

## **The Bailey Case** By Eugene Boyce

No controversy in the history of North Carolina has involved more legal complexities, more people and more money than the case of *Bailey, et. al. v. The State of North Carolina*.

**The Legal Questions:** Constitutional issues in Bailey included (1) the doctrine of “intergovernmental tax immunity,” (2) the U. S. Constitution clause that bars each state from enacting a law that “impairs the obligations of contract,” and (3) the N. C. Constitutional provisions requiring “uniform state taxation” and “equal protection of the laws.”

Constitutional issues appear profound, but these three are quite simple. First, state and federal governments may not levy taxes against one another without mutual agreement. Second, no state may pass a law that changes employees’ vested contract rights. Third, governments must treat all people equally, and tax laws must be uniform among persons and property of the same class.

**The U. S. Supreme Court:** Strangely, it was Michigan where the *Bailey* case had its origin. In early 1989, the U. S. Supreme Court had before it the question whether or not state and federal government retirees, not merely active government employees, are entitled to equal income tax treatment as between federal retirees and retirees of Michigan state government. North Carolina and 22 other states, the Supreme Court said, had been exempting state government employees from income taxation while taxing their retired federal and military citizens.

On March 28, 1989, the U. S. Supreme Court ruled that the constitutional doctrine and federal law that requires equal, reciprocal treatment among Michigan’s state government employees and 23 other states (including North Carolina) gave state and local government employees an exemption from state income tax and thus must give equal treatment to federal and military retirees living in their state. Every state must either tax all government employees equally or exempt all equally. Governments are immune from taxation by other governments.

**State’s Illegal Reaction:** The 1989 General Assembly, then in session, assumed it had the option of bringing North Carolina into compliance with federal law by repealing state employees’ tax exemption set forth in public employee retirement contracts rather than extending the exemption to current and future federal government retirees. Powerful and highly-financed lobbyists supported illegal solutions; backroom promises were made. Ignoring the rights of their retired members, the North Carolina Association of Educators (NCAE) and local government paid lobbyists, North Carolina Retired Government Employees’ Association (NCRGEA), assisted in passage of the law that took away teachers, state and local government employees’ tax benefits upon retirement. For the next 10 years these groups opposed the *Bailey* plaintiff’s effort to stop illegal taxation and recover taxes paid in violation of one’s constitutional rights. They refused even to run notices about what was going on in court. Requests for monetary and political support were refused.

**SEANC's Support:** On the other hand, SEANC and more than 30 other independent state and federal retiree groups consistently fought laws that impair the obligation of the retirement's contract benefits that existed for 50 years between North Carolina and its employees. Attorneys for Judge Bailey, three other judges, approximately 100 highway patrol and other law officers, teachers, principals and state and local government retirees fought to uphold and restore retiree rights for the next 12 years (with no assurance they would ever be paid).

**The Big Mistake:** The state's big mistake occurred on Aug. 12, 1989. Session Law 729 took away the tax exemption promised to hundreds of thousands of teachers and state and local government workers for 50 years. The promise was first made in 1939 and was in effect until 1989. Public employees who retired after 1989 were also deprived of the tax benefit that, at least in part, lured them into state employment and for which they dedicated many years in a career of public service.

**The First Bailey Case:** In February 1990, several attorneys for Judge Bailey and other retirees, who could not then compete with the political influence of self-servings lobbyists, filed suit in an effort to prevent the first year of illegal taxation of state employee retirement income. The first case, *Bailey I*, was successfully opposed by the attorney general on procedural grounds that prohibit suits to enjoin the collection of a tax that require payment of the tax followed within 30 days by a written protest to the secretary of revenue before a tax contest suit is filed.

**Bailey II:** After the Supreme Court dismissed *Bailey I* in December 1991, state and local government retirees persisted. Undaunted, they re-filed their case in November 1992 as *Bailey II*. The state asserted 12 complex legal defenses in its effort to get the case thrown out of court. Over 300,000 retired and current employees of state and local government and a like number of federal and military personnel had past and future tax exemption benefits at stake in the case. By the second year, the state collected a "mere" \$46 million and could have settled many times. In the end, however, over \$1.06 billion was collected from retirees. The retirees' numerous efforts to settle and compromise were met with a one-sentence rejection by the attorney general.

**Judge Thompson Appointed:** In 1994, after several years of legal skirmishing, the Supreme Court designated *Bailey* as an "exceptional case" and appointed Superior Court Judge Jack A. Thompson of Fayetteville to thereafter handle all motions, hearings and trials. The attorney general's motion to have *Bailey II* thrown out of court was denied in September 1994. A trial was ordered to begin in March 1995. The case was tried in Fayetteville with Judge Thompson sitting as judge and jury. It continued from time to time until August 31. Thousands of pages of letters, personnel pamphlets, meeting minutes, legislative history and other documents were introduced into evidence by both sides, and 37 witnesses testified. Thousands of hours were consumed in trial preparations, as well as trial and post-trial proceedings.

**"Jury" Rules for Retirees:** On Sept. 21, 1995, Judge Thompson entered judgment in favor of the Bailey retirees on all claims. He ruled that the 1989 repeal of state employees' tax exemption benefits under their retirement contract did "impair retirement provisions of public employee's employment contracts." Since the U. S. Constitution prohibited it, the state must be stopped from all further collection of income tax on state employee retirement income. Illegal taxes paid for 1989 – 1991 must be refunded Judge Thompson

said. Since the attorney general argued that the state could not be forced by court judgment to pay anything back, the judge ruled that retirees could recover their money through future tax credits.

**Illegal Tax Continues:** The attorney general sought and received a “stay order” and appealed. This maneuver made it possible for the state to continue collecting illegal taxes from retirees for another three years.

**N. C. Supreme Court Rules:** The attorney general’s appeal sank on May 8, 1998, when the Supreme Court said Judge Thompson ruled correctly on all constitutional issues. They further said taxpayers should have cash refunds, not just tax credits, and that Judge Thompson’s decision will be applied not only to persons already retired as of 1989, but to every vested state employee who began working for the state or local government at any time before Aug. 12, 1984.

**The Legislature Settles:** A few days following the Supreme Court’s decision, Rep. Leo Daughtry (R-Johnston) and Sen. Tony Rand (D-Cumberland) contacted the retirees’ attorney, met with them and by noon reached a compromise settlement for all aspects of both the state and federal retiree controversies for \$799 million and reinstatement of exemptions for all vested public employees.

**Settlement Process Begins:** The attorney general would not approve or sign the settlement agreement; however, 170 members of the General Assembly, the governor, 220,000 class members and Judge Thompson supported the retirees and other public employees who would get future benefits. In August 1998, a team of data information experts, claim processors, accountants and computer experts began work in Winston-Salem and Raleigh. Eventually over 134 people were employed. Most team members were retirees and many former employees of the N. C. Department of Revenue, the Internal Revenue Service, the Postal Service, Highway Patrol, public schools, etc. The “Locater Staff” was successful in finding current addresses for almost every one of 185,000 people who qualified for a refund.

The combined state and federal refund claim had reached \$1.06 billion. Since the federal case could have gone on another three to five years and state employees could get cash refunds, not tax credits, the \$799 million compromise was agreed to. All parties, excluding the attorney general, desired final and definitive conclusions to the decade of court fights.

Judge Bailey’s attorneys and the settlement team then proceeded to organize, invest the settlement proceeds, gather tax data and determine current addresses of retirees and survivors of deceased retirees. More than 45,000 retirees passed away during the litigation.

**Attorney Generals Appeals 2, 3, 4:** Even in 1998, however, the litigation did not stop. The attorney general appealed *Bailey III* in which he contested the date retirees were entitled to begin collecting interest on their settlement proceeds account. *Bailey IV* was the attorney general’s next appeal and an attempt to get settlement proceeds paid to ex-state employees who had been fired, quit public service or who otherwise never became retirees. Then in what came to be his last appeal, the attorney general tried to reverse Judge Thompson’s decision of an \*% fee award for the 12 years of litigation.

The attorney general lost all appeals, and in 2001 final refunds of taxes to 185,000 qualified and deserving retirees began.

**Retirees Received 98.7% of the Legislative Settlement:** Through good stewardship, efficient management and assistance from State Treasurer Harlan Boyles, the settlement fund grew to over \$886 million. The settlement team and plaintiff attorneys to the appeals cases rescued funds from possible taxation and interest payments. Of the \$799 million settlement \$788 million was returned to the 185,000 retiree taxpayers. Attorney's fees, litigation costs and administration costs were all paid from the extra money earned during the necessary administration phase. The final cost of litigation on each retiree was an average of \$38 per year. Getting the future benefits was free of charge.

*Eugene Boyce and Keigh Vaughan first became attorneys for the Bailey plaintiffs on April 12, 1989.*

*Eugene Boyce's Notes: I have been honored for 12 years to represent hundreds of thousands of fine public employees of the state of North Carolina and federal and military retirees living in this state. Nothing could please any attorney more than to be part of upholding the basic constitutional right of teachers and employees of the state and local governments and assuring that all benefits of their employment contract which they performed with honor and loyalty would come to them.*

*The Bailey case teaches a simple lesson: Employers who make promises must keep their promises to those who fulfill their part of the employment agreement - and this includes even our great State as the employer.*