**Bankrupt San Bernardino Fails to Make Pension Payments (10/23/12)**

**Just How Significant?**

The city of San Bernardino declared bankruptcy on August 1, 2012. It is our understanding that the city's original intent upon declaring a fiscal emergency was to continue honoring pension payments. However, the city has now stopped making payments to CalPERS (the agency that administers state and local pension plans). Currently, the city owes CalPERS between $5 and 6 million of which $1.2 million has been officially designated as delinquent. The city's failure to make the payments stands in direct contrast to the cities of Vallejo and Stockton, both of which remain current on their pension payments despite bankruptcy filings.

**Is This a "Shot Across the Bow" in the Battle Being Fought by Municipal Governments to Reign in Pension Costs?**

Possibly. While it is too early to draw a conclusion, it could be part of a negotiating plan merely to defer costs -- and not to challenge the increasing annual pension costs that are significantly contributing to the structural imbalances being experienced by multitudes of California and other municipalities nationwide.

**What It Is Not?**

- It does not, at this stage, appear to be a challenge to the legal interpretation that supports the premise that the California state constitution conveys strong legal protection to the sanctity of pension payments, including increasing cost of living allowances.
- However, it does give the bankruptcy judge the leeway to accept the "pension payment deferral" as part of the bankruptcy plan.

**What We Expect to Happen?**

- We suspect that sooner rather than later there will be a concentrated legal challenge to the constitutional protection that is afforded to California state and municipal pensions.
- It is also our understanding that approximately 12 states adopted the California constitutional model that protects public pensions. Therefore, any potential successful challenge could have national ramifications.
- We also believe that CalPERS will challenge any legal action that seeks to infringe on existing pension rules.

While the legal arguments regarding the California constitutional protections afforded pensions are beyond the purview of this statement, any challenge will seek to establish (among other arguments) that benefits not yet provided or earned are not contractually protected, and that such benefits granted infringe upon future elected legislatures.

While states have done much to implement pension reforms, the vast majority of reforms, to date, impact future costs and do little to alleviate more immediate pressures. Pension reform will remain in the headlines as unfunded liabilities remain high. People are living longer than originally projected when most plans were implemented. The number of state and municipal employees has mushroomed over the years. Low interest rates make it difficult to keep up with projected investment assumption rates as high as 7% per annum. Stretching further out the risk spectrum, to improve fund returns, may or may not be appropriate for all pension recipients.

Pension reform remains as an "emerging area" of law. We suspect that legal challenges promoting substantial reforms will eventually be taking center stage.


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