WILLIAM J. SCOTT
ATTORNEY GENERAL
STATE OF ILLINOIS
SPRINGFIELD

July 15, 1977

FILE NO. S-1265

CONSTITUTION:
Application of the State
Debt and Appropriation Provisions of the Constitution
to the Proposed Deferred
Compensation Plan

Honorable Robert J. Downing
Chairman
Illinois State Board of Investment
Suite 905, 180 North LaSalle Street
Chicago, Illinois 60601

COPY

Dear Judge Downing:

I have your letter wherein you ask the following questions:

1. Does money deferred under the State Employees Deferred Compensation Plan become a debt of the State for purposes of section 9 of article IX of the Illinois Constitution of 1970?

2. Because deferred compensation is considered to be a general asset of the State, does section 2 of article VIII of the Illinois Constitution of 1970 require that the State Board of Investment obtain an annual appropriation in order to distribute deferred compensation?

3. May the State Board of Investment or the Department of Personnel enter into contracts with vendors for a period longer than one year?

In response to your first question, it is my opinion that the State deferred compensation plan will not create State debt within the contemplation of section 9 of article IX of the Illinois Constitution of 1970. In response to your second question, it is my opinion that, because the deferred amounts will be considered public funds, an appropriation will be necessary before the funds or any interest accruing thereto may be distributed by the State. In response to your third question, it is my opinion that the length of contracts with vendors for the investment of deferred compensation funds will depend upon the type of appropriation used by the General Assembly to authorize the distribution of deferred compensation funds.

The limited obligation of the State to pay at a future date the balance then in a participant's deferred compensation account is not a State debt within the meaning of section 9 of article IX of the Illinois Constitution of 1970. Therefore, legislation authorizing the incurrence of such an obligation need not be passed by the extraordinary methods set forth in section 9.

Section 9(a) of article IX of the Illinois Constitution of 1970 provides as follows:

> "(a) No State debt shall be incurred except as provided in this Section. For the purpose of this Section, 'State debt' means bonds or other evidences of indebtedness which are secured by the full faith and credit of the State or are required to be repaid, directly or indirectly, from tax revenue and which are incurred by the State, any department, authority, public corporation or quasi-public corporation of the State, any State college or university, or any other public agency created by the State, but not by units of local government, or school districts." (Emphasis added.)

This provision, when originally presented by the Revenue and Finance Committee of the Constitutional Convention, would have defined "State debt" to include indebtedness to be repaid from non-tax revenues of the State. (VII Record of Proceedings,

6th Illinois Constitutional Convention, p. 2174.) The convention, however, excluded debt to be discharged from non-tax revenues and debt not secured by the full faith and credit of the State from the coverage of subsections (a) and (b) of section 9 and included subsection (f) which provides as follows:

> "(f) The State, departments, authorities, public corporations and quasi-public corporations of the State, the State colleges and universities and other public agencies created by the State, may issue bonds or other evidences of indebtedness which are not secured by the full faith and credit or tax revenue of the State nor required to be repaid, directly or indirectly, from tax revenue, for such purposes and in such amounts as may be authorized by law."

In the present situation, the obligation of the State is limited solely to paying a participant or his beneficiary the account balance as increased or decreased in consequence of the investment experience. Accordingly, it does not appear that the State can ever be obligated for future indebtedness payable out of the tax revenues of the State or supported by its full faith and credit. This conclusion is not countered by the circumstance that all fund

assets constitute the general property of the State, held in its general fund and subject to its unconstrained use and to claims of its general creditors.

The deferred compensation program should be viewed, quite simply, for what it is - a means by which a State employee may defer compensation to a later date at which time his income will presumably be lower and, thus, his tax rate will be lower. This program does not involve the issuance of a debt certificate or going to the market place to borrow money and, thus, does not appear to be the type of debt contemplated by the Constitutional Convention when it drafted section 9. See III Record of Proceedings, 6th Illinois Constitutional Convention, pp. 1926 - 1934, and 2095 - 2111; V Record of Proceedings, 6th Illinois Constitutional Convention, pp. 3848 - 3872, and 3896 - 3907.

Since all assets to be held in the deferred compensation fund, by definition and as a matter of law, will be general assets of the State, they will be public funds in a constitutional sense. Accordingly, the second question arises concerning the need for further legislative appropriation when

distributions of deferred compensation accounts are made to participants in the plan.

Section 2(b) of article VIII of the Illinois Constitution of 1970 provides explicitly as follows:

> "(b) The General Assembly by law shall make appropriations for all expenditures of public funds by the State.* * *"

Generally, the appropriation requirement has been interpreted strictly. The principle has long been established that the words used in the Constitution must be given effect according to their usual and ordinary signification. (Graham v. Dye (1923), 308 Ill. 283, 286.) Therefore, the words used in section 2(b) must be given effect in accordance with their plain meaning, and, since the section explicitly requires that appropriations must be made for all expenditures of public funds, an appropriation is required for the distribution of deferred compensation funds.

A subsidiary question arises relating to whether such required appropriation must be an annual one or whether it could be a continuing one. Most appropriations are annual in character, covering expenditures of a fiscal year. (Ill. Rev. Stat. 1975, ch. 127, par. 161.) It was, however, the

intent of the Sixth Illinois Constitutional Convention, in drafting section 2(b) of article VIII to leave the choice of methods of appropriation to the General Assembly, thereby eliminating further doubts concerning the validity of "no year" and continuing appropriations. The aforementioned intention of the convention is expressed in the report of the Revenue and Finance Committee wherein it was stated:

> "The Committee believes that since the legislature is charged with establishing financial controls, it should be free to determine the length of time appropriations are available for both obligation and expenditure purposes.
>
> * * *
>
> The Committee's proposal is not designed to require 'no year' appropriations. Rather it is designed to permit the legislature to adopt that device or others which may develop over the years." (VII Record of Proceedings, Sixth Illinois Constitutional Convention, p. 2028.)

See also Delegate Johnson's statement in the debates relating to the provision. (II Record of Proceedings, Sixth Illinois Constitutional Convention, pp. 883 and 884.) Therefore, it appears that in the context of a fund such as is contemplated by the proposed deferred compensation plan, the General Assembly

may fulfill its duty of appropriation with a continuing rather than an annual appropriation should it elect to do so.

Your third question relates to contracts with vendors for the investment of deferred compensation funds. Section 24-104.1 of the Illinois Pension Code (Ill. Rev. Stat. 1975, ch. 108 1/2, par. 24-104.1) provides that the costs of administration are to be paid out of earnings from investment of the deferred compensation funds, by prorating the cost among the participants or by some other appropriate and equitable method determined by the Board. Assuming that the costs of administration will come out of the earnings of the fund, which earnings are clearly public funds, an appropriation will be necessary for the payment of such costs. Thus, the permissible length of contracts with vendors will depend upon the type of appropriation used by the General Assembly in relation to the deferred compensation funds.

If the General Assembly appropriates on a yearly basis for the distribution of deferred compensation funds, contracts with vendors will necessarily be limited to a year

by section 30 of "AN ACT in relation to internal auditing in State government" (Ill. Rev. Stat. 1975, ch. 127, par. 166), which prohibits contracts binding the State in excess of amounts appropriated. I would, however, point out that it has been the practice of some State agencies to enter into contracts for periods longer than one year when the contracts in question contain a clause providing that State performance is subject to future appropriation. On the other hand, if the General Assembly passes a continuing appropriation of deferred compensation funds, there would appear to be no problem with the State Board of Investment or the Department of Personnel entering into contracts with vendors for periods in excess of one year.

At this point, I would like to discuss two questions concerning the validity of the State Employees Deferred Compensation Plan under the following related provisions of article VIII of the Illinois Constitution of 1970:

> "SECTION 1. GENERAL PROVISIONS
>
> (a) Public funds, property or credit shall be used only for public purposes.

> (b) The State, units of local government and school districts shall incur obligations for payment or make payments from public funds only as authorized by law or ordinance.
>
> * * * "

The pertinence of these requirements arises from two seemingly contradictory requirements in the Plan concerning earnings and increase of investments of the deferred compensation funds. On one hand, the Plan declares in section 6 that the State shall be the sole beneficiary of any investment contract entered into pursuant to the Plan while, on the other hand, section 5 provides that the "bookkeeping" accounts of participants are to include any increase or decrease incurred by the State of Illinois if it decides to invest the deferred compensation funds. In my opinion, the requirements in relation to the handling of earnings and increases require a statutory reconciliation not presently provided in Article 24 of the Illinois Pension Code (Ill. Rev. Stat. 1975, ch. 108 1/2, par. 24-101 et seq.), the absence of which throws doubt upon the constitutionality of the Plan when tested under subsections 1(a) and 1(b) of article VIII. My reasons for this conclusion and suggested corrective steps

to avoid the dangers of such constitutional invalidity, are next presented.

Since the employees' compensation actually deferred will be invested for indefinite periods of time, the earnings and increase therefrom will likely represent substantial parts of all future distributions to participants. Since by definition under the Plan such earnings and increases are "public funds" the following questions should be considered:

A. Will the distribution thereof be for a valid "public purpose"? (Section 1(a) of article VIII.)

B. If so, does article 24 of the Illinois Pension Code (Ill. Rev. Stat. 1975, ch. 108 1/2, par. 24-101 *et seq*.) effectively authorize the distribution of earnings and increases to fund participants as required by section 1(b) of article VIII?

Under the Illinois Constitution of 1870 problems of retroactivity arose in paying out somewhat comparable pension-type distributions to former State employees after termination of their public service. As was pointed out in G. Braden & R. Cohn, Illinois Constitution; an Annotated and Comparative Analysis 195 (1969):

" * * *

* * * Almost any politically feasible pension plan has elements of retroactivity in it, and against an argument that pension payments will be made in part for past service, the courts have had to find an answer. The answer, taken from J. Dillon, Municipal Corporations, Section 430 (5th ed. 1911), has been that pensions

> "'are in the nature of compensation for services previously rendered for which full and adequate compensation was not received at the time of the rendition of the services. It is, in effect, pay withheld to induce long-continued and faithful service, and the public benefit accrues in two ways:' By encouraging competent employees to remain in the service, and by retiring from the public service those who have become incapacitated from performing the duties as well as they might be performed by younger or more vigorous men." (People _ex rel_. Kroner v. Abbott, 274 Ill. 380, 384-85 (1916).)

The foregoing somewhat ingenuous argument suffices to get around giving credit for past service, but it is of no value in the case of an effort to increase the pensions of those already retired. Such efforts have been invalidated under Section 19 in the case of noncontributory pensions and compulsory contributory pensions. (_See_ Raines v. Board of Trustees, 365 Ill. 610 (1937); Porter v. Loehr, 332 Ill. 353 (1928).) * * *"

Distinction between invalid gifts of public funds to private persons, former employees of the State, and valid payments in the nature of additional compensation contracted

for by the State with its employees, scarcely requires elucidation. Public expenditures made to encourage public employment and to induce State employees to continue long and faithful service have been recognized by the Courts as being for "public purposes". Teachers Association of Central High School v. Board of Education (1970), 312 N.Y.S. 252. A corollary is the conclusion that such payments are not gifts to private persons. See Board of Trustees v. Teachers Union (1976), 62 Ill. 2d 470.

In light of these decisions it seems clear that the Plan, or employee contractual documents used under the Plan, should establish that the earnings and increases of investment to be paid out upon termination of a participating account are to be deemed additional compensation for continued service to the State during the period of fund participation. This would afford a basis of consideration for disbursement of such public funds meeting the requirements of the foregoing authorities and avoid the questions of retroactivity which arose in the pension cases under the Illinois Constitution of 1870. At present there appears to be no provision, either in

the authorizing act or the Plan itself, characterizing the ultimate distribution of earnings and increases as additional compensation. Absent such an understanding, it could be strongly argued that the very earnings and increases which under section 6 of the Plan are held for the benefit of the State of Illinois may not be paid to former employees, even if section 5 so provides. Such disbursement could be characterized as a gift to private persons and, thus, not an expenditure for public purposes.

The delegates to the Illinois Constitutional Convention were concerned with this basic distinction, although not specifically considering any question of deferred compensation. This emerges from Report No. 1 of the Revenue and Finance Committee (VII Record of Proceedings, Sixth Illinois Constitutional Convention p. 2029) wherein the Committee referred to the elimination of section 19 of article IV of the Illinois Constitution of 1870 which prohibited the General Assembly from granting or authorizing extra compensation to any public official after service had been rendered or to private persons with whom a contract had been made. The Committee stated:

> " * * *
>
> This section serves two distinct purposes. It prohibits payments of money without consideration and requires express authority to bind the government. These are traditional rules which would probably have developed in the absence of Section 19. Braden and Cohn, The Illinois Constitution: An Annotated and Comparative Analysis, 195 (1969). Moreover, the Committee has already incorporated in Section 1 a broad prohibition against the expenditure of public funds except as authorized by law. Thus, Section 19 can safely be removed.
>
> * * * "

Accordingly, it would appear that the Constitutional Convention, while eliminating section 19 of article IV of the Illinois Constitution of 1870, placed its reliance upon strict compliance with the provisions of section 1 of article VIII which it proposed for the new Constitution.

It does not appear from a reading of Article 24 of the Illinois Pension Code (Ill. Rev. Stat. 1975, ch. 108 1/2, par. 24-101 et seq.) that any express or implied authority is given to the State Board of Investment or to the Department of Personnel to distribute investment earnings and increases to fund participants. Section 24-101 of the Illinois Pension Code provides as follows:

> "Notwithstanding any law to the contrary, the State of Illinois or any unit of local government or school district may enter into a written contract with any of its employees to defer the whole or any part of their gross compensation and may invest such funds in any such manner as prescribed by the deferred compensation program adopted by it under this Article."

Any contention that this section leaves to the Board or Department the unlimited power to determine whether or not disbursement shall be made of earnings and increases would raise a serious question of impermissive delegation of legislative authority.

While the General Assembly may delegate to an administrative agency some legislative power, it may not invest an agency with arbitrary powers to obligate the State. In G. Braden & R. Cohn, Illinois Constitution: An Annotated and Comparative Analysis 115 (1969) it is stated:

> " * * *
> * * * Perhaps the best formulation of the rule of delegation is that the legislature must so express the limits of its delegation that a court can tell whether the executive has acted within those limits. Thus, a court will invalidate a delegation that is so vague that it is subject to arbitrary and capricious interpretation and application. (See People ex rel. Schoon v. Carpentier, 2 Ill. 2d 468 (1954).)
> * * * "

Furthermore, in presenting subsection 1(b) of article VIII to the floor of the Constitutional Convention, Delegate Cicero stated:

> "* * * This [section] is intended to be a reaffirmation of the general rule that requires expressed authority for agents of government to make contracts or obligations binding government or to make expenditures, payments, and so on.
>
> * * * "
>
> (II Record of Proceedings, Sixth Illinois Constitutional Convention, p. 871.)

Under the Plan as formulated, section 6.1 thereof provides, in part, that the State of Illinois "shall be the sole beneficiary of any investment contract entered into pursuant to this Plan." The circumstances that this contradiction with section 5 stems from the necessity of meeting federal income tax requirements to avoid constructive receipt of income is no answer whatsoever to the constitutional demand of section 1(b) of article VIII that payments of public funds must be authorized by law. This apparent failure of authorization strongly suggests the invalidity of the State Employees Deferred Compensation program. It calls for correction by an appropriate amendment of the statute expressly authorizing

payout of earnings and increases of fund investments in conjunction with the deferred compensation, as additional compensation.

Very truly yours,

A T T O R N E Y   G E N E R A L