. Rev. Rul. 71-91, 1971-1 C.B. 116; *see* S. REP. NO. 75-1567, at 24 (1938), *reprinted in* 1939-1 (pt. 2) C.B. 796.; S. REP. NO. 70-960, at 21-22 (1928), *reprinted in* 1939-1 (pt. 2) C.B. 423-24; H.R. CONFR. REP. NO. 70-1882 at 12 (1928), *reprinted in* 1939-1 (pt. 2) C.B. 445-46.

247. D.J. Lee, M.D. Inc., v. Commissioner, 92 T.C. 291, 297-99 (1989), *aff'd*, 931 F.2d 418 (6th Cir. 1991); Gillis v. Commissioner, 63 T.C. 11, 16-17 (1974); Trebotich v. Commissioner, 57 T.C. 326, 333-34 (1971).

248. *See* Tavannes Watch Co. v. Commissioner, 176 F.2d 211 (2d Cir. 1949); South Penn Oil Co. v. Commissioner, 17 T.C. 27 (1951), *nonacq.*, 1952-2 C.B. 6.

249. Treas. Reg. § 1.401-2(b) (1964); S. REP. NO. 75-1567, at 24 (1933).

that the trust is for the exclusive benefit of the participants and their beneficiaries,[251] and expressly prohibit diversion of assets to any other purpose.[252] Hence, the fact that the employer has financial difficulties and needs the money is irrelevant. For example, when New Jersey removed assets from a trust to close a budget gap, the IRS found the action was improper.[253]

E. *Prohibited Transactions*

The purpose for requiring plan assets to be held in trust is to protect them from actions of the employer. The prohibited transaction rules provide additional safeguards by proscribing[254] certain transactions between the trust and the employer.

The trust generally cannot make loans[255] to the employer unless there is a bona fide debtor-creditor relationship,[256] the trust receives a reasonable rate of interest,[257] and there is adequate security.[258] The security is adequate if it is reasonably anticipated that the security will prevent any loss of principal and interest in the event of default on the loan.[259]A loan based on the financial resources of the borrower is not secured[260] unless it qualifies for an exception.

The security requirement does not apply[261] if the trust pays the same price charged to independent[262] purchasers[263] of obligations and ownership is

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250. It is unclear whether the requirement of a trust instrument is satisfied where there is no writing other than a statute. Perhaps the statute satisfies the requirement if it expressly provides that the funds shall be held in trust, or if the administrator's express duties are equivalent to those of a trustee. *See* Rev. Rul. 69-231, 1969-1 C.B. 118.

251. Treas. Reg. § 1.401-2(a)(1) (1964).

252. *Id.* § 1.401-2(a)(2)-(3).

253. I.R.S. and N.J., *supra* note 3.

254. *See* S. REP. NO. 93-383, at 94-96 (1973), *reprinted in* 1974-3 (Supp.) C.B. 173-75.

255. The term "loan" includes purchasing bonds, debentures, notes, or other evidence of indebtedness. Treas. Reg. § 1.503(c)(1), § 1.503(c)-1(b) (1976).

256. The trust must be a business-like creditor by doing things such as promptly recording mortgages and demanding payment of principal and interest when due. Rev. Rul. 73-609, 1973-2 C.B. 187, *superseded by* Rev. Rul. 81-145, 1981-1 C.B. 350; Rev. Rul. 68-474, 1968-2 C.B. 240; Rev. Rul. 66-324, 1966-2 C.B. 230, *superseded by* Rev. Rul. 80-269, 80-2 C.B. 191.

257. The rate is adequate if it is equal to the prevailing rate in the community for similar loans. Treas. Reg. § 1.503(b)-1(c) ex.(4) (1976).

258. I.R.C. § 503(b)(1) (1994). The security requirement applies to loans by government trusts. Rev. Rul. 73-586, 1973-2 C.B. 186, *superseded by* Rev. Rul. 85-114, 1985-2 C.B. 163.

259. The criterion presumably is not satisfied unless the security also covers legal fees and other costs of dealing with a default. Treas. Reg. § 1.503(b)-1(b)(1) (1976). A loan which is partially secured is not adequately secured. *Id.* § 1.503(b)-1(c) ex.(2).

260. *Id.* § 1.503(b)-1(c) ex.(1).

261. Even if the security requirement does not apply, the obligation must bear a reasonable rate of interest. *Id.* § 1.503(e)-1(a)(3).

262. *Id.* § 1.503(e)-1(b)(3).

263. The exact requirements depend on whether the trust purchased on a market, from an underwriter, or directly from the employer. I.R.C. § 503(e)(1) (1994); Treas. Reg. § 1.503(e)-2(b)(2-4) (1976).

diversified.[264] The trust cannot purchase more than 25% of the outstanding obligations of the same issue,[265] at least 50% of those obligations must be held by persons independent of the employer, and no more than 25% of trust assets can be invested in obligations of relatives of the employer.[266]

Security is not required if a federal law prohibits pledging over half of the assets of the employer[267] and the other conditions are satisfied. A trustee who is independent of the employer must approve the investment[268] and the amount lent without receipt of adequate security cannot exceed 25% of the value of the assets of the trust.[269]

Loans that satisfy the restrictions of the prohibited transaction statute continue to be subject to the general requirements for qualification. Hence, they will be examined carefully to determine if the loan is for the exclusive benefit of the participants and their beneficiaries.[270]

Trustees of several New York City plans knew that if they purchased city bonds they would violate the exclusive benefit[271] and prohibited transaction rules due to the general unmarketability and high risk nature of the bonds.[272] Although a special exemption was granted,[273] Congress emphasized that the exemption was not a precedent for using plan assets to deal with financial crises if the transaction violated the rules.[274]

F. *Taxability of Trust Income*

There are two issues to resolve in determining whether a trust is taxable on its income. The income of qualified plans usually is exempt from taxation.[275] A government plan loses its exemption if the trust enters into a prohibited transaction[276] or becomes disqualified.[277]

Where the exemption has been lost, the question is whether the government is subject to tax on its income. Suggestions that Congress did

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264. Treas. Reg. § 1.503(e)-2(c) (1976).
265. *Id.* § 1.503(e)-1(b)(4), -2(e).
266. I.R.C. § 503(e)(2) (1994); Treas. Reg. § 1.503(e)-2(c) to -2(d) (1976).
267. Treas. Reg. § 1.503(f)-1(b)(2) (1976).
268. *Id.* § 1.503(f)-1(b)(3).
269. I.R.C. § 503(f) (1994); Treas. Reg. § 1.503(f)-1(b)(4), -1(d) (1976).
270. Treas. Reg. § 1.503(a)-1(b), (e)-1(a)(3), (f)-1(a)(2) (1976); *id.* § 1.401-1(b)(5)(ii).
271. Rev. Rul. 73-380, 1973-2 C.B. 124.
272. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEM 33-34 (Comm. Print 1978).
273. Pub. L. No. 94-236, 90 Stat. 238 (1976).
274. H.R. REP. NO. 94-851, at 7 (1976).
275. I.R.C. § 501(a) (1994).
276. *Id.* § 503(a)(1)(B). After the exemption is lost, the trust must apply for reinstatement, which will be granted if the IRS is satisfied that the trust will not again knowingly engage in a prohibited transaction. Treas. Reg. § 1.503(c)-1(a) (1976). Reinstatement is effective in the year after the application was filed. I.R.C. § 503(c) (1994). The trust will be subject to tax for at least one full taxable year. Treas. Reg. § 1.503(c)-1(b) (1976).
277. The 501 exemption depends on 401 qualification. I.R.C. § 501(a) (1994).

not receive the power to tax activities of state and local governments have been rejected[278] and the extent of the general exclusion for governmental income is unclear. One authority suggests that trust income is exempt because it would be imputed to the government.[279] Others are less certain of the proper application of the general exclusion.[280]

The general exclusion is not available if Congress decides the transaction is taxable. The prohibited transaction statute applies to pension trusts of state and local governments and the consequence of a prohibited transaction is loss of the qualified plan exemption.[281] Since loss of the exemption is irrelevant unless it makes the income taxable, it is clear that the income is taxable.[282]

Congress also decided that state and local government plans are subject to the pre-ERISA qualification rules.[283] Congress knew that one consequence of failure to qualify is loss of the qualified plan exemption.[284] Although Congress was uncertain about whether nonqualified government trusts were taxable,[285] a trust would have the burden of proving that it was entitled to the exemption. It may be impossible for an administrator of a trust to meet this burden.

G. *Enforcement by the IRS*

The IRS approach to applying the qualification requirements to government plans developed over a period of time.[286] The first substantial restrictions on qualification were enacted in 1942[287] and the policy of applying them to government plans[288] was published in a 1972 ruling.[289]

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278. *See* South Carolina v. Baker, 485 U.S. 505, 519 n.11, 523 n.14 (1988); New York v. United States, 326 U.S. 572, 583-84 (1946); Michigan v. United States, 40 F.3d 817, 822-23 (6th Cir. 1994). *See generally* Aprill, *supra* note 208, at 450-65 (arguing that principles of federalism compel Congress to revisit tax law).

279. I.R.C. § 115(1) (1994); STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEM 31 (Comm. Print 1978).

280. H.R. REP. NO. 93-779, at 163 (1974), *reprinted in* 1974-3 C.B. 406; Aprill, *supra* note 208, at 480-87; Black, *Tax Exemption Issues for Public Employee Retirement Systems*, 4 EXEMPT ORG. TAX REV. 801 (1991). *See generally* Marchesiello, *supra* note 208, at 434-42 (summarizing various approaches); Timothy Philipps, *Federal Taxation of Prepaid College Tuition Plans*, 47 WASH. & LEE L. REV. 291 (1990) (examining prepaid tuition plans and discussing IRS tax treatment of such plans).

281. I.R.C. § 503(a)(1)(B) (1976). *See generally* H.R. CONF. REP. NO. 93-1280 at 307 (1974), *reprinted in* 1974-3 C.B. 468 (discussing administration and enforcement).

282. *See* I.R.C. § 503(c) (1994) (government plan that has lost exemption may claim exemption for subsequent years); Treas Reg. § 1.503(c)-1(a) to -1(b) (1976) (government plan that has lost exemption is subject to taxation for at least one tax year).

283. H.R. REP. NO. 93-779, at 5 (1974), *reprinted in* 1974-3 C.B. 248.

284. I.R.C. § 401(a) (1994); H.R. REP. NO. 93-533, at 3 (1973), *reprinted in* 1974-3 C.B. 212.

285. H.R. REP. NO. 93-779, at 163 (1974), *reprinted in* 1974-3 C.B. 406.

286. *See* H.R. REP. NO. 93-807, at 102-05 (1974), *reprinted in* 1974-3 (Supp.) C.B. 337-40; S. REP. NO. 93-383, at 106-10 (1973), *reprinted in* 1974-3 (Supp.) C.B. 185-89.

287. Revenue Act of 1942, ch. 619, § 165, 56 Stat. 862-63 (1942).

288. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEM 33-34 (Comm. Print 1978).

Although there were occasional instances where plans[290] and beneficiaries[291] were denied the benefits of qualified status, a Congressional Committee concluded that enforcement was almost non-existent until an enforcement program[292] began in the early 1970s. It caused a flurry of protests[293] and revealed some of the weaknesses in the IRS approach to government plans.

Favorable rulings and determination letters were issued without attempting to ascertain whether the plans satisfied the rules.[294] One of the inconsistencies backfired when the Chief Counsel concluded the IRS could not litigate a case involving a discriminatory plan for state judges because he could not distinguish it from a favorable ruling issued to a discriminatory plan for federal judges.[295] This resulted in an announcement by the IRS that it would reconsider the application of the discrimination requirements[296] to state and local plans for elected and appointed officials, and whether those plans were subject to tax on their income. Apparently improper plans would be treated as qualified until the study was completed.[297]

The study probably was not completed,[298] and the IRS's claim that it was avoiding regular enforcement because the impact would fall solely on the participants[299] is suspect since private plans have grown steadily since the enactment of ERISA. While removal of the restrictions would make more money available to provide benefits, private employers must either absorb the extra cost or reduce contributions to pay the costs. It is much more likely that the IRS found that enforcement made many mem-

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289. Rev. Rul. 72-14, 1972-1 C.B. 106. Some federal plans obtained rulings at earlier times. *See* Rev. Rul. 61-218, 1961-1 C.B. 102 (judges). Others were considered qualified. *See* Rev. Rul. 56-1, 1956-1 C.B. 444 (civil service).

290. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 34-35 (Comm. Print 1978).

291. Dooley v. United States, 36 A.F.T.R.2d 75-6463 (E.D. Tenn. 1975).

292. Gen. Couns. Mem. 36,813 (Aug. 16, 1976) (citing the auditing guidelines).

293. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC RETIREMENT SYSTEMS 33 (Comm. Print 1978).

294. *See* Ridgeley A. Scott, *Rabbis and Other Top Hats: The Great Escape*, 43 CATH. L. REV. 1, 25-26 (1993).

295. Gen. Couns. Mem. 36,897 (Oct. 27, 1976). When considering the plan for federal judges, the IRS adopted the position of "extreme reluctance to find prohibited discrimination in any retirement plan of the Federal Government." Gen. Couns. Mem. 32,019 (June 26, 1961).

296. Gen. Couns. Mem. 36,897 (Oct. 27, 1976) (citing I.R.C. § 401(a)(3-4) (1974) and Dooley v. United States, 36 A.F.T.R.2d 75-6463 (E.D. Tenn. 1975)).

297. I.R.S. News Release IR-77-1869 (Aug. 10, 1977).

298. The IRS stated that tentative written results had been compiled, but that the matter was still being studied in 1983. *Joint Hearing*, *supra* note 34, at 162, 164.

299. *Id.* at 165.

bers of Congress unhappy and decided to forgo enforcement in the interest of promoting better relations with Congress.[300]

The IRS is still not willing to start applying the rules. Twelve years after the reconsideration began, the IRS announced that discrimination requirements would apply for 1989.[301] The effective date has been postponed several times[302] and the current deadline is 1999.[303] The ruling on the plan for federal judges[304] is still in force and it is unlikely to be changed since the IRS does not want to incur the wrath of federal judges or Congress.[305] The circumstances suggest that the discrimination rules will never be enforced against state and local plans.

The other qualification rules are also not regularly enforced. While state and local plans are subject to requirements such as definiteness,[306] participation,[307] funding,[308] anti-diversion[309] and financial reporting,[310] there is no evidence indicating they are regularly enforced.[311] A congressional committee found that enforcement of the reporting requirement would have a major impact on public employee retirement systems.[312]

H. *Enforcement by Participants*

Participants[313] have the right to bring a Tax Court action[314] for a declaratory judgment on the qualifications of a plan[315] if there has been an

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300. The desire to keep on the good side of Congress was an express consideration in the decision to approve a discriminatory plan for federal judges. Gen. Couns. Mem. 32,019 (June 26, 1961).

301. Minimum Coverage Requirements, 54 Fed. Reg. 21,441 (1989) (to be codified at 26 C.F.R. pt. 1).

302. *See* I.R.S. Notice 9236, 19922 C.B. 36

303. The deemed satisfaction approach applies to all plan years beginning before 1999. I.R.S. Ann. 95-48, 1995-23 I.R.B. 13. Different deadlines are specified for cetain types of plans. For example, the 401(k) date is October 1, 1997. I.R.S. Notice 96-64, 1996-2 C.B. 229.

304. Rev. Rul. 61-218, 1961-2 C.B. 102.

305. Gen. Couns. Mem. 32,019 (June 26, 1961). The Chief Counsel recommended reconsideration of the ruling on the plan for federal judges. Gen. Couns. Mem. 36,897 (Act. 27, 1976). There is no evidence that the ruling was reconsidered. *Id.*

306. South Texas Commercial Nat'l Bank v. Commissioner, 7 T.C. 764, 767-68 (1946), *aff'd*, 162 F.2d 462 (5th Cir. 1947); Lichter v. Commissioner, 17 T.C. 1111, 1118-19 (1952), *acq.*, 1952-1 C.B. 3, *aff'd per curiam*, 201 F.2d 49 (6th Cir. 1952).

307. I.R.C. § 401(a)(3) (1974).

308. Rev. Rul. 71-91, 1971-1 C.B. 116; Rev. Rul. 75-505, 1975-2 C.B. 364; Gen Couns. Mem. 36,897 (Oct. 27, 1976), *reprinted in* 1976 IRS GCM Lexis 420.

309. I.R.C. § 401(a)(2) (1974); Treas. Reg. § 1.401-2(a) (as amended in 1981); I.R.S. and N.J., *supra* note 3.

310. I.R.C. § 6058 (1994).

311. *Joint Hearing*, *supra* note 34, at 165.

312. HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 33 (Comm. Print 1978).

313. I.R.C. § 7476(b)(1) - 1(d)(2) (1994); Treas. Reg. § 1.7476-1(b)(1) (1988).

314. There are 2 time limits. If the IRS has not made a decision, a petition cannot be filed less than 270 days after the application. If the IRS makes a decision and notice was mailed to the person, that person cannot file a petition more than 90 days after the date the notice was mailed. I.R.C. §

application for a determination letter.[316] If the employer did not apply,[317] a participant can seek a determination on the overall plan[318] or his interest in the plan. This individual interest application should be adequate since any determination or failure to make a determination with respect to the qualifications of a plan apparently satisfies the jurisdictional statute.[319]

A person who seeks a declaratory judgment probably should apply for his own determination letter. Since the review usually is limited to the matters which appear in the administrative record,[320] participants should develop the facts during the administrative proceedings. If the applicant feels that his position would be strengthened by material from an application by the employer, this material becomes part of the record if it is referenced in the participant's application.[321]

The action may involve review of an IRS decision or failure to make a decision. Participants may seek a disqualification of the plan for failure to satisfy initial or continuing qualification requirements.[322] Hence, participants can argue that the plan is not qualified because the plan is not definite,[323] the employer has not satisfied the funding requirements,[324] or the employer has removed assets from the trust.[325]

Whether a declaration that the plan is disqualified would achieve the desired result is uncertain. Since state and local governments are not concerned about expense deductions, that pressure is not present. On the

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7476(b)(3, 5) (1976). *See generally* Federal Land Bank Assoc. v. Commissioner, 573 F.2d 179 (4th Cir. 1978), *on remand*, 74 T.C. 1106 (1980) (finding that a notice requirement does not apply if the plan is not subject to ERISA); Treas. Reg. § 601.201(o)(3)(xiv-xvi) (1976) (finding a requirement for notice by applicant to interested parties); Treas. Reg. § 1.7476-3 (1976) (finding a requirement for notice by IRS to applicant and certain interested parties).

315. The term plan includes pension, profit sharing and annuity plans. I.R.C. § 7476(c) (1976).

316. I.R.C. § 7476(a) (1994); Gen. Couns. Mem. 37,417 (Feb. 14, 1978); James J. Clark, Recent Developments, 42 ALBANY L. REV. 153 (1977); *see* S. REP. NO. 93-383, at 112-16 (1973); LAURENCE CASEY ET AL., FEDERAL TAX PRACTICE § 639a (rev. ed. 1992); George G. Short, *Using the Tax Court's Declaratory Judgment Procedure to Obtain Plan Determinations*, 45 J. TAX'N 90 (1976) (discussing when and how the declaratory judgment procedure may aid ERISA applicants in securing a favorable plan determination).

317. One study found that over 75% of governmental plans did not apply for an initial determination, and those that did frequently made changes without requesting approval. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 33 (Comm. Print 1978).

318. The I.R.S. may refuse to accept an application which is not filed by the employer, a plan sponsor, or a plan administrator. I.R.C. § 7476(b)(1) (1994).

319. I.R.C. § 7476(a) (1994).

320. TAX CT. R. 217(a); Joseph P. Clawson, M.D., Inc. v. Commissioner, 63 T.C.M. (RIA) 799 (1993); Tamko Asphalt Prods., Inc. v. Commissioner, 71 T.C. 824, 837 (1979), *aff'd*, 658 F.2d 735, 738-39 (10th Cir. 1981); H.R. REP. NO. 93-807, at 108 (1974), *reprinted in* 1974-3 C.B. (Supp.) 343.

321. TAX CT. R. 211(a), (c)(5).

322. S. REP. 93-383, at 115-16 (1973), *reprinted in* 1974-3 C.B. (Supp.) 194-95.

323. *See* Spiller v. State, 627 A.2d 513 (Me. 1993).

324. Dadisman v. Moore, 384 S.E.2d 816 (W.V. 1989).

325. I.R.S. and N.J., *supra* note 3.

other hand, participants would lose the benefits of qualification. If the government made a contribution to a vested account, the participant would be required to report it as income.[326] Taxation of contributions presumably would cause considerable political pressure.

Another possibility involves forcing the IRS to collect tax on income of the plan.[327] Although the IRS usually is not subject to injunction,[328] a participant may obtain injunctive relief if the suit seeks to require the IRS to perform a duty.[329] Hence, the court may order the IRS to perform if it fails to perform a ministerial duty.[330]

The probability of success is not great. An act is not ministerial if it involves the IRS' discretion.[331] Since the courts usually try to avoid interfering with activities of the IRS, and the IRS has express discretion to compromise civil suits,[332] the courts probably would refuse to force the IRS to collect the tax from a government plan.

The probability of success may be irrelevant. Suppose the action also seeks to have the IRS collect tax from every vested participant.[333] Political pressure from the participants, especially those who hold relatively high office such as legislators and judges, may put the government in such a difficult position that it will favorably resolve the problem.

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326. I.R.C. § 402(b)(1) (1974).

327. One decision concludes that a state-related trust is not taxable unless Congress has expressly imposed tax. State of Michigan v. United States, 40 F.3d 817 (6th Cir. 1994); Marchesiello, *supra* note 208. Results may depend on construction of the statutes. Congress may have intended to impose tax since governmental plans are subject to the qualification requirements, and the consequence of failure to qualify is denial of an exemption. A similar argument applies to denial of exemption because of a prohibited transaction. I.R.C. § 401(a) (1974); I.R.C. § 501(a) (1994); 503(a)(1)(B) (1994). *See generally* STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 34-35 (Comm. Print 1978) (outlining the consequences in the few instances where the IRS enforced qualification requirements against public plans).

328. I.R.C. § 7421(a) (1994).

329. 28 U.S.C. § 1361 (1994); Vishnevsky v. United States, 581 F.2d 1249 (7th Cir. 1978); Blair v. United States *ex rel.* Union Pac. R.R. Co., 6 F.2d 484 (D.C. Cir. 1925); *see* Tull v. United States, 69 F.3d 394 (9th Cir. 1995). *See generally* John A. Lynch, *Nontaxpayer Suits: Seeking Injunctive and Declaratory Relief Against IRS Administrative Action*, 12 AKRON L. REV. 1 (1978) (arguing that the APA properly permits review of IRS rulings in appropriate circumstances).

330. United States *ex rel.* Dunlap v. Black, 128 U.S. 40 (1888); United States *ex rel.* Botany Worsted Mills v. Helvering, 89 F.2d 848 (D.C. Cir. 1937); *see Tull*, 69 F.3d at 394 (9th Cir. 1995).

331. United States *ex rel.* Ashley v. Ashley, 3 A.F.T.R. 3420 (D.C. 1917); Murray v. United States, 585 F. Supp. 543 (D.N.D. 1984), *aff'd*, 751 F.2d 271 (8th Cir. 1985).

332. I.R.C. § 7122(a) (1994). The IRS settled a qualification controversy with New Jersey. I.R.S. and N.J., *supra* note 3.

333. If the plan is not qualified, a contribution for a vested participant is taxable in the year when it is received by the plan. I.R.C. § 402(b)(1) (1974).

I. *Recapitulation*

State and local government plans seeking the benefits of qualification are subject to the pre-ERISA qualification rules.[334] The plan will be disqualified if the government does not contribute enough money to fully satisfy the funding rules every year.[335] The fact that the government is not obligated by statute to make the contribution[336] and would prefer to spend the money on something else is irrelevant.

Assets of the plan must be held by a qualified trust.[337] If the government removes assets for any purpose at any time,[338] the plan will be disqualified, and trust income is taxable if the trust makes an improper loan to the government.[339] The fact that the government was not obligated by statute to make the contributions[340] and has a desperate need for use of trust assets is irrelevant.[341]

It is unlikely that the IRS will begin actively enforcing the law. The IRS always feels it is understaffed and it prefers to use its resources in areas which are more likely to produce substantial revenue without becoming involved in political controversies. Hence, the participants and other interested persons such as unions probably will be the only ones who are concerned about enforcement.

It is unlikely that interested persons will be able to judicially enforce the qualification rules. The utility of a declaration that the plan is disqualified[342] is uncertain because the IRS is reluctant to enforce the law.[343] A suit to require the IRS to enforce the law[344] probably would be unsuccessful since the IRS has discretion to settle civil controversies.[345]

The ability to obtain judicial enforcement of the law may be irrelevant. If enough people are upset over the consequences of disqualification, they

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334. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 30-35 (Comm. Print 1978).

335. PRESIDENT'S COMM. ON CORPORATE PENSION FUNDS, PUBLIC POLICY & PRIVATE PENSION PROGRAMS 49-50 (1965); P.S. No. 57 (Aug. 5, 1946), *reprinted in* 3 STAND. FED. TAX REP. (P-H) § 76,237 (1946); IRS Publication 778, pt. 2(b) (Feb. 1972), *reprinted in* 3 STAND. FED. TAX REP. (CCH) ¶2605.70 (1973).

336. Trebotich v. Commissioner, 492 F.2d 1018, 1025 (9th Cir. 1974).

337. Treas. Reg. § 1.401-1(a)(3) (1964).

338. The only exception is when the plan has been terminated. Treas. Reg. § 1.401-2(a)(1) (1964).

339. I.R.C. § 503(a)(1)(B)-(b)(1), 4975(g)(2) (1994).

340. *Trebotich*, 492 F.2d at 1025.

341. I.R.S. and N.J., *supra* note 3.

342. I.R.C. § 7476 (1994).

343. *Joint Hearing*, *supra* note 34, at 165.

344. *See* United States *ex rel.* Dunlap v. Black, 128 U.S. 40 (1888).

345. I.R.C. § 7122(a) (1994). The IRS settled a qualification controversy with New Jersey. I.R.S. and N.J., *supra* note 3.

presumably will put sufficient pressure on the government to force it to timely follow the qualification rules.[346]

IV. REFORM

A. *Introduction*

Promises by state and local pension systems may be enforceable if there is a contract. The contract approach may not provide adequate protection since many jurisdictions permit modification of a promise.[347] Even states which have express constitutional protection frequently find ways to avoid requiring compliance.[348]

Rights are much more uncertain where there is no contract. Enforcement depends on a denial of due process, which means that complaints will be upheld only where property has been taken without compensation.[349] Most courts feel that due process is satisfied by public notice and an opportunity to be heard on proposed changes.[350]

The IRS can control the conduct of governments by denying tax benefits. State and local plans are not qualified unless they satisfy the requirements of pre-ERISA law,[351] which means that the plan must be definite and enforceable.[352] Since the IRS has shown little interest in forcing governments to follow the rules,[353] it probably will not do anything to provide assistance to participants.

Several proposals to regulate public pension plans have been defeated. Horrified at the prospect of being subjected to rules, state and local governments sent a parade of witnesses to each of the hearings involving

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346. New Jersey agreed to settle with the IRS since it had already planned to return assets to the trust, and wanted to avoid costly litigation. I.R.S. and N.J., *supra* note 3.

347. *See generally* Abbott v. City of Los Angeles, 326 P.2d 484, 493 (Cal. 1958) (stating that substitution of a fixed pension for a fluctuating pension is not permissible unless accompanied by commensurate benefits); Allen v. City of Long Beach, 287 P.2d 765, 767 (Cal. 1955) (invalidating portion of pension plan which modified pension rights without offering any commensurate advantages).

348. *See* People *ex rel.* Sklodowski v. State, 642 N.E.2d 1180, 1181-82 (Ill. 1994) (involving transfer of money from pension funds to general revenue fund); Musselman v. Governor, 533 N.W.2d 237, 239-40 (Mich. 1995) (involving an executive order reducing the appropriation to the public school employees retirement system).

349. *See* Pierce v. State, 910 P.2d 288, 304 (N.M. 1995) (stating that public retirement plans create property interests that cannot be taken without just compensation).

350. *See Pierce*, 910 P.2d at 304 (finding that before the legislature may alter retirement benefits, it must provide employees and retirees with adequate notice and an opportunity to respond).

351. H.R. REP. NO. 93-779, at 5 (1974), *reprinted in* 1974-3 C.B. 248.

352. South Tex. Commercial Nat'l Bank v. Commissioner, 7 T.C. 764, 767 (1946), *aff'd* 162 F.2d 462 (5th Cir. 1947) (finding that a qualified pension did not exist when the provisions of the trust agreement are vague and tenuous).

353. *See Joint Hearing*, *supra* note 34, at 165; STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 34-35 (Comm. Print 1978).

these proposals.[354] The representatives of state and local governments principally argued that there would be a substantial increase in costs which would cause termination of some plans and reduce the benefits available under other plans.[355]

Congress took no action. Although several committee reports recommended regulation, neither house of Congress passed a bill. After years of effort, those concerned decided that passage was improbable and there was no effort to obtain passage after 1984.[356]

B. *Legislative Background*

An early draft of ERISA did not contain an exemption for governmental plans.[357] State and local governments argued that applying the statute to their plans was undesirable because they were substantially different than private sponsors. Many of the problems that led to ERISA involved employers who had become unable to contribute to their plans.[358] State and local governments contended that this problem was not applicable to governmental sponsors since they had the power to tax to raise the necessary funds.[359] Further, they argued that the cost of complying with unnecessary regulations would lead to termination of some plans and a decrease in benefits available under other plans.[360]

Congress was suspicious of the explanation. Reports suggested that some governments could not raise taxes enough to pay for the benefits which they had promised.[361] Since there was inadequate evidence about whether the need for regulation would justify the cost, Congress exempted governmental plans pending completion of a congressional study.[362] The report was over 1,000 pages long and concluded that there was ample justification for regulation of several aspects of governmental plans.[363]

The report criticized every phase of pension affairs. Legislative bodies typically create and modify pension plans with little or no information about the effect of their actions.[364] Instead of seeking data about the

354. For an illustrative sample of witnesses, see *Joint Hearing, supra* note 34, at 367-71.

355. *See id.* at 369-70 (statement of the National Association of Counties).

356. *See* Scott, *supra* note 38, at 590.

357. *See* H.R. REP. NO. 93-779, at 90 (1974), *reprinted in* 1974-3 C.B. 333.

358. *See* H.R. REP. NO. 93-779, at 12 (1974), *reprinted in* 1974-3 C.B. 255.

359. *See* H.R. REP. NO. 93-779, at 90 (1974), *reprinted in* 1974-3 C.B. 333.

360. *See Joint Hearing, supra* note 34, at 369-70 (statement of the National Association of Counties).

361. *See* STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 140 (Comm. Print 1978); H.R. REP. NO. 93-779, at 90 (1974), *reprinted in* 1974-3 C.B. 333.

362. H.R. REP. NO. 93-779, at 90 (1974), *reprinted in* 1974-3 C.B. 333

363. *See* STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 81-82, 101, 179, 198 (Comm. Print 1978).

364. *See generally id.* at 63 (stating that the specialized nature of pensions requires technical knowledge).

probable future cost of proposed actions, legislators made decisions based on the politics of the moment.[365] The fact that taxes could not be raised enough to pay promised benefits[366] was no problem if the fact was unknown. Any thought that financing might become difficult or impossible was dismissed on the grounds that it would be the problem of a future legislative body.[367]

C. *PERISA*

The congressional study led to several proposals to regulate state and local governmental plans. They were comparable to some aspects of ERISA[368] but they were more modest apparently because committees felt that governmental plans did not require as much regulation as private plans. Since the evidence does not support the implication that governmental workers are less likely to be shortchanged, it is likely that the difference is based on friendships between federal politicians and those holding state and local offices.

1. Discrimination

Private plans must make membership available to a fair cross section of the employer's work force.[369] The plan generally satisfies this requirement if an adequate portion of the participants are from the middle and lower compensation ranges.[370] For example, suppose the only people who are eligible for a plan are judges. If they are highly compensated,[371] the plan is disqualified unless it is proper to evaluate the plan in combination with another plan, and the combination has an adequate quantity of persons in the middle and lower compensation ranges.[372]

Benefits from private plans must be nondiscriminatory.[373] The rule is satisfied if all members receive benefits which are an equal percentage of their pay.[374] Other formulas may be satisfactory as well.[375] Thus, even if the plan for judges has adequate membership, it will fail if benefits are discriminatory. For example, if the benefits for employees who are not

365. *Id.* at 63-64.

366. *See id.* at 139-42.

367. *See generally id.* at 63-64 (stating that legislatures modify one system without regard for fiscal consequences).

368. PERISA is an acronym for Public Employees Retirement Income Security Act. H.R. 14138, 95th Cong. (1979).

369. I.R.C. § 401(a)(4) (1994); *id.* § 401(a)(3)(B) (1974).

370. Treas. Reg. § 1.401-1(b)(3) (1972); Rev. Rul. 70-200, 1970-1 C.B. 101.

371. I.R.C. § 414(q) (1994).

372. *See* Treas. Reg. § 1.401-3(f) (1997); Rev. Rul. 61-218, 1961-2 C.B. 102; Gen. Couns. Mem. 36,897 (Oct. 27, 1976).

373. I.R.C. § 401(a)(4) (1994).

374. Treas. Reg. § 1.401-4(a)(2)(i) (1997).

375. *Id.* § 1.401-4(a)(2)(iii).

judges are 5% of compensation and judges receive 10%, the plan for judges fails because the benefits are discriminatory.[376]

The nondiscrimination requirements were imposed on private plans because Congress felt that it should grant tax benefits only if the plan was sufficiently available to workers. None of the proposals would have applied a nondiscrimination rule to public plans.[377]

2. Funding

Employers must make adequate contributions to pension plans.[378] Studebaker and similar cases convinced Congress that employers should contribute the amount necessary to cover the present value of future benefits so that funds would be available when benefits were due to be paid even if the employer went out of business.[379]

Legislators frequently put off funding to make money available for other purposes.[380] Since governments do not go out of business and they have the power to tax, the employer will continue to be accountable to some extent. However, participants and their beneficiaries may lose all or some of the promised benefits if taxes cannot be raised enough to pay the benefits or if legislative authorities are unwilling to eventually fund the benefits.[381]

None of the bills would require governments to satisfy a funding standard.[382] Hence, governments would be permitted to use any arrangement from full funding to pay as you go. Once a funding standard has been adopted, it would be enforceable by the fiduciary since their duty is to administer the plan according to its terms.[383] However, the bills would not expressly prohibit modification of the standard in a plan for services rendered after the date of the change.

3. Modification of Plans

When governments are unwilling to make adequate current contributions, they frequently decide to reduce their liability by modifying

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376. *See generally* Loper Sheet Metal, Inc. v. Commissioner, 53 T.C. 385, 392-93 (1969) (concluding that disparity between profit-sharing plan for salaried employees and pension plan for union employees was discriminatory with respect to both contributions and benefits); Rev. Rul. 81-5, 1981-1 C.B. 171 (1981) (finding that disparity in corporate benefits between profit-sharing plan for salaried employees and pension plan for hourly employees was discriminatory).

377. *See* H.R. 14138, 95th Cong. (1979).

378. I.R.C. § 412(a) (1994).

379. H.R. REP. NO. 93-779, at 12-13 (1974), *reprinted in* 1974-3 C.B. 256.

380. *See, e.g.*, Dadisman v. Moore, 384 S.E.2d 816, 829 (W. Va. 1988) (finding diversion of earned pension trust fund contributions to general revenue fund unconstitutional).

381. *See* STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 139-42 (Comm. Print 1978).

382. *See* H.R. 14138, 95th Cong. (1979).

383. *See id.*

the terms of the plan.[384] The modifications usually include retroactive reductions in benefits.[385] Attempting to change the terms of a plan after a benefit has been earned is improper.[386]

Definiteness is a requirement for qualification. Hence, an employer must delete a reserved right to change the plan, and the terms of the plan must be published to the employees.[387] The IRS requires publication for the purpose of establishing detrimental reliance as a ground for enforcing the plan,[388] and a series of decisions conclude that plans subject to change are not qualified.[389] ERISA continued the publication requirement[390] and established substantial ownership requirements.[391]

Private plans must make participants the owners of their benefits not more than seven years after the beginning of participation.[392] Congress felt the benefits were earned, and should not be forfeitable after a worker completed a substantial period of participation in the plan, even if he left the job or committed a wrongful act.[393]

The effect of the bills on the right to modify plans depends on the circumstances. Since they require publication of the terms of the plan to

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384. *See* STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 43-46 (Comm. Print 1978); Gregory, *supra* note 186, at 40; Romano, *supra* note 2, at 802-03.

385. *See* Spiller v. State, 627 A.2d 513, 514 (Me. 1993) (reviewing statute which reduced benefits to state employees with fewer than seven years of service).

386. *See* Rubin G. Cohn, *Public Employee Retirement Plans—The Nature of the Employees' Rights*, 1968 U. ILL. L.F. 32, 33 (1968) (discussing a split in jursidictions regarding the permanency of contractual rights within a plan); Selleck, *supra* note 54, at 205-06.

387. *See* Treas. Reg. § 1.401-1(a)(2) (1972); Rev. Rul. 72-509, 1972-2 C.B. 221 (determining that a plan not communicated to employees at the time of establishment does not satisfy the elements for a qualified plan); Rev. Rul. 71-90, 1971-1 C.B. 115 (permitting substitute methods of informing employees about a qualified plan).

388. *See generally* Engineered Timber Sales, Inc. v. Commissioner, 74 T.C. 808, 827-28 (1981) (stating that the purpose of a written plan is to inform plan participants of their benefits, rights, and obligations, and to ensure the plan's enforceability); G & W Leach Co. v. Commissioner, 41 T.C.M. (CCH) 998 (1981) (finding general notice distributed to employees did not satisfy the requirements for a written plan).

389. *See generally* Lichter v. Commissioner, 17 T.C. 1111, 1118-20 (1946), *acq.*, 1952-1 C.B. 3, *aff'd per curiam* 201 F.2d 49 (6th Cir. 1952) (finding that a trust is not qualified if the trustor reserves the right to alter, modify, or amend the trust provisions); South Tex. Commercial Nat'l Bank v. Commissioner, 7 T.C. 764, 767-68 (1946), *aff'd* 162 F.2d 462 (5th Cir. 1947) (refusing to allow a trust to be a qualified plan when the trustor retains power to amend the plan).

390. 29 U.S.C. § 1021(a)(1) (1974).

391. Pre-ERISA law required vesting when a participant retired, and when the plan terminated. I.R.C. § 401(a)(7) (1994).

392. Benefits from employee contributions must always be 100% vested. Benefits from employer contributions must occur no later than either on completion of the fifth year of service, or on a sliding scale beginning with completion of the third year and ending with completion of the seventh year. I.R.C. § 411(a) (1994). *See generally* STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 87-92 (Comm. Print 1978) (describing different vesting schedules).

393. I.R.C. § 411 (1994).

participants and provide a federal enforcement right, an attempt to retroactively reduce vesting, benefits, or funding would be improper.[394]

Prospective modifications present a different set of considerations. They would be improper to the extent that state law prohibited the change. There would be no relief for modifications that did not contravene state law and only the the definiteness requirement for qualification might prevent them.

4. Trust

Private employers must deliver contributions to a trust[395] and trustees are subject to several express duties. The overall rule is that they act solely for the benefit of participants and their beneficiaries.[396] Hence, any act which does not benefit the participants is improper.

The arrangements for holding government contributions frequently are unclear. Where assets are held in a governmental account, politicians and bureaucrats may feel they are merely another item of state property.[397] New Jersey claimed it was entitled to remove assets from a trust since New Jersey was the owner of the assets.[398] However, unless there was an express right to remove assets, the claim was frivolous.[399]

The duties of the fiduciaries are equally uncertain. Statutes frequently are silent or indefinite about their responsibilities and court decisions may be similarly vague.[400] Where duties are unclear, fiduciaries frequently are cooperative with the employer[401] because they are friendly with or feel they owe a duty to elected or appointed officials.[402]

The bills established standards for fiduciary conduct which are patterned after ERISA. Hence, fiduciaries would have been required to act solely for the benefit of participants and their beneficiaries, and would be subject to various subsidiary rules aimed at achieving the overall goal.[403]

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394. *See* H.R. 14138, 95TH CONG. §§ 102(a), 302(a)(1)(B), 302(e) (1978).

395. 29 U.S.C. § 1103(a)(1)(A).

396. *Id.* § 1104(a)(1)(A).

397. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 188-92 (Comm. Print 1978).

398. I.R.S. and N.J., *supra* note 3.

399. BOGERT & BOGERT, *supra* note 25, § 42.

400. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 188-89 (Comm. Print 1978).

401. Dadisman v. Moore, 384 S.E.2d 816, 825-26 (W. Va. 1988).

402. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 71 (Comm. Print 1978).

403. *See, e.g.*, H.R. 14138, 95th Cong. § 204(a) (1978).

The threat of a suit to enjoin improper fiduciary conduct[404] could be enough to force a fiduciary to sue the government for unpaid contributions.[405]

D. *Fate of the Bills*

State and local governments were horrified at the prospect of being subject to federal standards. Even minimal requirements could be a substantial hindrance to unbridled discretion. Moreover, it is easier to amend an existing statute than it is to enact the first measure. Establishment of minimal regulations would tend to focus attention on the problems and make it easier to adopt additional requirements for the purpose of further reducing discretion. Politicians decided to conduct a determined campaign against each of the bills and a parade of witnesses opposed each proposal.[406]

The principal argument was that any sort of regulation was unjustified because it would increase the cost of providing pensions. Some of the arguments were clearly groundless. Suggesting that current funding would increase costs is the reverse of the truth. The only cost is to make timely contributions. Making timely contributions reduces the amount the employer would eventually have to contribute since the money will earn income while it is in the plan.

Reducing or eliminating the ability to make retroactive changes would not increase costs. The problem is that governments frequently make pension arrangements by determining the amount to be paid as a retirement allowance. Unions and other representative bodies typically are concerned only with getting large allowances, and legislative officials rarely hear anything initially about the cost of those allowances.[407] When the bill becomes due at some later time, legislative officials frequently seek to reduce it by making retroactive modifications to the plan.[408] If those changes were prohibited, the government would be forced to contribute amounts in excess of that which is convenient.

Failure to establish the actual cost in advance is not the fault of the participants who relied on the plan and does not sound like a reasonable ground to permit governments to avoid their apparent promises. If politicians know they will be forced to honor their commitments, they presumably will be more responsible about making promises.

Preventing the employer from removing assets from the trust and making the trustee subject to a duty to act solely for the benefit of

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404. *See, e.g., id.* § 302(a)(3).

405. *See Dadisman*, 384 S.E.2d at 825-26 (holding that a failure to act in the face of illegal legislative maneuvers is a breach of fiduciary duty by the trustees of a public employee pension).

406. Scott, *supra* note 38, at 590.

407. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 63-64, 180-81 (Comm. Print 1978).

408. Spiller v. State, 627 A.2d 513, 514 (Me. 1993).

participants should not require any discussion.[409] Settlors usually cease to have any property interest in assets contributed to a trust[410] and assets are placed in a pension trust to increase the probability that participants will be timely paid in full.[411]

Government officials frequently see things in a different light. Since the government contributed the money, the money should be available if the government needs it for another purpose such as balancing the budget.[412] Government officials who act as trustees frequently can not obtain a reasonably clear idea of their duties, and they usually will willingly do the bidding of legislative and executive officials.[413] One court used strong language to describe the actions of trustees who cooperated in the removal of assets from a pension trust.[414] The court wondered why they did not sue to prevent the removals instead of appearing as defendants.[415]

Governments want to retain their ability to remove assets and manipulate trustees. Their suggestion that strict rules surrounding retaining assets and the conduct of trustees would increase costs is illogical. The real explanation is that it would force governments to make hard choices. When the funds in pension trusts are not available for other purposes, legislators are more likely to be forced to either reduce spending or obtain money from other sources.[416] The fact that some projects would have to be curtailed or taxes raised or money borrowed is not a reasonable justification for jeopardizing the payment of benefits which have been promised to participants.

E. *Prospects for Change*

Proponents eventually decided that change was unlikely. Committees adopted several bills between 1978 and 1984, but neither house of Congress passed any of them. Failure to secure favorable action on the 1984 bill was the last straw, and no member of Congress introduced a subsequent bill.[417] Hence, state and local governments managed to avoid even minimal regulation of their retirement plans.

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409. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 183 (Comm. Print 1978).

410. BOGERT & BOGERT, *supra* note 25, § 42.

411. *See, e.g.*, D.J. Lee, M.D., Inc. v. Commissioner, 92 T.C. 291, 299 (1989), *aff'd*, 931 F.2d 418 (6th Cir. 1991).

412. People *ex rel.* Sklodowski v. State, 642 N.E.2d 1180, 1180-82 (Ill. 1994); Dadisman v. Moore, 384 S.E.2d 816, 825-26 (W. Va. 1989); I.R.S. and N.J., *supra* note 3.

413. STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 71 (Comm. Print 1978).

414. *Dadisman*, 384 S.E.2d at 825 n.12.

415. *Id.*

416. *Id.* at 829.

417. Scott, *supra* note 38, at 590.

Records of hearings on the bills identify the lobbyists and their public testimony.[418] What is unknown is the quantity of personal lobbying by state and local government officials. The fact that the committees adopted several of the bills but neither house of Congress passed any of them suggests that personal lobbying was successful with many members of Congress.

No effort to secure passage was made after 1984 because it was clear that Congress was not willing to approve. Since lobbying by state and local governments has always been successful, another campaign is unlikely unless there is enough support from the public or interest groups to give it a reasonable prospect for passage.

The problem has been lack of organization. While interest groups have been very active in dealing with specific local or statewide issues, there has been little or no effort to organize a campaign to obtain national legislation. Hence, Congress concluded that the complaints were not of sufficient magnitude to justify even minimal regulation of state and local pension plans.

F. *Recapitulation*

Unions and other interest groups have merely reacted to problems. They spent much time and money on litigation and other efforts to deal with specific state and local situations.[419] However, they have spent little or no effort to obtain national legislation which could be a much more effective method of dealing with the immediate problems of their constituents.

There may be several explanations for their actions. Some are not interested because they have never had a problem. Others are reluctant to spend money at times when their arrangements are satisfactory. That may be especially true if they fear a program could be counter-productive because it might move legislators to take unfavorable actions against satisfactory arrangements.

Perhaps their outlook will change when there is a bigger demand for funds. Whenever there is a depression, governments are more aggressive in their efforts to finance their budgets without raising taxes. If a sufficiently large group began to take unfavorable actions against pension arrangements at the same time, interest groups may decide to promote efforts aimed at obtaining national legislation.

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418. *Joint Hearing, supra* note 34, at v.

419. *See* Board of Admin. of the Pub. Employees' Retirement Sys. v. Wilson, 61 Cal. Rptr. 2d 207 (Cal. Ct. App. 1997); McDermott v. Regan, 624 N.E.2d 985 (N.Y. 1993); Pennsylvania Fed'n of Teachers v. School Dist., 484 A.2d 751 (Pa. 1984).

VI. CONCLUSION

Politics is the principal concern of legislative bodies. When pension arrangements are being created or modified, benefits to be paid are established by criteria such as the amount legislators think would be attractive to prospective employees and interest groups. There is little or no thought given to who will pay the bill or how the bill will be paid.[420]

Legislators usually do not consider payment problems because the courts do not force them to honor their promises. Refusing to pay because other demands deserve greater priority would be acceptable if no previous commitment existed. Once the government commits itself to make future expenditures and people act in reliance on the commitment, the government should be required to fulfill the commitment.

While some states force legislators to literally honor their promises,[421] most permit some changes[422] and some have no significant restrictions on changes. One state found there was no contract, and due process was satisfied since there was notice and an opportunity to be heard on proposed changes.[423]

The rules for qualified plans may offer some hope. A plan is not qualified if the essential terms are subject to modification.[424] The consequences of a finding that a plan is not qualified could be an effective weapon. The tax rules have not been a significant factor because the IRS has been unwilling to undertake significant enforcement activities,[425] and there is substantial doubt about the ability of participants and interest groups to enforce the tax rules.

Results demonstrate that federal legislation is the only possibility for forcing many legislative bodies to honor their pension promises. The statute should expressly prohibit retroactive changes, and permit participants, beneficiaries and representative groups to sue to enforce the plan.[426] Further, benefits should be fully funded in the year they are earned[427] and the funds should be held in trust.[428] Finally, removal of funds by the employer should

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420. STAFF ON HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 63-64 (Comm. Print 1978).

421. *Pennsylvania Fed'n*, 484 A.2d at 752-53.

422. Abbott v. City of Los Angeles, 326 P.2d 484, 488-89 (Cal. 1958); Allen v. City of Long Beach, 287 P.2d 765, 767 (Cal. 1955).

423. Pierce v. State, 910 P.2d 288, 299-304 (N.M. 1995).

424. South Tex. Commercial Nat'l Bank v. Commissioner, 7 T.C. 764, 767-68 (1946), *aff'd*, 162 F.2d 462 (5th Cir. 1947); Lichter v. Commissioner, 17 T.C. 1111, 1118-20, *acq.*, 1952-1 C.B. 3, *aff'd per curiam*, 201 F.2d 49 (6th Cir. 1952).

425. *Joint Hearing, supra* note 34; STAFF OF HOUSE COMM. ON EDUC. & LABOR, 95TH CONG., 2D SESS., PENSION TASK FORCE REPORT ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS 34-35 (Comm. Print 1978).

426. *See* 29 U.S.C. § 1132(a) (1994) (empowering certain persons to bring a civil action).

427. I.R.C. § 412 (1994).

428. 29 U.S.C. § 1103(a).

be prohibited[429] and other uses should be limited to arm's length transactions[430] which satisfy adequate fiduciary safeguards.[431]

429. BOGERT & BOGERT, *supra* note 25, § 42.

430. *See* Note, *Public Employee Pensions*, *supra* note 47, at 1005-16 (commenting on options available to government when need for funding modifications arise). *Compare* 29 U.S.C. § 1103(c) (stating that assets of plan are not to inure to the benefit of employer unless within an enumerated exception), *with* 29 C.F.R. § 2550.408b-2 (1996) (providing statutory exemption for services of office space).

431. 29 U.S.C. § 1104.