

**To: David R. Schwartz, Susan Plimpton Segal**

**May 4, 2000**

**Udail, Shumway, Blackhurst, Allen & Lyons, PC**

**Re: School District Early Retirement  
Plans**

**Gust Rosenfeld P.L.C.**

**I00-010**

**R00-016 - R00-022**

Pursuant to Arizona Revised Statutes ("A.R.S.") § 15-253(B), Mr. Schwartz recently submitted for review an opinion prepared for the governing board of the Glendale Elementary School District ("Glendale") concerning that district's early retirement plan ("ERP"). Ms. Segal submitted for review an opinion to the Deer Valley Unified School District ("Deer Valley") concerning ERPs. Because the subject matter of Mr. Schwartz's and Ms. Segal's opinions is similar, this Opinion addresses them together. This Opinion revises both opinions and clarifies the legal requirements for school district ERPs.

### **Question Presented**

1. May ERP benefits be paid over the course of more than one year?
2. May school district governing boards offer employees ERP benefits for more than one year without requiring continued employment of the retiree?<sup>(1)</sup>

### **Summary Answers**

1. Yes. The benefits provided by a school district pursuant to an ERP may extend beyond one year, as long as the terms of the ERP require annual renewals to ensure adequate funds are available to make the required payments.
2. Yes. A retiree need not continue working in order to receive the benefits included in an ERP, as long as the school district has received adequate consideration for the promised benefits.

### **Background**

#### **A. District ERPs.**

According to the opinion to Deer Valley submitted for review, district ERPs offer a package of benefits to induce district employees to retire early. These programs allow the district to reduce its personnel costs when filling the positions previously held by employees who accept early retirement. The opinion to Deer Valley notes that some district ERPs require former employees to work during the years they receive ERP benefits, and others do not impose an ongoing work requirement.

The Glendale opinion submitted for review provides more detail about that district's ERP. That district has offered its employees an ERP since the mid-1980s. Although some of the benefits provided by Glendale's ERPs have changed over the years, each of the ERPs:

1. has been available only to employees with at least 15 years of service;
2. required employees to provide notice of intent to participate by a specific date;
3. required approval by the governing board of each participant in the ERP;

4. has been subject to budget limitations;
5. required agreement by participants that they will not work full-time for the district after retiring; and,
6. has been subject to applicable laws and regulations.

Beginning with the 1990-1991 school year, Glendale's ERP paid the difference between an early retiree's health and dental insurance costs and the amount paid by the Arizona State Retirement System ("ASRS") until the retiree reached age 65. The ERP did not require the early retirees to perform any additional work in order to earn this benefit or any of the other benefits provided by the ERP. In considering amendments to the ERP for the 2000-2001 school year, the Glendale attorneys, relying on past opinions issued by this Office, advised the district that ERP benefits could be given only to retirees who performed services on a part-time basis for the district during the year in which the benefits were paid.

### **B. Statutory Authority Regarding ERPs and Prior Interpretations of That Authority.**

The statutes that govern the authority of school districts do not specifically address ERP benefits. However, this Office has previously determined that school districts may offer benefits to their employees pursuant to an ERP. Ariz. Att'y Gen. Ops. I84-097, I86-096, I87-009. In those Opinions, this Office concluded that:

- .the "consideration" the district receives for its paying ERP benefits is measured by the rights forfeited by the employee taking early retirement;
- .under A.R.S. § 15-502(A), teacher employment contracts must be for no longer than one year;
- .a school district must pay any ERP benefits during the employee's last year of employment; and
- .age-based criteria must not be used in order to comply with prohibitions against age discrimination.

See *id.* In addition, this Office has recommended that fringe benefits, including ERP benefits, be incorporated in district employment rules and regulations. Ariz. Att'y Gen. Op. I84-097.

These conclusions are based on a handful of statutes and cases that do not themselves expressly address ERPs. Section 15-502(A), A.R.S., authorizes school district governing boards to "employ and fix the salaries and benefits of employees necessary for the succeeding year." This Office's past opinions on ERPs have also cited A.R.S. § 15-905(N), which requires, with limited exceptions, that school district expenditures be for purposes included in the district's yearly budget. The other relevant statute is A.R.S. § 15-906, which establishes procedures to ensure school districts pay all liabilities due at the end of a fiscal year.

This Opinion re-examines the statutory and constitutional requirements for ERPs to provide guidance for school districts establishing and implementing these programs. This Opinion focuses on two issues: (1) whether districts may provide ERP benefits over time to early retirees without requiring that they continue to work for the district while receiving benefits; and (2) the

district's responsibility to ensure that the public receives adequate consideration in the ERP. Deer Valley and Glendale should reconsider their recommendations regarding their district ERPs in light of the analysis and guidance provided in this Opinion.

## Analysis

### **A. Prior Attorney General Opinions Properly Determined That Districts May Offer ERPs.**

In prior Opinions regarding ERPs, this Office properly determined that (1) districts may offer ERPs as fringe benefits pursuant to A.R.S. § 15-502(A); (2) ERP benefits must be commensurate with the value of the employment rights an employee is forfeiting; (3) ERP benefits must be included in an eligible employee's employment contract during that employee's final year of district employment; and (4) districts must not use age-based criteria to determine ERP eligibility.<sup>(2)</sup> Ariz. Att'y Gen. Op. I84-097. This Office also recommended that districts include ERPs in district rules and regulations. *Id.* This Opinion reaffirms these conclusions.

### **B. School District Governing Boards May Offer Their Employees ERPs That Provide for the Payment of Benefits Over Time.**

One requirement described in earlier Attorney General Opinions, however, needs modification. Earlier Attorney General Opinions concluded that the district must pay any amounts it owes under an ERP during the last year of the participating employee's employment with the district. See, e.g., Ariz. Att'y Gen. Ops I84-097 and I86-096. This interpretation prohibits districts from providing installment payments - including payment for medical and dental benefits - over time to retirees, unless those payments are provided through an annuity paid for during the employee's final year. See Ariz. Att'y Gen. Op. I86-096 (annuity may be purchased for retiree "if agreed upon by the teacher and the District in the last year's contract and so long as the cost for such annuity is paid for in the applicable fiscal year"). To overcome the one-year limitation, some school districts have provided medical benefits or some other benefits in future years, but have imposed a minimal work requirement for "retirees" in those years. In that way, the "retirees" remain district employees and continue to provide the district some consideration for the benefits received.

Three reasons have been given for prohibiting districts from paying ERP benefits over time: (1) A.R.S. § 15-502, governing fringe benefits for district employees; (2) the district budget statutes, particularly A.R.S. §§ 15-905 and -906; and (3) the principle that governing boards cannot bind future boards. For the reasons described below, this Opinion concludes that school districts may pay for ERP benefits over time. This is consistent with the statutory language and allows districts more flexibility to structure ERPs to suit local needs. It also eliminates the need for ERP participants to continue working in the retirement years they receive ERP benefits.

#### **1. Section 15-502(A) Does Not Prohibit Payments Over Time.**

Section 15-502(A), A.R.S., authorizes school district governing boards to "employ and fix the salaries and benefits of employees necessary for the succeeding year." As Attorney General Opinions have correctly concluded, an ERP is a fringe benefit a district may offer its employees. Ariz. Att'y Gen. Op. I84-097. Although A.R.S. § 15-502(A) requires the district to "fix the salaries and benefits of employees necessary for the succeeding year," it does not impose any requirements regarding the time frame over which the district may provide or pay benefits for such employees. Instead, the time frame for paying those benefits is properly a matter for the local school district governing board to determine in its discretion. Although the governing board must ensure that the school district receives adequate consideration from its employees, it is not

statutorily required to pay early retirement benefits all in one year.

At least one Opinion from this Office reached a similar conclusion. In 1983, an Attorney General's Opinion stated that school districts may pay insurance premiums for employees for a period of time exceeding one year after they retire, provided that the benefit is part of the employees' current contracts with the school district, "ma[king] it part of the consideration for which the employee is working." Ariz. Att'y Gen. Op. I83-051. Thus, the interpretation of Section 15-502(A) adopted in this Opinion not only comports with the statutory language -- the school district governing board establishes the salaries and benefits of employees necessary for the succeeding year -- but also resolves some inconsistencies in prior Attorney General Opinions, allows districts flexibility when structuring ERPs, and avoids the somewhat contrived and widely varied work requirements that districts have imposed so they could make ERP payments over multiple years.

A district, however, generally cannot pay benefits that were not offered to retirees before they ended their employment with the district. The employee's early retirement was the consideration the district received in exchange for the ERP benefits promised when the employee retired. For existing retirees, additional and adequate consideration would be required to justify the district's payment of any additional benefits that were not part of the ERP when the employee retired. See Ariz. Att'y Gen. Op. I83-051 (concluding that district could not pay newly adopted benefits to previous retirees).

## 2. If School Districts Pay for ERP Benefits Over Time, Future Boards Must Annually Review the Availability of Funds and Include Required Payments in the Budget for That Year.

Earlier Attorney General Opinions establishing the prohibition against payment of benefits over time have also relied on the school district budget statutes, A.R.S. §§ 15-905 and -906, to support that conclusion. Section 15-905, A.R.S., describes the annual budget process for school districts. That statute provides, in part, that:

[n]o expenditure shall be made and no debt, obligation or liability shall be incurred or created in any year for any purpose itemized in the budget in excess of the amount specified for the item irrespective of whether the school district at any time has received or has on hand funds in excess of those required to meet the expenditures, debts, obligations and liabilities provided for under the budget except expenditures from cash controlled funds as defined by the uniform system of financial records and except as provided in § 15-907 and subsection G of this section.

A.R.S. § 15-905(N). Under A.R.S. § 15-906, a school district having "levy fund liabilities payable on June 30" is required to file "an advice of encumbrance" with the county school superintendent. The county school superintendent may draw warrants against the amounts listed, and any obligations for unpaid amounts lapse after 60 days. A.R.S. § 15-906(C).

Although the language differs, these statutes serve a similar purpose to statutes such as A.R.S. § 35-154, which applies to State government. The Court of Appeals has concluded that A.R.S. § 35-154 requires a "fiscal out" clause that "operates as a condition subsequent, allowing the . . . [State] to avoid its obligations if the requisite funding is not forthcoming." *University of Arizona v. Pima County*, 140 Ariz. 184, 187-88, 722 P.2d 352, 355-56 (App. 1986) (concluding four-year contract for university basketball coach not prohibited by A.R.S. § 35-154). The Court of Appeals approvingly cited an Attorney General's Opinion concluding the State Board of Education could approve a contract binding a successor board so long as the contract included a release of the board's obligation if funds were unavailable. *Id.* at 186, 722 P.2d at 354 (citing Ariz. Att'y Gen.



Op. 180-022).

Similarly, A.R.S. §§ 15-905 and -906, which address school district expenditures, do not prohibit payment of contracts over time, provided that the payments are included in a school district's yearly budget and are subject to available funding each fiscal year. *Cf.* ARIZ. CONST. art. IX, § 8.1 (allowing unified school district to become indebted as long as the debt does not exceed 30% of the district's real property tax base). Indeed, the procurement rules that apply to school districts specifically permit contracts for materials or services for a period of time up to five years, provided that payments under such contracts are subject to the availability of funds. Arizona Administrative Code R7-2-1093. In addition, under A.R.S. § 15-906, the district must pay any obligation that is due before the end of the appropriate fiscal year or include unpaid amounts on an "advice of encumbrance" form filed with the county school superintendent. This requirement does not prevent the district from paying for the ERP benefits over time, provided that the district pays the amount owed in any particular fiscal year by June 30.

Apart from the specific statutory requirements, the concept that a governing board cannot bind successor boards has also been a concern. School district governing boards are required to determine policy for their districts, consistent with state statutes and regulations. A.R.S. § 15-341(A). As public officers, school board members must fulfill their responsibilities in a manner that, in their judgment, serves the public interest. *School Dist. No. 69 v. Altherr*, 10 Ariz. App. 333, 338, 458 P.2d 537, 542 (1969) *overruled in part on other grounds by Board of Trustees v. Wildermuth*, 16 Ariz. App. 171, 492, P.2d 420 (1972). As applied to ERPs and other employee benefits, this means a governing board may modify the school district's ERP prospectively to apply to employees not yet participating in the ERP as it deems appropriate. However, if a district has previously agreed to provide medical benefits or other benefits over time to employees who accepted a duly authorized ERP, the board must fulfill that previous commitment, unless funding is unavailable to do so.

In sum, if a school district governing board offers or "fixes" employment benefits in contracts, A.R.S. §§ 15-502(A), -905(N), and -906 do not invalidate those contracts even though the benefits earned are to be paid by the school district over more than one year. To the extent that previous Opinions of this Office conflict with this conclusion, this Opinion rejects the conclusions of those earlier Opinions.

### **C. The Gift Clause Requires That the District Receive Adequate Consideration, But Does Not Require Retirees to Perform Services for the District During the Year in Which They Receive Benefits.**

Article IX, section 7 of the Arizona Constitution, commonly called "the Gift Clause," prohibits the State, counties, cities, towns, municipalities and subdivisions of the State from giving or making any "donation or grant, by subsidy or otherwise, to any individual, association or corporation." This provision applies to school districts because they are political subdivisions of the State. *See Wistuber v. Paradise Valley Unified Sch. Dist.*, 141 Ariz. 346, 687 P.2d 354 (1984). In *Wistuber*, the Arizona Supreme Court held that the payment of public monies does not violate the Gift Clause if (1) the agreement pursuant to which the monies are paid serves a public purpose, and (2) there is valuable and valid consideration for the agreement. *Id.* at 348-49, 687 P.2d at 356-57. ERPs serve a public purpose. As explained in the Deer Valley opinion submitted for review, ERPs are beneficial to school districts because they allow them to replace higher paid employees with employees whose salaries are lower, thus saving the districts money. In addition, because ERP benefits are generally offered only to employees who have been with an organization for a certain number of years - in the case of the Glendale's ERP, for

at least 15 years - employers may use ERPs in their efforts to recruit and retain qualified employees. See *McClead v. Pima County*, 174 Ariz. 348, 358, 849 P.2d 1378, 1388 (App. 1992) (cost of living adjustments provided to retirees did not violate the Gift Clause because the agreement served a public purpose).

To comply with the Gift Clause, the district governing board approving the ERP must ensure the public receives adequate consideration. The Supreme Court in *Wistuber* noted that even if the public receives some consideration, "the Constitution may still be violated if the value to be received by the public is far exceeded by the consideration being paid by the public." *Id.* at 349, 687 P.2d at 357. The court recognized that "in reviewing such questions, the courts must not be overly technical and must give appropriate deference to the findings of the governmental body." *Id.*

When employees choose to participate in any ERP, they give up their employment after several years of service. This is the consideration they offer. Under the tenure statutes, after three years of employment with the district, teachers are statutorily entitled to continued employment, pursuant to which they can be dismissed only for cause or as part of a district-wide reduction-in-force ("RIF"). See A.R.S. §§ 15-538.01 (district governing board must offer contract of employment to teachers with at least three years of experience); 15-544 (teachers with at least three years of experience who are dismissed because of a RIF are entitled to a preferred right of re-employment; limiting district actions in reducing salaries of teachers with at least three years experience ). By choosing to participate in the ERP, employees give up those contract renewal and re-employment rights and voluntarily cease their employment before they otherwise would have.<sup>(3)</sup> The district should consider the various benefits the district will receive from a program allowing early retirement, and seek to assure that those public benefits are reasonably proportionate to what the district will pay to provide the promised ERP benefits.

The Gift Clause does not require that employees accepting an ERP perform some additional service for the district every year after taking early retirement. ERP participants have provided consideration for the promised ERP benefits through their long-term employment and their agreement to retire early. Therefore, unless made a term of an ERP, participants do not need to provide *additional* consideration by continuing to work after they have retired. As the Arizona Court of Appeals stated in *McClead*, "retirement benefits are not a gratuity but deferred compensation for services rendered." 174 Ariz. at 358, 849 P.2d at 1388. Although ERP benefits are not retirement benefits, they are benefits received based on past service and a forfeiture of employment rights, which are valuable consideration.

### Conclusion

School districts may offer ERPs as benefits to employees under A.R.S. § 15-502(A). A district may provide the benefits under an ERP program over several years, if the governing board so chooses, provided that benefits in future years are subject to the availability of funds. The district, to comply with the Gift Clause of the Arizona Constitution, must also ensure that the public receives adequate consideration. The Gift Clause does not require that employees continue to work for the district every subsequent year in which they receive benefits under an ERP.

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Janet Napolitano  
Attorney General

1. Ms. Segal's opinion also discussed whether the doctrine of equitable estoppel would require school districts to comply with the terms of existing ERPs, but in light of the conclusions regarding the first two questions, this Opinion does not address the estoppel issue.
2. School districts participate in the Arizona State Retirement System established in Title 38, chapter 5, article 2. *See* A.R.S. § 38-711(12) (defining "employer"). ERPs are not retirement benefits, but rather are fringe benefits provided under A.R.S. § 15-502(A).
3. Although they do not have statutory rights to continued employment with the district after a number of years of employment, district employees who are not teachers nonetheless forfeit the ability to work for the district before they are eligible for retirement benefits under ASRS, and the consideration given for ERP benefits by these employees may therefore also be valuable. As with all employees who are offered ERP benefits that will be paid over the course of several years, whether the consideration given by the employees is sufficient for purposes of the Gift Clause depends on the specific facts of each case and should be assessed by school district governing boards in determining whether to offer such benefits to certain classes of employees.

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