

EARLY RETIREMENT INCENTIVES

PERC and court cases, providing interpretations of statutes, hold that a board of education may not, without legislative authorization and action, negotiate or enact an early retirement incentive program.¹ The leading court cases (*Maywood*, 131 N.J. Super. 551, and *Fair Lawn*, 79 N.J. 574) are clear in their determination that an incentive which tends to encourage early retirement goes beyond the board's statutory authority over compensation and would upset actuarial assumptions of the Teachers' Pension and Annuity Fund (TPAF). In addition, a 1991 memo from the Director of the Division of Pensions reaffirms the state's position that such incentives are not permissible.

Following is a summary of the reasons cited in various decisions that early retirement incentive programs are not allowed:

- TPAF costs will be increased, shifting costs to the state;
- actions by a state agency which affect retirement age will affect actuarial assumptions of a statutory pension system and are impermissible unless clearly and unequivocally authorized by the Legislature;
- the New Jersey Employer-Employee Relations Act does not confer authority upon the local board to agree to compensation schemes which bear no relation to the amount and quality of the services which its teaching employees have rendered;
- payments unrelated to service do not constitute "compensation" or "customary fringe benefits" which are proper subjects of negotiation (*Englewood*, 64 N.J. 1, 1973).

Based on the record of PERC and court cases, the following appear to be statutorily permissible:

- plans for payment of accumulated sick leave, as long as they are not related to age;
- plans that do not encourage early retirement, thereby endangering TPAF actuarial assumptions;
- plans which are related to service (rewarding additional service);

- plans which are related to the "quality" of service provided by the employee.

Please note that this summary is based on existing case law, which is subject to modification by future litigation and legislative action.

Information from the Division of Pensions

1991 Memo from Margaret McMahon, Director, Division of Pensions On December 12, 1991, the Division issued a memo addressing the issue of early retirement incentives. It emphasizes that the Division will scrutinize any attempts by local employers to implement an early retirement incentive program of their own making. Excerpts from the memo follow.

The memo begins with:

It has come to our attention that some local employers are considering their own early retirement incentive programs for their employees. Please be advised that local employers are not authorized to offer early retirement incentive programs for their employees unless the programs are specifically authorized by state law.

The second paragraph of the memo states that the only early retirement programs authorized by law are the recent programs for TPAF and PERS members enacted by the state. The third paragraph of the memo focuses on the financial impact of early retirement incentives:

The potential for financial harm to the state-administered retirement systems from un-authorized local early retirement programs is clearly demonstrated by the cost estimates provided by the actuaries to the state retirement systems for the early retirement incentive programs. The potential cost to local employers are substantial and may be justifiable only by substantial offsetting salary savings. A local

¹Legislative authorization results from specific enactment of statutes authorizing boards to enter into a program of incentives for early retirement. Periodically, the legislature has specifically authorized these programs for a defined period of time. The latest authorization, occurring in July 2003, is effective until July 2004. Under this law, boards can choose whether or not to offer the incentive to staff covered by the act. Details of this program, and issues for board consideration can be found on the 2003 Early Retirement page of the NJSBA web site at www.njsba.org

employer which implements its own early retirement program will generate similar costs for any state retirement system affected by the program.

In its final paragraph, the memo clearly indicates that any attempts by a local employer to implement its own incentive program will be met with severe penalties:

Do not implement such a program. If we discover that an employer has implemented its own early retirement incentive program, we will conduct an audit of the employer's pension records and accounts. If we find that employees have retired under an unauthorized local early retirement program, we will have the actuary of the affected state retirement system or systems determine the additional liability created by the local program. This liability will be added to the unfunded accrued liability of the employer. For local employers under TPAF, an unfunded accrued liability will be established and billed to the employer over the remaining time period for the unfunded accrued liability of the system which is currently 28 years. (emphasis added)

1976 Memo from J. McGarrity, Assistant Director, Division of Pensions This memo, dated September 1976, states that the Attorney General had determined that:

a local board of education may not modify the retirement rights, benefits and privileges which are accorded uniformly to all members of the TPAF throughout the state by establishing a local supplemental program. Such a supplemental retirement program would constitute modification of the comprehensive scheme which has been established by statute for the retirement of members of the Teachers' Fund and, lacking direct statutory authority permitting the establishment of retirement benefit programs by local boards of education, the statutory benefits of the Teachers' Fund cannot be increased, decreased or otherwise modified.

The memo outlines the plan that prompted the opinion: a district had agreed to pay retiring teachers a supplemental retirement benefit of twice their annual salary if they retired within a specified period of time. Teachers as young as 55 years of age with 25 years of service would be eligible. The memo does contain an explanation of what type of a plan may be acceptable:

nominal payments by an employing agency to a retiring employee covering accumulated sick leave or severance pay are readily distinguish-

able from supplemental retirement benefits and are not foreclosed by [this] opinion.

1998 Opinion from the Division of Pensions In response to a district's inquiry, a staff member from the Division issued an opinion that the district's contemplated "Separation Agreement" did not constitute an early retirement incentive program "because it will be offered to all eligible employees regardless of years of service and is not contingent upon retirement." The district's "Separation Agreement," negotiated with the local association and submitted for the Division's review, added a supplemental payment to the parties' contractual payment for unused sick leave for a limited period of time. The additional payment was available to any teacher, without regard to years of service or age, who submitted a letter of resignation by a certain date.

Note: The Division's letter clearly stated that its response to the board's inquiry was an "opinion" and was not to be construed as the Division's approval of the proposed separation agreement.

Boards are urged to discuss any approach to "early retirement" or "separation agreements" with their legal and labor relations resources. Boards may also direct their questions to the Division of Pensions and Benefits, at (609) 292-9012.

Court Cases

Maywood and *Fair Lawn* are the two major rulings on the subject of early retirement incentives.

Maywood Education Association, 131 N.J. Super. 551, decided December 6, 1974. This case, brought by the union, sought to gain enforcement of a contractual provision for additional retirement compensation based on unused sick leave. The contract clause provided: "...a longevity increment to the last yearly salary to personnel retiring...[of] five percent of the unused portion of accumulated sick leave days...times the daily rate of pay established by the existing guide at the time of retirement..." A twenty year service requirement in the Maywood district was also included in the clause. The dispute arose when the district refused to pay two retiring teachers the additional retirement compensation based on their unused sick leave (\$537 and \$706), claiming that the provisions of the agreement requiring payment were "illegal and unenforceable." The Board cited N.J.S.A. 18A:30-1 *et seq.* as prohibiting payment for unused sick leave, and further claimed that the absence of express authority to pay employees for unused sick leave should be interpreted as an implied prohibition against such payments. This argument was based on the Legislature's sanctioning of the payment for unused sick leave for certain state employees (see N.J.S.A. 11:14-9, Civil Service, supplemental compensation upon retirement²). The court disagreed, stating that the only statutory

² N.J.S.A. 11:14-12 limits lump sum payment of \$12,000.

limitations on sick leave for school employees is that an employee may not accumulate more than 15 days per year for future use. The court added that while the Legislature mandated payments for certain state employees, its inaction in doing so for other classes of employees, such as school teachers:

cannot be interpreted as evidencing a legislative intent to prohibit payment for unused sick leave to nonstate public employees. A more reasonable interpretation of its action is that as to other public employees such payments were and continue to be committed to the discretion of the public employer within their existing statutory authority to compensate their employees.

Citing *N.J.S.A. 18A:27-4*, the court stated that:

[t]his statutory grant of authority (to make rules governing employment, including salaries) is broad enough to encompass payment for unused sick leave either as part of the teacher's annual salary or in the form of additional compensation upon retirement.

The Board also asserted that the extra compensation was a gift of public monies, and therefore prohibited by the New Jersey Constitution (Article VIII, Section III, paragraph 2). The court held that, in general, New Jersey courts have:

adopted the view that compensation paid to public employees, whatever the label, is not a gift so long as it is included within the conditions of employment either by statutory direction or contract negotiation.

The Association prevailed, and the provision was upheld.

Fair Lawn Education Association, 79 *N.J.* 574, decided May 16, 1979. In this case, the New Jersey Supreme Court affirmed the Appellate Division's holding that local early retirement incentives are illegal. The dispute revolved around the Association's challenge to the Board's refusal to administer a plan it viewed as illegal. The Association sought to have the court declare the plan valid and enforceable. The Board had agreed to an "Early Retirement Remuneration Plan," the main thrust of which was that the value of the payment made to retiring employees was linked to age at retirement, with those retiring at an earlier age receiving a larger benefit. The Supreme Court held that the statute permitting the Board to set terms and compensation for employees:

did not confer upon [a] board of education the authority to establish a supplemental retirement benefits program which rewarded early retirement rather than the amount and quality of work that particular teacher had performed; the Employer-Employee Relations Act did not authorize [the] school board to establish the supplemental retirement benefits

program; and [the] supplemental retirement benefits program which was established by [the] school board and which provided incentive for early retirement was invalid because it could substantially affect retirement age and thus the actuarial assumptions of the Teachers' Pension and Annuity Fund.

Additionally, the court ruled that:

[a]ctions taken by a state agency which may substantially affect retirement age and thus the actuarial assumptions of the Teachers' Pension and Annuity Fund are impermissible unless clearly and unequivocally authorized by [the] Legislature.

The testimony of a consulting actuary for TPAF indicated that if early retirement became widely adopted and caused retirements earlier than would have otherwise occurred, costs of funding the TPAF would significantly increase. He estimated that a one year reduction in the average retirement age would result in the need for an annual increase in the state's contribution to TPAF of nearly \$12 million.

Other points made in the decision:

- payments unrelated to service do not constitute "compensation" or "customary fringe benefits" which are proper subjects of negotiation (*Englewood*, 64 *N.J.* 1, 1973);
- an early retirement incentive plan reduces the school district's educational expenses when lower paid replacements are hired; but, by doing so, TPAF costs, which are borne by the state, are increased, in effect shifting expense from the district to the state;
- absent clear and unequivocal statutory authority, early retirement incentive plans such as *Fair Lawn's* may not be established.

Other Court Decisions There have been several other court decisions regarding early retirement incentives:

Vera Miller, et al, v. Board of Trustees of the Teachers' Pension and Annuity Fund, 179 *N.J. Super.* 473, decided June 29, 1981. In this case, two districts had implemented a retirement allowance which consisted of an additional salary increase (\$500 for each of 3 years in one district, \$300 for up to 7 years in the other) above guide for several years prior to retirement when prior notice of intent to retire was given. All the parties involved, with the exception of the TPAF, claim that the additional compensation was to reward employees for long and faithful service, not to induce early retirement (with the formula used for determining pension benefits, an increase in salary near retirement would increase benefits). The retirements were prior to the *Fair Lawn* decision. After *Fair Lawn*, the Board was successful in court action to have the return of the extra compensation ordered from the retirees. On appeal, the court concluded that the circumstances in the case did not warrant a

Public Employment Relations Commission Cases

Negotiability of Payment for Unused Sick Leave

In a number of cases, PERC has found that payment for unused sick leave is a *negotiable* topic. See, for example:

Union City Board of Education v. Union City Education Association, PERC No. 84-79, decided December 14, 1983, 10 *NJPER* 15026. This 1983 decision, issued by the Chairman of PERC, determines that compensation for unused sick leave upon retirement is mandatorily negotiable. The clause in question, entitled “substitution incentive compensation, accelerated retirement,” allowed retirement on a date “which would facilitate consuming each unused sick leave day.” In other words, the teacher could retire 100 days early if they had accumulated that many sick days. The contract also provided for a lump sum payment of one half day’s pay for each accumulated sick day, payable upon retirement. The Board objected to the carryover of the clause into the successor agreement, citing *Fair Lawn* and pension statutes as prohibiting such a provision. PERC disagreed, relying on *Maywood* and *N.J.S.A. 18A:27-4*. PERC held that the Board’s statutory authority over compensation is:

broad enough to encompass compensation for unused sick leave, whether in the form of the teacher’s annual salary, the form of additional compensation on retirement, or the form of additional compensatory time off accelerating the date of retirement.

Township of Edison, PERC No. 84-89, 10 *NJPER* 15063, also affirms the negotiability of payment for unused sick leave.

Negotiability of Early Retirement Incentives In a number of cases, PERC has found that an early retirement incentive is a nonnegotiable topic. See, for example:

Morris School District Board of Education, PERC No. 97-142, 23 *NJPER* 28200, where PERC restrained the board from implementing a factfinder’s recommendation which the Commission found to be an unlawful inducement to retire.

Borough of Butler, PERC No. 99-83, 25 *NJPER* 30073, in which PERC holds that a provision that payment for unused sick leave upon retirement that declines with additional years of service falls in the category of illegal early retirement incentive.

Distinction Between Severance Pay and Impact on Retirement Compensation

In a number of cases, PERC has distinguished between the negotiability of issues such as severance pay and compensation for the purposes of retirement benefit. PERC has held that, in

remand. The decision stated that both parties believed, in good faith, that the retirees were entitled to the additional compensation, as the plan had been submitted to and approved by TPAF. The court also stated that the retirees had permanently and irrevocably relinquished their tenured positions and opportunity to amass additional pension benefits by accepting the contractual retirement provisions. The order of benefit reduction was reversed, and the employees were allowed to retain their additional benefits.

State v. State Supervisory Employees Association, 78 *N.J.* 54, decided August 2, 1978. This New Jersey Supreme Court case dealt with several labor relations issues, including the negotiability of the topic of public employee pensions:

Our holding permitting negotiation concerning matters not covered by a specific statute does not apply to pension statutes. The Legislature has determined that the entire subject matter of pensions is to be insulated from negotiated agreement which would contravene or supplement its comprehensive regulation of that area. Public employees and employee representatives may neither negotiate nor agree upon any proposal which would affect the sacrosanct subject of employee pensions.

Camden v. Dicks, 135 *N.J. Super.* 559, decided July 2, 1975. The city of Camden brought suit to recover additional severance pay in the form of payment for unused sick leave to a retiring employee. The contract clause provided payment for 50% of the employee’s accumulated sick time with a maximum of \$12,000 upon retirement. For this particular employee, the payment amounted to \$4,615. The city sought to recover the payment on the basis that it had no authority or power to agree to the payment, and that the contract provision constituted an ultra vires act on its part. The city also argued that since the Legislature did not specifically provide municipalities with the authority to provide payment for unused sick leave, it is beyond the municipality’s power to agree to such a payment. The court cited *Englewood* and *Maywood* in ruling in favor of the employee and upholding the legality of the provision.

N.J. Civil Service Assoc., Camden Council No. 10, 135 *N.J. Super.* 308, decided June 30, 1975. This case, which primarily dealt with dental insurance, reaffirmed the court’s judgement that:

[c]ompensation is surely part of terms and conditions of employment which are subject to negotiation within the contemplation of the Employer-Employee Relations Act. N.J.S.A. 34:13A-5.3; also Englewood, 64 N.J. 1, (1973).

The union prevailed, and the benefit was upheld.

general, severance pay and terminal leave are negotiable topics, but that the issue of whether those benefits can be included in employees' base pay for the purposes of calculating retiree benefits is one that must be addressed by the Division of Pensions. See, for example, Township of Galloway, PERC No. 98-113, 24 *NJPER* 29125.

Relevant Statutes

N.J.S.A. 18A:27-4. In notes of decisions, number 10, *Fair Lawn* and *Maywood* are cited with an explanation that:

This section providing that local board of education may set the terms and tenure of employment, salaries and time and mode of payment thereof did not confer upon board of education the authority to establish a supplemental retirement benefits program which rewarded early retirement rather than the amount and quality of work that particular teacher had performed. Fair Lawn.

School board had authority to authorize payment of retirement benefits based on unused sick leave, notwithstanding contention that legislature's failure to provide such benefits to teachers while providing them to other public employees impliedly prohibited payments to teachers. Maywood.

N.J.S.A. 18A:66-193 through 196. These sections of statute provide for an early retirement incentive for colleges and universities, effective April 7, 1987. It is included merely to show that the legislature appears willing to adopt such programs in limited instances. Limitations on the incentive were a maximum of 100% of the faculty member's current salary for those age 55 to 64, and no more than 50% of current salary for those age 65 to 69 for retirements taking effect on June 30, 1987. The maximums dropped to 80% and 35% of current

salary for retirement effective June 30, 1988. The college or university was responsible for financing the incentive program.

N.J.S.A. 18A:66-203. This section of statute grants the Department of Higher Education the authority to reimburse institutions of higher education for the cost of hiring faculty for the 1987-88 academic year to replace faculty retiring pursuant to the provisions of the incentive program. The limitations were "within the limit of funds made available to it" and a maximum of \$2,000 per course and \$10,000 per faculty member per year.

N.J.S.A. 34:13A-8.1. This section of the Employer-Employee Relations Act (the PERC law) was amended in 1974 and states "nor shall any provision hereof annul or modify any pension statute or statutes of this state."

P.L.2003,c. 129 Signed into law July 14, 2003, this statute amends P.L. 1979, c. 130 to authorize school districts to choose to participate in an early retirement plan delineated and defined in the act's provisions. The plan is available for a limited period of time: boards that elect to participate must adopt appropriate resolutions by July 2004. For a full discussion of the provisions of the new law and the issues that boards should consider in weighing their options, please go to the NJSBA web page at www.njsba.org and click on 2003 Early Retirement site.

Relevant NJSBA Policy

"Early Retirement Remuneration Plan: NJSBA seeks legislation to allow local school districts to provide an Early Retirement Remuneration Plan (ERR) which would be paid as extra compensation and not contractual salary to the teaching employee." (File Code 4145, Delegate Assembly, June 1987). The intent of this policy is to allow each district to craft a plan (if they choose to do so) which will address their particular and unique staffing and financial situation.