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Robert R. Corbin

September 26, 1986

Ms. Janice Sandler
Udall, Shumway, Blackhurst,
Allen, Lyons & Davis, P.C.
30 West First Street
Mesa, Arizona 85201

Re: I86-096 (R86-096)

Dear Ms. Sandler:

Pursuant to A.R.S. § 15-253(B), we have reviewed the opinions expressed in your letter of June 24, 1986 to Dr. James K. Zaharis, Superintendent of the Mesa Public Schools. We concur with your conclusion that the Mesa District is authorized to adopt and implement a voluntary early retirement incentive plan. However, we direct your attention to the Addenda to Ariz. Atty. Gen. Op. I85-069 and I85-071. An early retirement incentive plan, in order to be valid, should be developed so that the sum paid to the early retiree is based on the value of the tenure rights waived by the retiree, and is not inversely proportional solely to the early retiree's age or length of service. In addition, in calculating this value, the District should not assume that new hires as a group be disproportionately younger than the available workforce.

With regard to the methods the District may use in implementing the early retirement incentive plan, we concur with your opinion that the District may pay the retiring teacher incentive pay in one lump sum, as long as the last year's contract with the teacher so provides.

We also concur with your conclusions that the District may purchase, on behalf of the retiree, an annuity or comparable vehicle in lieu of a lump sum payment, if agreed

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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.

We revise your opinion to add that the acquisition of such an annuity is governed by A.R.S. § 15-213 and State Board of Education rules dealing with school district procurement.

We also revise your opinion that the District is authorized to enter into multiyear contracts with retiring employees to make periodic payments extending beyond the last year of the employee's employment. We addressed this subject in Ariz. Atty. Gen. Op. I84-097. In that opinion we concluded that school districts may enter into employment contracts only as authorized in A.R.S. §§ 15-502, 15-503 or 15-538.01. A.R.S. § 15-502 authorizes school boards to enter into one year employment contracts with teachers, principals, janitors, attendance officers, school physicians, school dentists, nurses and other necessary employees. A.R.S. § 15-503 authorizes employment contracts with superintendents and principals for any period not exceeding three years. A.R.S. § 15-538.01 authorizes school boards to renew the employment contracts of currently employed certificated teachers for the next ensuing school year. We are not aware of any statute, other than those enumerated above, that would authorize a school board to enter into an employment contract with a terminating employee during the last year of that employee's employment on any different terms. School boards have only the authority granted by statute. School District No. 69 of Maricopa County v. Altherr, 10 Ariz. App. 333, 458 P.2d 537 (1969).

We conclude, therefore, that a contract between the District and a terminating employee under which the District agrees to make termination incentive payments beyond the end of the term of the employee's final employment contract is not valid. See Ariz. Atty. Gen. Op. I84-097.

You also concluded that a District funded employee benefit trust established under A.R.S. § 15-382 is authorized (a) to make periodic payments to the terminated employee from District funds paid into the trust and (b) to acquire an "indemnification policy on the retiring teacher" under which the employee benefit trust would be the beneficiary. We revise your opinion as follows.

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The issue with respect to this question is whether an early retirement incentive plan which, in essence, is the payment of a sum of money to induce an employee to voluntarily terminate the employment relationship, is included within the scope of A.R.S. § 15-382. We conclude that it is not.

A.R.S. § 15-382(A) provides, in part:

The school district governing board may determine that self-insurance is necessary or desirable in the best interest of the district and may provide for a self-insurance program or programs for employee benefits for the district including risk management consultation.

A.R.S. § 15-382(E) defines the term "self-insurance program" to be:

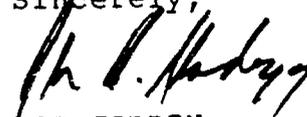
[P]rograms established and wholly or partially funded by the school district governing board. Self-insurance programs shall not include a decision by the [governing] board not to carry insurance upon a particular risk or risks.

A.R.S. § 15-382 does not define or delineate the self-insurance programs that a school district governing board may establish. However it does delineate what trust monies may be used for. A.R.S. § 15-382(C) provides that funds may be used for payment of uninsured losses, claims, defense costs and other related expenses. This leads us to believe that the Legislature intended that a governing board's authority to establish self-insurance programs is coterminous with the risks to which a school district might be exposed and against which, in the best interest of the district, a governing board might decide to self-insure rather than purchase insurance. The risks to which a school district may be subject and against which it might decide to self-insure in employing and retaining a productive work force include the risks of death, illness and injury of the District's employees and their dependents. We do not question, therefore, the authority of a school district governing board under A.R.S. § 15-382 to establish a self-insurance program that will protect the district by providing payments to employees and their dependents in the event of the death, injury, illness or other loss to employees.

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The District, however, has proposed to adopt an early retirement incentive plan to encourage employees, in the best interest of the school district, to terminate their employment prior to their normal or mandatory retirement date. We are unable to discern the risk of loss to which a school district would be exposed and consequently what self-insurance program a school district board might establish under § 15-382 to insure the school district against the risk of loss occasioned by the early retirements that the board has concluded serve the best interests of the district. In the absence of a risk of loss, A.R.S. § 15-382 does not authorize either the establishment of a self-insurance program, or payments to be made from a trust established to fund an authorized self-insurance program, respecting a voluntary early retirement incentive plan.

Sincerely,


FOR BOB CORBIN
Attorney General

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EDUCATION OPINION
ISSUE NO LATER THAN:

9-26-86

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834-7200

June 24, 1986

786-096

7/28/86

Martin

Dr. James K. Zaharis
Superintendent
Mesa Public Schools
549 North Stapley Drive
Mesa, Arizona 85203

Dear Dr. Zaharis:

You have requested an opinion from our office regarding the following issues:

- (1) May the District "buy-out" a teacher's tenure in order to allow and encourage a teacher to retire early?
- (2) What methods may the District use to "buy-out" a teacher's tenure under an early retirement incentive program?
 - (a) May the District pay the retiring teacher in one lump sum?
 - (b) May the retiring teacher be paid the same lump sum amount but at regular intervals over a period of time through an annuity purchased by the District?
 - (c) May the District make periodic payments to the retiring teacher, without requiring that the teacher provide services in the years the payments are made?
 - (d) May the District-funded Employee Benefit Trust be used to make periodic payments to the retiring teacher?
- (3) May the Employee Benefit Trust buy an indemnification policy on the retiring teacher's life, enabling the District to indirectly recoup the amount of the lump sum payment it pays to the teacher plus ?

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policy premiums, thereby decreasing the amount the District must deposit into the Trust to fund the Trust?

Please refer to the body of this letter for our response to each question.

1. Permissibility of a Tenure "Buy-Out" Program

It is now well established that a school district may enter into contracts providing for payments to employees who are tenured teachers or administrators in exchange for the voluntary release by the employee of tenure rights or employee benefits rights incurred during their employment. Ariz. Atty. Gen. Ops. 184-026; 184-043; 184-097. However, both A.R.S. Section 15-502(A)¹ and the Attorney General's recent opinions regarding the validity of early retirement programs underscore the necessity of having the Board adopt the benefit program prior to contracting with the employee for the upcoming year. These opinions conclude that it is possible to have an early retirement incentive program as long as it is part of the employee's contract (i.e., agreed to before the school year) and is voluntary on the employee's part. Ariz. Atty. Gen. Ops. 185-069; 183-051; 184-043; 184-097.

For example, in 183-051, the Attorney General determined "that a district, as part of its current employee negotiations, may agree to pay health insurance premiums for employees as they retire." More recently, the Attorney General held that a district may, by contract, agree to pay a teacher in return for the teacher's voluntary resignation. Ariz. Atty. Gen. Op. 184-026. Absent a contractual provision providing for payment to a tenured teacher to obtain that teacher's resignation, a school district has no express or implied statutory authority to pay a teacher in exchange for the teacher resignation. Ariz. Atty. Gen. Op. 183-096; See School District No. 69 of Maricopa County v. Altherr, 10 Ariz. App. 333, 458 P.2d 537 (1969). To be legal then, the program should provide that a teacher apply for and the Board approve the early retirement prior to entering the contract for the final year of employment, thus making the resignation and benefits contractual in nature.

¹ A contract for the ensuing school year includes only the employee fringe benefits which the governing board adopts for the next ensuing school year before it offers the contract.

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2. Permissible Methods of "Buying-Out" a Teacher's Tenure

a. Permissibility of a Lump Sum Payment

The Attorney General has held that a district may include in its contracts with administrators an agreement to make a lump sum payment upon an administrator's voluntary resignation. Ariz. Atty. Gen. Op. 184-043 (citing Ariz. Atty. Gen. Op. 184-026). The District should therefore be able to make a lump sum payment to a teacher-retiree, as it is already doing, so long as the District is receiving "valuable consideration" for the payment, and the benefit plan is established prior to the time of contracting. Generally, the retiring teacher will give value to the District by giving up his/her tenure right to work until the mandatory retirement age, thereby giving the District the opportunity to hire a new employee at a significantly lower starting salary, and perhaps replace a burned-out employee with a more energetic one.

b. Permissibility of Periodic Payments Through an Annuity Purchased by the District

A second option is for the District to buy an annuity for the retiring teacher pursuant to a contract in lieu of the lump sum payment. This method of payment is consistent with A.R.S. Section 15-906, because the District will pay for the benefit (purchase of the annuity) with funds available for expenditure for that purpose by the District in the fiscal year of the employee's last employment. Further, this method of payment does not obligate the District and its future boards to make expenditures in years subsequent to the year in which services are to be rendered. A.R.S. Section 15-906; See Ariz. Atty. Gen. Ops. 179-25, 181-119, 184-097.

c. Periodic Payments Without a Future Services Requirement

A third option, which you have suggested, is to let early retirees choose periodic payments of a lump sum amount. Since tenure is being purchased over time, no services would be required in exchange for the periodic payments of the lump sum amount. For example, a teacher who was entitled to receive a lump sum amount of \$20,000 in the year of retirement could choose instead to receive four (4) annual payments of \$5,000. The teacher would be given the opportunity to choose this payment plan at the time s/he agrees to participate in the early retirement incentive program. The advantages of this plan for the school district are (1) the lower costs of paying the lump sum out over time; and (2) it may provide teachers who are

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concerned about the adverse tax consequences of a lump sum payment with an additional reason to retire early.

This method of payment is the most difficult to sustain because (1) it could be construed as a gift since no services are being required; (2) it appears to contravene A.R.S. Section 15-906 by binding future boards to make expenditures in years subsequent to the year in which services are to be rendered, and (3) it necessitates payments from funds not available for that purpose in the fiscal year of the employee's last employment. However, it is our opinion that an extended payment program might still be a viable alternative, for the reasons set forth below.

Prior to 1984, district governing boards were not authorized by law to provide for employee fringe benefits in their contracts with school personnel. In 1984, new language was added to A.R.S. Section 15-502(A), to permit a governing board to provide for "employee fringe benefits, including sick leave, personal leave, vacation and holiday pay, jury duty pay, merit pay, pay bonuses and other benefits." This language is expansive, and arguably includes benefits contracted for with regard to early retirement incentive programs. If so, installment payments in lieu of a lump sum might be characterized as another type of fringe benefit - one designed to encourage a tenured employee to leave the school system early.

During the same year that A.R.S. Section 15-502 was amended to provide for employee fringe benefits, the Arizona Supreme Court acted to expand the range of services that could constitute valuable consideration for payments by a school district. In 1984, the Court held that a provision of a collective bargaining agreement between a district and the local teacher's association did not violate Ariz. Const. Art. 9, Section 7, where it released the association's President from teaching duties while the District continued to pay a portion of her salary. Wistuber v. Paradise Valley Unified School District, 141 Ariz. 346, 687 P.2d 354 (1984). In return for the release and continued salary, the President engaged in a substantial number of activities that clearly benefitted the district. Id. at 356. The Court noted that while governmental bodies may only distribute funds for a public purpose, what constitutes a "public purpose" changes to meet new developments and conditions of the times. Id. It then explained that the constitutional prohibition against gift-giving was intended to prevent governmental bodies from depleting the public treasury by giving advantages to special interests or engaging in non-public enterprises. The Court concluded that the benefit obtained from a private entity as consideration for payment from a public body may constitute "valuable

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consideration," and not an unconstitutional gift, so long as the value to be received by the public is not far exceeded by the consideration being paid by the public. *Id.* at 357.

Wistuber may open the door further to allow installment payments in early retirement incentive programs, where the employee's early retirement clearly benefits the school district. As the Court said, "public purpose" is a malleable concept that may change to meet the times. The Court upheld the constitutionality of payments to a teacher who was not providing conventional teaching services in exchange for those payments. Likewise, the District might want to make payments to a teacher who retires early, because that teacher is providing a valuable service to the District, albeit an unconventional one. As stated above, the retiree is providing a benefit to the District by allowing it to replace a highly paid teacher with a less costly and ostensibly more energetic one. The teacher is giving valuable consideration by offering his/her tenure rights in exchange for a sum of money. As a practical matter, the governing board can protect itself against the claim that it is making an unconstitutional gift by making a case-by-case determination as to what benefits will accrue to the District by having the particular applicant retire early. The District will want to be sure that the value it is receiving is at least as great as the value it is giving.

Another reason why an installment payment plan may be a viable alternative is that, as mentioned above, the Attorney General has held that a district may, as part of its current employee negotiations, agree to pay health insurance premiums for retiring employees. Ariz. Atty. Gen. Op. I83-051. The Attorney General felt that the installment payments on an employee's health insurance plan constituted a part of his/her salary and fringe benefits, so long as the payments were a part of the employee's contract while he/she was employed at the school. The Attorney General's reasoning in I83-051 seems applicable to the installment payment plan that the District has proposed for its early retirement system, which is arguably just another type of fringe benefit.

Contracting for installment payments rather than the lump sum is a way for the District to spread out the cost of the program. In order to be cost-effective and to stay within the bounds of A.R.S. Section 15-906, the District will have to employ sound accounting methods to accurately determine how much funding will be needed in each year of the program. Teachers should be made aware that the program has funding limits, and that only a

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certain number of applicants will be chosen to participate in the program each year. Further, teachers should be made aware that if the school district lacks the necessary funds to offer the program in a particular year, the program will be discontinued until funding becomes available. In this way, future boards are not being bound.

In summary, the 1984 Amendment to A.R.S. Section 15-502(A), the Arizona Supreme Court's recent pronouncements in Wistuber, and Atty. Gen. Op. I83-051 give rise to a strong argument that periodic future payments to a retired teacher are not violative of the state constitution and laws, so long as a "public purpose" exists for such a program.

d. Permissibility of Payments made by Trust

A fourth suggested alternative is for the District to pay a designated lump sum amount to the Employee Benefit Trust, which handles fringe benefits, instead of to the retiring teacher. The Trust would then make periodic payments to the retiree, perhaps on an annual basis. It is our opinion that this plan is acceptable, for the reasons stated above, unless it can be construed as an unacceptable attempt to compete with the State Retirement System.

3. Permissibility of Having the Trust Purchase an Indemnification Policy from Trust Reserves

A school district governing board may determine that self-insurance is necessary or desirable in the best interest of the district and may provide for a self-insurance program or programs for employee benefits. A.R.S. Section 15-382(A). A plan has been proposed whereby the District-funded Employee Benefit Trust would buy an indemnification policy on the retiring teacher during the final year of the teacher's employment. The policy amount would be large enough to cover both the cost of the District's "buy-out" and the policy premiums. The purpose of this plan is to provide a way for the District to (1) indirectly recoup the "lump sum" payment amount; and (2) over the long run, reduce the amount that the District must put into the Trust to keep it funded.

For example, assume that a tenured teacher with 20 years of service has applied for and been accepted into the program. The District has agreed to pay this teacher a lump sum of \$20,000 in return for the teacher's early retirement. Under the proposal, Trust reserves would be used to purchase an indemnification policy

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on the retiring teacher. The Trust would be the beneficiary of the indemnification policy.

If the policy premiums would amount to \$X on this particular teacher, the Trust would purchase a policy for \$20,000 plus \$X (which would cover the \$20,000 lump sum payment and the \$X premium amount). For a number of years, the Trust would be paying out more money than the policies would bring in. However, at some time in the future, the policies would pay off and be deposited into the Trust. As the Trust reserves increased as a result of the policy payments, the District would be able to reduce its funding of the Trust.

It is our opinion that the proposed plan with regard to Trust reserves is appropriate, but with certain reservations. The language used in A.R.S. Section 15-382 (above) is open-ended with regard to the types of employee benefits that the District may decide to self-insure. Under general legal principles, the Trustees of the trust have the obligation to manage trust funds in a fiduciarily sound and prudent manner. Thus, the District could use its trust reserves to buy an indemnification policy if fundamental trust requirements for reserves pursuant to federal statutes, rules and regulations which are applicable, are not violated.

This opinion is being sent to the Attorney General's Office for review pursuant to A.R.S. Section 15-253 (B).

Very truly yours,

UDALL, SHUMWAY, BLACKHURST,
ALLEN, LYONS & DAVIS, P.C.

Janis Sandler

Janis Sandler

JS:jw
cc: Dr. Chuck Essigs
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