STATE OF ARIZONA

OFFICE OF THE ATTORNEY GENERAL

ATTORNEY GENERAL OPINION By MARK BRNOVICH ATTORNEY GENERAL August 9, 2019	No. I19-004 (R18-019 and R18-021 consolidated) Re: Whether payments for public retirement plan unfunded liabilities are excluded by Article 9, Section 20(3)(d)(i) from a political subdivision's constitutional expenditure limits

To: Lindsey A. Perry, CPA, CFE
Arizona Auditor General

Bill Montgomery
Maricopa County Attorney

Issue Presented

Article 9, § 20(1) of the Arizona Constitution limits "expenditures" by counties, cities, and towns. Expenditures are defined as "any authorization for the payment of local revenues." *Id.* § 20(3)(c). If something is excluded from "local revenues," it is thus outside the scope of the expenditure limit. There are several such exclusions, including "[a]ny amounts or property received from the issuance or incurrence of bonds or other lawful long-term obligations issued or incurred for a specific purpose, or collected or segregated to make payments or deposits required by a contract concerning such bonds or obligations." *Id.* § 20(3)(d)(i).

The Arizona Auditor General and the Maricopa County Attorney both requested legal opinions on the following question, which we restate for purposes of this opinion:

> Maricopa County pays monies each fiscal year to satisfy the County's duty to pay annual amounts necessary to amortize unfunded liabilities for certain public

retirement plans ("Amortization Amounts"). Are the Amortization Amounts excluded from "local revenues" under § 20(3)(d)(i)?[1]

Summary Answer

No. The Amortization Amounts are not excluded under § 20(3)(d)(i). First, the duty to compensate county employees for their services, whether through salaries or benefits, is not a "bond or other lawful long-term obligation[]." Ariz. Const. art. 9, § 20(3)(d)(i). The "other lawful long-term obligations" that are excluded from local revenues must be bond-like, and the County must receive "amounts or property" from their issuance or incurrence. *Id.* Payments for services do not result in the receipt of amounts or property. Second, the County did not voluntarily "incur[]" the Amortization Amounts as "long-term obligations," as the Constitution requires, *id.*; instead, those liabilities are the result of the statutory requirement that the County contribute to the plans on an annual basis, as well as the performance of the plans' investments, among other things. Third, the payment of the Amortization Amounts is not "required by a contract," *id.*, but rather by "obligations created and mandated by the state." *Rochlin v. State*, 112 Ariz. 171, 176-77 (1975). Fourth, excluding the Amortization Amounts from local revenues would contravene article 9, § 20's history and purpose.

Background

A. The Adoption of Constitutional Expenditure Limits

The Legislature referred and the voters approved constitutional expenditure limits for counties, cities, and towns. 1980 Ariz. Sess. Laws Ch. 10, S.C.R. 1001, at § 9 (2d Spec. Sess.) (Prop. 108) (codified as amended at Ariz. Const. art. 9, § 20). That referral was part of a larger package of new and amended fiscal restraints on state and local governments related to public

[1] The Auditor General's request posed the additional question whether the County is in violation of Article 9, §§ 20 and 21 of the Arizona Constitution. We decline to answer that question.

debt, revenue, and taxation—all of which passed. *See, e.g.*, *id.* §§ 5–8, 10 (Props. 104–107, 109) (codified as amended at art. 9, §§ 8, 17–19, 21). The spending limits added to earlier such limits that applied to state government only. 1978 Ariz. Sess. Laws Ch. 206, S.C.R. 1002, at § 1 (2d Reg. Sess.) (Prop. 101) (codified as amended at art. 9, § 17).

The purpose of the expenditure limits in article 9, § 20 was to stop runaway growth of local government spending and an "ever-increasing local tax burden." 1980 Special Election Publicity Pamphlet, Leg. Council Arguments Supporting Prop. 108 at 66, https://azmemory.azlibrary.gov/digital/collection/statepubs/id/10632. The other spending limits had a similar purpose. *See, e.g.*, 1978 General Election Publicity Pamphlet, Leg. Council Arguments Favoring Prop. 101 at 12, https://azmemory.azlibrary.gov/digital/collection/statepubs/id/10626 ("Lack of a formal limitation on state spending has resulted in dramatic increases in appropriations which are responsible for the ever-increasing state tax burden.").

B. The County, City, and Town Expenditure Limit in Article 9, Section 20

Subject to certain exceptions, article 9, § 20(1) states that "[t]he governing board of any [county, city, or town] shall not authorize expenditures of local revenues in excess of" the spending limits "prescribed in this section." Generally speaking, those spending limits are the fiscal year 1979–80 expenditure levels for each particular locality, adjusted annually for population and cost-of-living changes, as well as for any transfer of government programs or change in boundaries. *See id.* § 20(1), (4), (5); *see also La Paz Cty. v. Yuma Cty.*, 153 Ariz. 162, 167 (1987); 1980 Special Election Publicity Pamphlet at 64.

"Expenditure[s]" are defined as "any authorization[s] for the payment of local revenues." Ariz. Const. art. 9, § 20(3)(c). "Local revenues" are defined as "all monies, revenues, funds, fees, fines, penalties, tuitions, property, and receipts of any kind whatsoever received by or for

the account of a political subdivision or any of its agencies, departments, offices, boards, commissions, authorities, councils and institutions." *Id.* § 20(3)(d). If something is excluded from the definition of "local revenues," then the authorization for expending that amount is excluded from the definition of "expenditure," *see id.* § 20(3)(c), and does not count toward the overall spending limit in § 20(1), which applies only to "expenditures." *See Mountain States Legal Found. v. Apache Cty.*, 146 Ariz. 479, 483 n.7 (App. 1985) (concluding "the revenues are not local revenues and therefore … not an expenditure within the constitutional definition").

C. The County's Obligation To Pay Amortization Amounts

The County participates in four public retirement plans: the Arizona State Retirement System (ASRS), the Elected Officials' Retirement Plan (EORP), the Public Safety Personnel Retirement System (PSPRS), and the Corrections Officer Retirement Plan (CORP). For each plan, the State mandates that unfunded actuarial accrued liability be paid each year. *See* A.R.S. §§ 38-737(A, C) (ASRS); 38-810(C, D) (EORP); 38-843(B) (PSPRS); 38-891(A) (CORP).

Analysis

I. The Plain Language of § 20(3)(d)(i) Confirms That the Amortization Amounts Do Not Fit Within its Exception to "Local Revenues"

The Amortization Amounts do not fit within the exception to "local revenues" in § 20(3)(d)(i) based on the plain language of that exception. "When interpreting the scope and meaning of a constitutional provision," the "primary purpose is to effectuate the intent of those who framed the provision and … the electorate that adopted it." *Jett v. City of Tucson*, 180 Ariz. 115, 119 (1994) (citing *McElhaney Cattle Co. v. Smith*, 132 Ariz. 286, 289 (1982)). This intent is effectuated by "'fairly interpreting the language used.'" *Cave Creek Unified Sch. Dist. v. Ducey*, 233 Ariz. 1, 6–7 ¶ 21 (2013) (quoting *Rumery v. Baier*, 231 Ariz. 275, 278 ¶ 15 (2013)). When a term is undefined, a court will "consider how the[] term 'is generally understood and

used by the people.'" *Fields v. Elected Officials' Ret. Plan*, 234 Ariz. 214, 219 ¶ 19 (2014) (citing *McElhaney Cattle Co.*, 132 Ariz. at 290; *State v. Jones*, 188 Ariz. 388, 392 (1997)). A court will thus "first examine the provision by assigning each word its 'natural, obvious, and ordinary meaning.'" *Id.* (citing *State ex rel. Morrison v. Nabours*, 79 Ariz. 240, 245 (1955)). And "[w]e read constitutional provisions as a whole, and give meaningful operation to each part in harmony with the others." *State v. Lee*, 226 Ariz. 234, 238 ¶ 11 (App. 2011) (citing *Corp. Comm'n v. Pac. Greyhound Lines*, 54 Ariz. 159, 170 (1939)).

Section 20(3)(d)(i) provides as follows:

> Any amounts or property received from the issuance or incurrence of bonds or other lawful long-term obligations issued or incurred for a specific purpose, *or collected or segregated to make payments or deposits required by a contract concerning such bonds or obligations*. For the purpose of this subdivision long-term obligations shall not include warrants issued in the ordinary course of operation or registered for payment, by a political subdivision.

(emphasis added). Reading § 20(3)(d)(i) as a whole, the italicized language means that localities may exclude from local revenues amounts that are collected or segregated to make payments or deposits required by a contract concerning bonds or other lawful long-term obligations incurred for a specific purpose. Several of those criteria are missing here.

A. Unfunded Pension Liabilities Are Not Bond-Like Obligations

The duty to compensate county employees for their services—whether through salaries or benefits—is not a "bond[] or obligation[]" within the meaning of § 20(3)(d)(i), because the County will not receive "amounts or property" from their "issuance or incurrence."

The phrase "such bonds or obligations" in the provision's second clause necessarily refers back to the phrase "bonds or other lawful long-term obligations issued or incurred for a specific purpose" in the provision's first clause. *Id.* This tells us, first, that the "obligations"

referred to in both clauses must be bond-like, such as certificates of participation.[2] Nearby constitutional provisions confirm this interpretation. *See Kilpatrick v. Superior Court*, 105 Ariz. 413, 419 (1970) ("[C]onstitutions must be construed as a whole and their various parts must be read together."). Throughout article 9, sections 17 through 21—the other constitutional sections added by S.C.R. 1001—the phrase "other lawful long-term obligations" is repeatedly joined with "bonds." This is a strong indicator that the "long-term obligations" referred to in § 20(3)(d)(i) must be bond-like to qualify.

Reading § 20(3)(d)(i) holistically also tells us the "bonds or other lawful long-term obligations" that qualify must be ones for which "amounts or property [were] received" in the first place. The text points in that direction. So does the placement of that provision in the context of "local *revenues*," which the Constitution defines as a long list of "receipts," but not services. *Id.* § 20(3)(d) (emphasis added).

The second clause of § 20(d)(3)(i) thus excludes from local revenues amounts "collected or segregated to make payments or deposits required by a contract concerning" bonds or other lawful long-term obligations for which amounts or property were initially received. The Amortization Amounts do not qualify. Compensating employees for services is not like making bond payments, and the County received no amounts or property from participating in the public retirement plans.

B. Unfunded Pension Liabilities Are Not "Long-Term Obligations" Under § 20(3)(d)(i)

The unfunded pension liabilities also are not "long-term obligations." Ariz. Const. art. 9, § 20(3)(d)(i). Again, § 20(3)(d)(i) must be read as a whole, and the phrase "such bonds or obligations" in the provision's second clause necessarily refers back to the "bonds or other

[2] The Attorney General previously referred to this subsection as "bond related expenditures." 1986 Ariz. Op. Att'y Gen. 72 (1986). And the Auditor General has long interpreted this subsection as only covering bonds, certificates of participation, and sale-leasebacks.

lawful long-term obligations issued or incurred for a specific purpose" referred to in the first clause. Maricopa County and the Auditor General appear to agree on this point. They also agree that "long-term" refers to obligations that will take more than a year to pay back. Where Maricopa County is mistaken is in asserting that unfunded liabilities are long-term obligations within the meaning of § 20(3)(d)(i). They are not.

Counties operate on a pay-as-you-go basis, and debts that (when issued) will not be paid back in the fiscal year must either (1) be special segregated funds that do not obligate the taxpayers or (2) comply with the county debt limitations in article 9, section 8 of the Constitution. *See Am.-La France & Foamite Corp. v. City of Phoenix*, 47 Ariz. 133, 139 (1936) (describing purpose of budget law, now codified at A.R.S. § 42-17106 as "[t]o put county affairs on a cash basis" (quoting *Bank of Lowell v. Cox*, 35 Ariz. 403, 410 (1929)); *see also City of Phoenix v. Phoenix Civic Auditorium & Convention Ctr. Ass'n, Inc.*, 99 Ariz. 270, 287 (1965). Counties do not budget compensation, including payment of benefits, as long-term obligations but rather as part of each fiscal year. And Arizona law requires localities to make up any unfunded pension liabilities on an annual basis. *See, e.g.*, A.R.S. §§ 38-737(A, C) (ASRS); 38-810(C, D) (EORP); 38-843(B) (PSPRS); 38-891(A) (CORP). Unfunded liabilities therefore are not long-term obligations.

C. Unfunded Pension Liabilities Are Not "Incurred For A Specific Purpose"

Even if they were long-term obligations, the Amortization Amounts would not be excludable from local revenues because they were not "incurred for a specific purpose." Ariz. Const. art. 9, § 20(3)(d)(i). Incurrence implies voluntary action. *See Rochlin*, 112 Ariz. at 176 ("Obligations which have not been voluntarily incurred but which have been imposed by state law have been held not to be debts in the constitutional sense."); *see also Incur*, WEBSTER'S NEW INT'L DICT. (2d ed. 1951) ("to become liable or subject to; to bring down upon oneself," and

"incur emphasizes the idea of liability, and commonly implies voluntary action … as, to *incur* an obligation[.]").

That voluntary action is required is confirmed by § 20(3)(d)(i)'s juxtaposition of "issuance … of bonds" with the "incurrence of … other lawful long-term obligations," both of which must be "issued or incurred for a specific purpose." Under the canon *noscitur a sociis*, a term "is interpreted in context of the accompanying words." *Estate of Braden ex rel. Gabaldon v. State*, 228 Ariz. 323, 326 ¶ 13 (2011); *accord City of Surprise v. Ariz. Corp. Comm'n*, 246 Ariz. 206, 211 ¶¶ 13–14 (2019). Localities issue bonds voluntarily and purposefully. Accordingly, a long-term obligation qualifies for the exception in § 20(3)(d)(i) only if a locality voluntarily incurs it, too, for a specific purpose.

Here, the County did not voluntarily incur the unfunded pension liabilities. By their nature, the Amortization Amounts are the result of unfunded liabilities that develop over time based on a plan's performance and other factors, and then are assessed against the County by the State pursuant to statute. *See Rochlin*, 112 Ariz. at 176–77.

D. Payment of the Amortization Amounts Is Not "Required by a Contract"

The Amortization Amounts also are not "required by a *contract*." Ariz. Const. art. 9, § 20(3)(d)(i) (emphasis added). Instead, the County is required by *statute* to pay them.

In *Yeazell v. Copins*, 98 Ariz. 109 (1965), our supreme court held that retirement benefits are a contract between the employee and the State. *Id.* at 112–17. This "contractual underpinning of public retirement systems" was subsequently "codified" in article 29, section 1 of the Arizona Constitution. *Fields*, 234 Ariz. at 221, ¶ 31. But only a few years before the Legislature and voters adopted article 9, § 20, the court concluded that the obligation to pay unfunded public pension liabilities is not one that the State's political subdivisions voluntarily incurred. *Rochlin*, 112 Ariz. at 177. Rather, those obligations were "created and mandated by

the state," and were required by "the state … of its political subdivisions." *Id*.; *see* A.R.S. §§ 38-737(A, C) (ASRS); 38-810(C, D) (EORP); 38-843(B) (PSPRS); 38-891(A) (CORP). Thus, although "[m]embership in a public retirement system is a contractual relationship" between employees and the State, Ariz. Const. art. 29, § 1(C), a County's obligation to pay unfunded pension liabilities is statutory, not contractual. Because the County is required by statute (not a contract) to pay the Amortization Amounts, those payments fall outside of § 20(3)(d)(i).

II. This Interpretation Furthers Section 20's Purpose

This interpretation is not only mandated by § 20(3)(d)(i)'s plain text, it is consistent with § 20's purpose. *See Cain v. Horne*, 220 Ariz. 77, 80, ¶ 10 (2009) ("When a provision is not clear, we can consider 'the history behind the provision, the purpose sought to be accomplished by its enactment, and the evil sought to be remedied.'" (quoting *McElhaney Cattle Co.*, 132 Ariz. at 290)). That section was designed to stop runaway growth of local government spending and an "ever-increasing local tax burden." *See, e.g.*, 1980 Special Election Publicity Pamphlet at 66. If any payments made for any more-than-a-year obligation were excludable from local revenues, then localities could circumvent constitutional spending limits by making any obligation a long-term one—for example, an obligation that takes a year and a day to come due. That obviously was not the Legislature's or the voters' intent in enacting § 20. *Cf. Whitman v. Am. Trucking Assocs.*, 531 U.S. 457, 468 (2001) (Congress "does not … hide elephants in mouseholes.").

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Conclusion

The Amortization Amounts are not excluded from the definition of "local revenues" by article 9, § 20(3)(d)(i). Instead, such amounts must be included in "expenditures" for purposes of the county, city, and town spending limits in § 20(1).

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