It's (Still) the Economy, Stupid!

The Evolving Doctrine of Fiscal Emergency in Public Sector Labor Relations

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In the aftermath of the passage of Proposition 13, California's local public agencies suffered an unprecedented loss of revenue and responded with aggressive measures to reign in employee wages and benefits. The California Legislature passed measures granting additional funding to local public agencies so long as the agencies did not grant cost of living adjustments in excess of the increases provided to state employees. The Legislation also voided any agreement by a local agency to pay a cost of living increase in excess of the increases provided to state employees.

In response, numerous public employee unions filed writs challenging the legislation as an invalid impairment of contract in violation of article I, section 10, of the United States Constitution and article I, section 9, of the California Constitution.
The California Supreme Court, following federal precedent in *Home Building and Loan Association v Blaisdell*, 290 U.S. 473 (1937), identified a four-factor test for determining the lawfulness of a legislative impairment of a contract in an emergency situation:

1. the contract modification must arise out an actual emergency;
2. relief from the contract must be necessary to protect a basic societal interest rather than for the benefit of a particular group of individuals;
3. the modification or relief must be appropriately tailored to the emergency it was designed to address, and the conditions that result must be reasonable; and
4. the modification imposed must be temporary and limited to the exigency that prompted the legislative response.

Sonoma County Organization of Public Employees v. County of Sonoma, 23 Cal. 3d 296 (1979). Applying the four-factor Blaisell test to the circumstances, the Court found the legislature had overreached in voiding all contracts which provided cost of living increases in excess of those provided to state employees. Accordingly, the court struck down that portion of the law as an impermissible impairment of contract. For the next three decades, Sonoma's four-factor test has strongly limited local public agencies' use of fiscal emergencies to modify collective bargaining agreements.

The Re-Emergence of Fiscal Emergency

In 2008, massive foreclosures triggered one of the worst stock market losses in U.S. history, resulting in significant job losses and other economic damage. The so-called "Great Recession" has had a significant impact on sales, transient occupancy, and (especially) property taxes, three of the most significant revenue sources for most local public agencies. With Proposition 13's legacy of reduced inflation in property taxes, suppressed revenues will likely continue long after the economy as a whole returns to normal. At the same time, local public agencies are struggling with increases in personnel and benefit costs, such as medical benefits and increased pension costs. The increases to pension costs – which for most local agencies will be phased in over the next few years – are expected to continue for the next three decades.

In the face of these challenges, several local public agencies have declared a state of fiscal emergency to justify changes to employee wages and benefits set forth in otherwise "closed" labor agreements. In addition to the well-publicized Chapter 9 Bankruptcy filing by the City of Vallejo in May of 2008, cities have begun to use fiscal emergencies to impact personnel costs.

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[1] Proposition 13, incorporated into the California Constitution as Article 13A, imposed significant limitations on the taxing power of local and state governments. Among other things, Proposition 13 limits ad valorem property taxes to one percent of assessed value.

[2] The United States Supreme Court, in the seminal case of Home Building & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934), which upheld an act restricting foreclosures on mortgages during the Great Depression, noted that "to assign contracts, universally, a literal purport, and to exact from them a rigid literal fulfilment [sic], could not have been the intent of the constitution. It is repelled by a hundred examples." Id. at 429. In particular, the Blaisdell Court recognized that conditions may arise "in which a temporary restraint of enforcement [of a contract] may be consistent with the spirit and purpose of the constitutional provision and thus be found to be within the range of the reserved power of the state to protect the vital interests of the community," including those produced by economic causes. Id. at 439-440.

[3] Subsequent decisions appear to have abandoned the requirement of an emergency and the temporary nature of a response to an emergency to justify the impairment of a contract. See, e.g., Veix v. Sixth Ward Building & Loan

On June 22, 2010, the City of Stockton, faced with a budget deficit of $23 Million for the coming fiscal year was approaching fiscal insolvency. Having already imposed significant layoffs on City staff, including police, the City found itself unable to close the budget deficit using normal means. The City had closed contracts with

both police and firefighter unions, both of which included formula-driven pay raises. After weeks of unsuccessful negotiations, the City used its emergency powers to freeze raises for police and firefighters and to take a fire truck out of service. The Police and Fire Unions have sued the City in both state and federal court and have sought grievance arbitration over the City's actions.

Similarly, in *City of Los Angeles v. Superior Court (Engineers & Architects Ass'n)*, 193 Cal. App. 4th 1159, 2011 WL 1088039 (March 25, 2011), the City of Los Angeles – facing a $500 million budget deficit – passed an ordinance declaring a state of fiscal emergency and authorizing the Mayor to implement a furlough plan as a cost saving measure. The Mayor subsequently implemented a plan furloughing civilian employees for up to 26 days per fiscal year. The Engineers and Architects Association claimed the furloughs violated the memorandum of understanding and sought arbitration. A unanimous panel from the Second District Court of Appeal struck down the trial court's order compelling the City to arbitration, concluding that arbitration in this case would amount to an improper delegation of legislative authority. The Court therefore concluded that "[a]s the decision to impose mandatory furloughs due to a fiscal emergency is an exercise of the City Council's discretionary salary setting and budget making authority, the City Council cannot delegate this authority to an arbitrator." *Id*. at *9.

Conclusion

As the foregoing cases show, the doctrine of fiscal emergency remains alive and well. It is highly likely that, as declining revenues and increasing personnel costs continue, declarations of fiscal emergency and more litigation challenging those declarations will increase. The doctrine will continue to develop and changes will undoubtedly be made. However, it remains a viable alternative to declarations of bankruptcy as a means for local public agencies to adjust existing contractual obligations.

Ass'n, 310 U.S. 32, 39-40 (1940) (emergency need not be declared and relief measure need not be temporary). In *United States Trust Co. v. New York v. New Jersey*, 431 U.S. 1 (1977), the Court acknowledged this shift: while "the existence of an emergency and the limited duration of a relief measure are factors to be assessed in determining the reasonableness of an impairment, . . . they cannot be regarded as essential in every case." *Id*. at 23. The Court established a new standard to evaluate whether a contract impairment is constitutional and permissible, holding that "an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose." *Id*. at 25 (citations omitted).