

MEMORANDUM

TO: County Council

FROM: Robert H. Drummer, Senior Legislative Attorney 

SUBJECT: **Public Hearing:** Expedited Bill 16-10, Personnel – Retirement – Imputed Compensation Limit

Expedited Bill 16-10, Personnel – Retirement – Imputed Compensation Limit, sponsored by Councilmember Andrews, was introduced on April 6, 2010. A Management and Fiscal Policy Committee worksession is tentatively scheduled for April 29 at 2:00 p.m.

Background

Although the general wage adjustments for FY10 negotiated with each of the 3 County employee unions representing police, fire, and general government workers were “postponed” last year, Expedited Bill 18-09 required that the calculation of regular earnings used to determine a retirement benefit include the FY10 general wage adjustment as if the employee had received it on July 1, 2009.¹ This imputed compensation is scheduled to carry over into the calculation of regular earnings used to calculate a defined benefit pension for the rest of an employee’s County career. Expedited Bill 16-10 would amend the retirement laws to limit the effect of the imputed compensation to the calculation of regular earnings for FY10 only.

Last year, the County’s actuary, Mercer, estimated that this imputed compensation would require the County to increase its annual contribution to the Employees’ Retirement System Trust Fund by \$8.589 million per year for the next 40 years. A copy of Mercer’s April 27, 2009 report is at ©5-7 and a memorandum reviewing it from the Council’s actuarial advisor, Thomas Lowman of Bolton Partners, Inc. dated May 6, 2009, is at ©8. Mr. Lowman currently estimates that the actual savings from limiting this imputed compensation to FY10 is \$7.2 million for FY11. Annual savings would continue for a total of 40 years.

Issues

1. How would this Bill affect employees in the 3 bargaining units?

The County has three different retirement plans for its employees.² All public safety employees (police, fire, corrections, and deputy sheriffs) are members of the Employees’

¹ Employees of the Montgomery County Public Schools also agreed to “postpone” a negotiated general wage adjustment for FY10, but did not receive this imputed compensation.

² The County has a separate Elected Officials Retirement Plan that would not be affected by this Bill.

Retirement System (ERS). Although pension benefits differ between different ERS plans for public safety employees, each is a defined benefit plan with a pension benefit calculated using a formula based upon years of credited service and regular earnings. Non-public safety employees hired before October 1, 1994 are also in the ERS defined benefit plan. All non-public safety employees hired after October 1, 1994 are eligible for the Retirement Savings Plan (RSP) or the Guaranteed Retirement Savings Plan (GRIP). The RSP is a defined contribution plan where the County contributes 8% of an employee's salary and the employee contributes 4% of salary to a self-directed investment account.³ An employee's RSP benefit is based upon the value of the account at retirement. RSP participants may elect to participate in the GRIP instead of the RSP. The GRIP is a cash balance plan that creates a separate account for each employee funded by an 8% employer contribution and a 4% employee contribution. However, an employee's GRIP account is invested by the County Board of Investment Trustees (BIT). The County credits each account with a return on investment of 7.25% without regard for the actual returns received by the BIT.

The imputed GWA enacted by Expedited Bill 18-09 last year will provide a one-time payment of .36% of salary to members of the RSP and GRIP, averaging \$186 per member. The total cost of this one-time additional payment is \$919,750. **Bill 16-10 would not affect the pension benefit received by these employees.**

The imputed GWA provided a much larger benefit for ERS employees. Bill 18-09 included the GWA that employees did not receive in FY10 in the calculation of an employee's regular earnings for FY10 and compounded this imputed GWA into the calculation of regular earnings for each future year of an employee's County career. As noted above, the County's actuary estimated that this provision would cost **\$8.6 million** per year for up to 40 years. Most of these costs are due to the compounding of this imputed GWA in future year salaries. In short, it requires the County to pay a defined pension benefit based, in part, on regular earnings that were never paid. **Bill 16-10 would not eliminate the use of the imputed GWA in FY10 earnings, but it would limit its use to the calculation of FY10 earnings.** An employee's defined benefit pension is based upon the highest earnings over either 12 months or 36 months. If an employee's FY10 regular earnings are part of the employee's highest 12 or 36 months of earnings, then the employee would receive the benefit of the imputed GWA. However, Bill 16-10 would prevent the compounding of the FY10 imputed GWA in the calculation of future earnings. Therefore, if an employee's FY10 regular earnings are not part of the employee's high 12 or 36 months, the employee would not benefit from the imputed GWA.

The breakdown of employees in each retirement group broken down by bargaining unit is:⁴

³ The 8% employer contribution should be compared with the average County contribution for ERS employees, which is currently almost 35% of salary.

⁴ The following chart was provided by the Office of Human Resources at the request of Council staff.

County Employees
Retirement Enrollment
By Plan as of April 1, 2010

ERS Enrollment	
FOP	1102
IAFF	1113
MCGEO	1763
Unrepresented	773
Total	4751

GRIP Enrollment	
MCGEO	672
Unrepresented	249
Total	921

RSP Enrollment	
MCGEO	2516
Unrepresented	622
Total	3138

State Plan Enrollment	
MCGEO	95
Unrepresented	50
Total	145

Not Enrolled in a Retirement Plan	
MCGEO	62
Unrepresented	32
Total	94

ERS - Employees Retirement System
GRIP - Guaranteed Retirement Income Plan
RSP - Retirement Savings Plan

The Council's actuarial adviser now estimates that limiting the provision to FY10 would save **\$7.2 million** not only in FY11 but for future years as well. Total savings could exceed **\$200 million**. These savings from Bill 16-10 would not affect the pension benefit for 65% of the employees (3283 of 5046) represented by MCGEO or 54% of the unrepresented employees (921 of 1694).⁵

⁵ The 10 furlough days in the Executive's FY11 Recommended Budget are limited to non-public safety employees, which overwhelmingly targets RSP and GRIP employees who do not benefit from the ghost GWA after FY10.

2. Legal Authority.

Bill 16-10 would modify a law that was enacted to implement collective bargaining agreements with each of the 3 County employee unions. This raises the question as to the Council's legal authority to enact this Bill. The County Attorney and Council staff agree that Bill 16-10 would not violate the Contract Clause of the United States Constitution because it does not substantially impair vested legal rights. The Bill would apply prospectively to the calculation of regular earnings in future years that have not yet occurred. A copy of the County Attorney's Opinion dated April 18, 2010 is at ©9-12, and a copy of a Council staff legal opinion dated April 1, 2010 is at ©13-17.

This packet contains:	<u>Circle #</u>
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Legislative Request Report	4
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Bolton Partners Memorandum	8
County Attorney Opinion dated April 18, 2010	9
Council Staff Legal Opinion dated April 1, 2010	13

Expedited Bill No. 16-10
Concerning: Personnel - Retirement -
Imputed Compensation Limit
Revised: April 1, 2010 Draft No. 2.1
Introduced: April 6, 2010
Expires: October 6, 2011
Enacted: _____
Executive: _____
Effective: _____
Sunset Date: None
Ch. _____, Laws of Mont. Co. _____

COUNTY COUNCIL FOR MONTGOMERY COUNTY, MARYLAND

By: Councilmember Andrews, Trachtenberg, and Berliner

AN EXPEDITED ACT to:

- (1) amend the definition of regular earnings to limit certain imputed compensation under the employees' retirement system to FY10 only; and
- (2) generally amend the law regarding the employees' retirement system.

By amending

Montgomery County Code
Chapter 33, Personnel and Human Resources
Sections 33-35

Boldface	<i>Heading or defined term.</i>
<u>Underlining</u>	<i>Added to existing law by original bill.</i>
[Single boldface brackets]	<i>Deleted from existing law by original bill.</i>
<u>Double underlining</u>	<i>Added by amendment.</i>
[[Double boldface brackets]]	<i>Deleted from existing law or the bill by amendment.</i>
* * *	<i>Existing law unaffected by bill.</i>

The County Council for Montgomery County, Maryland approves the following Act:

Sec. 1. Section 33-35 is amended as follows:

Sec. 33-35 Definitions

In this Article, the following words and phrases have the following meanings:

* * *

Regular earnings: Except as otherwise provided, gross pay for actual hours worked, not including overtime. To calculate regular [Regular] earnings, for FY10 only, a Group A, E, or H member who is employed on July 1, 2009 and participates in the integrated or optional plan must include amounts as if the member had received an increase of 4.5% in the member's gross pay as of July 1, 2009, except for the purpose of calculating a member's contribution under Section 33-39. To calculate regular [Regular] earnings, for FY10 only, for a Group F member who is employed on July 1, 2009 and participates in the integrated or optional plan must include amounts as if the member had received an increase of 4.25% in the member's gross pay as of July 1, 2009, except for the purpose of calculating a member's contribution under Section 33-39. To calculate regular [Regular] earnings, for FY10 only, for a Group G member who is employed on July 1, 2009 and participates in the integrated or optional plan must include amounts as if the member had received an increase of 4% in the member's gross pay as of July 1, 2009, except for the purpose of calculating a member's contribution under Section 33-39. Regular earnings for an elected official is gross pay for services rendered to the County. Regular earnings must not exceed the limit under Internal Revenue Code Section 401(a)(17), as adjusted by the Internal Revenue Service. Gross pay must be used to determine benefits even if the County implements a pick-up plan under Section 414 of the Internal Revenue Code. Gross pay must be used to determine benefits even if a member has agreed to a reduction in earnings under:

28 (a) the County's deferred compensation plan under Section 457 of the
29 Internal Revenue Code; or

30 (b) any statutory fringe benefit program sponsored by the County and
31 permitted by the Internal Revenue Code.

32 * * *

33 **Sec. 2. Expedited Effective Date.** The Council declares that this Act is
34 necessary for the immediate protection of the public interest. This Act takes effect
35 on July 1, 2010.

36 *Approved:*

37

38

Nancy Floreen, President, County Council Date

39 *Approved:*

40

Isiah Leggett, County Executive Date

41 *This is a correct copy of Council action.*

42

Linda M. Lauer, Clerk of the Council Date

LEGISLATIVE REQUEST REPORT

Expedited Bill 16-10

Personnel-Retirement-Imputed Compensation Limit

DESCRIPTION: Bill 18-09 required that the calculation of regular earnings used to determine a retirement benefit include the general wage adjustment for FY10 as if the employee had received it on July 1, 2009. This imputed compensation is scheduled to carry over into the calculation of regular earnings used to calculate a defined benefit pension for the rest of an employee's County career. Expedited Bill 16-10 would amend the Retirement Laws to limit the effect of the imputed compensation to the calculation of regular earnings for FY10 only.

PROBLEM: The County has experienced a severe reduction in revenue and must reduce its FY11 expenditures in order to balance the budget.

GOALS AND OBJECTIVES: The estimated savings of \$7.2 million for FY11 would partially offset the need to use furloughs or a reduction-in-force to reduce expenditures.

COORDINATION: Human Resources, County Attorney

FISCAL IMPACT: To be requested.

ECONOMIC IMPACT: To be requested.

EVALUATION: To be requested.

EXPERIENCE ELSEWHERE: To be researched.

SOURCE OF INFORMATION: Robert H. Drummer, Senior Legislative Attorney

APPLICATION WITHIN MUNICIPALITIES: Not applicable.

PENALTIES: Not applicable

Douglas L. Rowe, FSA, MAAA, EA
Principal

MERCER



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April 27, 2009

Mr. Wes Girling
Montgomery County Government
101 Monroe Street, Seventh Floor
Rockville, MD 20850-2589

Confidential
Via Electronic Mail

Subject: Imputed Compensation Pension Cost

Dear Wes:

This letter summarizes the cost calculations you requested for the imputed compensation bill. The calculations are based on the July 1, 2008 actuarial valuation data for group A, E, F, G and H members. The actuarial assumptions and methods and plan provisions are the same as those used in our July 2008 actuarial valuation report except for the assumptions and incentive provisions noted below. Please note that actual cost of the imputed compensation will differ based on the number of individuals that are active as of July 1, 2009.

We have projected all costs from the July 1, 2008 valuation date to the effective date of July 1, 2009 using standard actuarial approximation techniques. By cost/savings, we mean the change in Normal Cost and an amortization of any changes in unfunded liability unless otherwise indicated. Cost/savings will change over time as experience develops.

Cost Calculated From Two Viewpoints

We have calculated the cost of imputing pay from two viewpoints – just the legislation (which increases benefits by imputing pay) that we were provided, and as a package which takes away previously negotiated pay increases, but then calculates pensions as if those pay increases had occurred. The cost for the second viewpoint is that employee contributions are not made on the imputed pay.

Other Considerations – Legislation Only Viewpoint

We have recommended that the County consider a shorter amortization period for future plan improvements in order to restore the funded ratio more quickly following a benefit improvement and in order to better align the cost of the improvement with the service of participants receiving an increase for service already performed. Applying that concept to this retirement program might result in a 10 to 20 year amortization period. We show detailed results below for the County's traditional 40 year amortization period.

The dollar impact of the Normal Cost increase on the County's contribution will tend to increase as employees near retirement, but decrease as the number of affected employees decreases over time. Please let me know if you would like a projection to quantify this pattern. Everything else being equal, the cost impact will increase (decrease) if actual future pay increases exceed (trail) assumed pay

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Montgomery County Government

increases. The amortization payment will remain level for the chosen period – 40 years unless a shorter period is chosen.

Other Considerations – Package Viewpoint

Lower employee contributions also reduce “refund” benefits (e.g., the return of employee contributions to nonvested terminated employees) but this impact is negligible compared to the contributions themselves. Employee contributions are subtracted from the total required contribution each year to determine the County’s contribution. The reduced subtraction (which results in a higher County contribution) due to the package will decrease over time as employees on July 1, 2009 leave employment.

Plan Provisions

- Employees on July 1, 2009 in groups A, E, and H would receive benefits as if their gross pay increased 4.50% on July 1, 2009 and remained 4.50% higher than actual pay for the remainder of their careers. This does not include benefits that are based on employee contributions.
- Employees on July 1, 2009 in group F would receive benefits as if their gross pay increased 4.25% on July 1, 2009 and remained 4.25% higher than actual pay for the remainder of their careers. This does not include benefits that are based on employee contributions.
- Employees on July 1, 2009 in group G would receive benefits as if their gross pay increased 4.00% on July 1, 2009 and remained 4.00% higher than actual pay for the remainder of their careers. This does not include benefits that are based on employee contributions.
- This legislation does not apply to Retirement Savings Plan or Guaranteed Retirement Income Plan participants.

Estimated Costs of Proposed Changes

Annual Costs using 40-year amortization for represented and non-represented members.

	Legislation Alone	Package
Group A	\$1,656,000	\$155,000
Group E	\$ 975,000	\$ 90,000
Group F	\$2,233,000	\$185,000
Group G	\$1,938,000	\$190,000
Group H	\$1,787,000	\$155,000
Total	\$8,589,000*	\$775,000

Numbers may not add up due to rounding.

* The total would increase to \$10,673,000 if a 15 year amortization period is used.

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Presumably, you want to use one column above or the other, depending on the viewpoint. You would not want to add the columns.

Increase in Actuarial Accrued Liability for represented and non-represented members

	Legislation Alone	Package
Group A	\$14,166,000	
Group E	\$ 7,094,000	
Group F	\$16,968,000	Insignificant Decrease
Group G	\$14,962,000	
Group H	\$15,058,000	
Total	\$68,248,000	

Numbers may not add up due to rounding.

Please let me know if you have any questions or need any further information. I can be reached at 410 347 2806. I meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this letter. I am not aware of any direct or material indirect financial interest or relationship, including investments or other services that could create a conflict of interest that would impair the objectivity of our work

Sincerely,

Douglas L. Rowe, FSA, MAAA, EA
Principal

Copy:
Aquil Ahmed, Mercer

The information contained in this document (including any attachments) is not intended by Mercer to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code that may be imposed on the taxpayer.

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MEMORANDUM

DATE: May 6, 2009
TO: Management and Fiscal Policy Committee
FROM: Thomas Lowman, Bolton Partners, Inc. TL
SUBJECT: Comments on the Pension Amendment/definition of compensation

I have reviewed the May 4th memo from Joseph Beach to Phil Andrews, and Mercer's April 27th letter to Wes Girling. These both addressed the pension cost associated with changing the definition of compensation due to elimination of previously negotiated wage increases. The higher annual pension cost of \$8.589 million looks reasonable, given that the active liability is about \$1.5 billion.

I was asked to comment on the amortization period. I agree with the fourth paragraph of Mercer's April 27th letter that a 10-20 year amortization period would be more appropriate. Basically, there is no good reason to fund this beyond the time when those benefiting from the change will be working. Thus, Mercer's 15 year amortization cost of \$10.673 million is more appropriate.

My understanding is that this change is permanent for all current employees; this means that someone retiring 20 years from now, will have their pension based on a higher pay amount than they actually will be receiving in 17-20 years (however, someone hired on 7/1/09 will not have such an advantage). There are reasons to argue an alternative position: any change of this sort should apply as an add-on but only to pay earned during the duration of the union contract (when the additional pay increase was eliminated). This more limited design would have a materially lower cost and can legitimately be said to address the same issue (even if leaving open the need to have future negotiations over whether the pay levels have "returned" to the appropriate level).

My understanding is that Montgomery County is not alone in considering this issue. Anne Arundel County has also prepared proposed legislation. However, Anne Arundel County's proposal only increases compensation in FY10. If someone's final average pay does not include pay in FY10 (most will leave far enough into the future that it will not include FY10), there would be no impact on their pension. This makes the cost materially less than what Mercer determined for the more generous proposal.

My main concern is over the funded status of the plan and the projected contribution increases. The plan's recent serious investment losses will start showing up in FY11 contributions and be fully reflected by FY15. The current FY10 contribution of \$115 million, will likely climb by tens of millions. I appreciate the reason for passing a bill of this nature, but it should not be passed without a full appreciation of the future funding demands that will arrive shortly (and ideally a belief that these increases can be handled).



OFFICE OF THE COUNTY ATTORNEY

Isiah Leggett
County Executive

Marc P. Hansen
Acting County Attorney

MEMORANDUM

TO: Wes Girling
Office of Human Resources

FROM: Marc Hansen *Marc Hansen*
Acting County Attorney

DATE: April 18, 2010

RE: Bill 16-10, Retirement-Imputed Compensation Limit

Kathleen Boucher, Assistant Chief Administrative Officer, has asked this Office to review for legal sufficiency Bill 16-10. The Bill, which limits an imputed compensation increase for retirement benefits calculation purposes to FY 2010, raises the issue of whether the Bill violates the contract clause of the United States Constitution. I conclude that Bill 16-10 does not violate the contract clause, because the legislation operates prospectively.

Contract Clause Analysis

Article I, §10, clause 1 of the United States Constitution provides that “No State shall...pass any Law impairing the Obligations of Contracts...” Courts have held that this clause does not prohibit governments from impairing contracts, but limits a government’s right to do so. A violation of the contract clause occurs only if the government substantially impairs a party’s right under the contract. Legitimate expectations of the parties determine whether the impairment was substantial. However, a government may substantially impair a contract if reasonable and necessary to serve a legitimate public purpose. Courts generally defer to the government in determining the reasonableness and necessity of a particular measure, unless the government seeks to impair its own contracts.

But where the government acts to impair its own contracts, the courts apply a more rigorous analysis to determine if the impairment is appropriate. A court will not uphold legislation that

impairs a government's own contracts unless the impairment is both reasonable and necessary. Reasonableness is determined in light of whether the contract had "effects that were unforeseen and unintended by the legislature". Necessity means that the government did not have a less drastic modification available and the government could not achieve its goals without altering the contractual terms.¹

Maryland courts have held that pension plans statutes establish contractual rights between employees and the government. Although the pension plans constitute contractual benefits, under certain circumstances, governments can modify the terms of a pension plan as long as the changes do not adversely affect the benefits, or if adversely affected, are replaced with comparable benefits.² In *Baltimore Teachers Union v. Mayor and City Council*,³ the Fourth Circuit Court of Appeals noted that the Supreme Court provided little guidance as to what constitutes substantial impairment, but concludes that a substantial impairment occurs "where the right abridged was one that induced the parties to contract in the first place . . . or where the impaired right was one on which there had been reasonable and especial reliance."⁴ Following the Fourth Circuit's decision in *Baltimore Teachers Union*, the United District Court for Maryland found that the diminution of pension benefits is more likely than not a substantial impairment because individuals plan their lives based on pension benefits.⁵

The Contract Clause Prohibits Retroactive Impairment

Generally a contract clause issue only exists if the legislation operates retroactively, not prospectively. There can be no expectation that pension plans can not be altered as to future benefits to be earned by future service. As the United States District Court for Maryland noted in *Maryland State Teachers Association, Inc. v. Hughes*⁶, a government cannot enter into a contract binding subsequent legislatures to pay government employees a specified level of compensation in the future. The Court stated,

In fact, the plaintiffs [the Teachers Association], presumably recognizing the preposterousness of a position that a contract of this type is irrevocable, admit that the contract asserted to exist here may be altered.

Under Maryland law, the State has reserved the power to amend or alter pension contracts, and that reserved power ". . . is part of each pension plan which a legislature enacts, whether explicitly or not." [Citations omitted]⁷

Hughes involved a number of prospective changes to the Maryland teachers' retirement system that included a change to the formula used to calculate retirement benefits from 1.8% of average

¹ *United States Trust of New York v. New Jersey*, 431 U.S. 1 (1977); *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234.

² *City of Frederick v. Quinn*, 371 A.2d 724 (1977).

³ 6 F.3d 1012 (4th Cir. 1993).

⁴ *Id.*, 1017.

⁵ *Andrews v. Anne Arundel County*, 931 F.Supp. 1255 (1996), *affirmed without opinion*, 114 F.3d 1175 (1997), *cert. denied* 522 U.S. 1015 (1997)

⁶ 594 F. Supp. 1353, 1362 (1984). *See also, Howell v. Anne Arundel County*, 14 F. Supp. 2d 752 (D. Md. 1998).

⁷ *Id.*, 1362.

final compensation to .8% of average final compensation for years of service earned after the effective date of the legislation. The Court upheld these changes because they were prospective.

Impairment Permitted if Necessary and Reasonable

If there is a retroactive impairment, the necessity and reasonableness of a particular legislative act is a factual inquiry. In *Baltimore Teachers Union v. Baltimore*,⁸ the Fourth Circuit held that a mid-year City salary reduction plan adopted to meet immediate budgetary shortfalls did not violate the contract clause. Although the court found that Baltimore City had substantially impaired its contract with its employees, the Court concluded that the City's action was reasonable and necessary. Preserving the City's financial integrity was a significant public purpose justifying City action.

Although the US District Court in *Hughes* held that the plaintiffs did not suffer any impairment because the changes to the pension plan were prospective, the Court discussed whether the changes were reasonable and necessary had there been an impairment. The Court concluded that due to the financial circumstances of the pension system and the State, the non drastic nature of the impairment and the unavailability of a more moderate course of action, the changes would be permitted.

On the other hand, in *Andrews v. Anne Arundel County*⁹, which involved retroactive changes to a pension plan, the Court did not find the County's action to be reasonable and necessary. Although the County argued the legislation was necessary for the restoration of the actuarial soundness of the A&E Plan, the Court ruled that the County "has failed to make a sufficient showing that the means which it has adopted to address the problem is the least drastic available."¹⁰ The Court also noted that the County acknowledged that an emergency did not exist and that courts have typically upheld "such extreme modifications only in the face of an emergency or temporary situations".¹¹

Application to Bill 16-10

The Montgomery County Code creates a contract by providing the terms of the defined benefit retirement plan (ERS). The ERS provides a monthly retirement benefit generally based on the highest average consecutive 36 months of earnings and years of credited service. Last year, in accordance with the collective bargaining agreements, the Council amended the definition of earnings to provide that a member's benefit would include a 4.5% cost of living adjustment (COLA) for FY 2010—even though the COLA was not, in fact paid to employees. This means that, unless amended, any future increase in earnings would include the 2010 COLA and could impact a member's retirement benefit regardless of the year a member retired. The proposed legislation limits the 2010 COLA to 2010 earnings. This means that only members who retire with 2010 included as their highest average consecutive 36 months of earnings would benefit.

⁸ 6 F.3d 1012 (4th Cir. 1993), *cert. denied*, 510 U.S. 1141 (1994).

⁹ See fn 5, *supra*.

¹⁰ 931 F.Supp. at 1266,

¹¹ *Id.*

All other members would no longer have the COLA included in their earnings for the purpose of calculating their pension benefit.

In order for a contract clause violation to occur in a pension plan statute, the legislation must operate retroactively. Bill 16-10 operates prospectively because the effective date is July 1, 2010, and earnings would include the imputed COLA for fiscal year 2010. The imputed COLA would not apply to future earnings and any member whose highest average consecutive 36 months of earnings includes 2010 receives the imputed COLA.

One might argue that the legislation does have a retroactive effect because the majority of members will no longer have the imputed COLA included in their earnings for years of service earned before June 30, 2010. For example, without the proposed legislation a member whose imputed COLA equaled \$1,000 would have that \$1,000 included in the member's benefit even if that member retired in 2020. Under the Bill, the member no longer receives that \$1,000 COLA even with regard to service earned before the change in law. But this argument assumes continued COLA's that will build on top of the elevated base created by the imputed COLA granted in FY 2010. Employees have no contractual right to expect compensation increases in the future. In fact, no legal principle would prevent a future Council from nullifying the effect of the imputed COLA by offsetting a future COLA by an appropriate amount. Basing an argument for retroactivity on some perceived right to future compensation increases is flawed for the reason pointed out in *Hughes*—the power to amend pension contracts is reserved to the government.

Because I have concluded that the Bill does not have a retroactive effect, I have found that it is not necessary to determine whether the change made by Bill 16-10 would constitute a necessary and reasonable impairment. Nevertheless, because litigation has been threatened by at least one employee union, I recommend that significant information concerning the depth of the current budget crisis that has overtaken the County should be included in the legislative history of Bill 16-10 so that an alternative argument can be made that the change proposed by Bill 16-10 is reasonable and necessary.

Please let me know if you have any questions or concerns about this advice.

Cc: Kathleen Boucher
Amy Moskowitz
Joe Beach
Joe Adler
Ed Lattner
Bob Drummer

MEMORANDUM

April 1, 2010

TO: Steve Farber, Council Staff Director

FROM: Robert H. Drummer, Senior Legislative Attorney

SUBJECT: Council's Authority to Amend the Imputed Compensation Law

You have requested an opinion concerning the Council's authority to amend the changes to the retirement laws enacted in Expedited Bill 18-09, Personnel-Retirement-Imputed Compensation. Specifically, you have requested a review of the Council's authority to amend the retirement laws to limit the effect of the imputed compensation to the calculation of regular earnings for FY10 only.

Background

Bill 18-09 was introduced at the request of the Executive to implement collective bargaining agreements with the 3 County employee unions last year. Each of these agreements contained a provision to "postpone" a previously negotiated general wage adjustment, but also provided that the calculation of regular earnings used to determine a retirement benefit must include the general wage adjustment for FY10 as if the employee had received it on July 1, 2009. This imputed compensation is scheduled to carry over into the calculation of regular earnings used to calculate a defined benefit pension for the rest of an employee's County career.¹ The County's actuary estimated that this imputed compensation would require the County to increase its annual contribution to the ERS Trust Fund by \$8.589 million per year for the next 40 years.²

Issues

1. Can the Council, without further collective bargaining, enact a Bill that would modify laws which resulted from collective bargaining agreements or involves issues that are within the scope of collective bargaining?

For the reasons discussed below, Council staff concludes that the Council has complete authority to enact legislation which involves a mandatory topic of collective bargaining or amends a law that was enacted to implement a collective bargaining agreement.

¹ Bill 18-09 also provided an imputed compensation increasing the Employer's contribution to the Retirement Savings Plan and the Guaranteed Retirement Income Plan for FY10 only.

² The actual savings from limiting this imputed compensation to FY10 is estimated to be \$7.2 million for FY11.

Delegation of legislative authority. The current County Charter was adopted by the voters in 1968, as authorized by Article XI-A of the Maryland Constitution. Article XI-A, §3 provides that:

Every charter so formed shall provide for an elective legislative body in which shall be vested the law-making power of said City or County. Such legislative body in the City of Baltimore shall be known as the City Council of the City of Baltimore, and in any county shall be known as the County Council of the County.

* * *

...the County Council of said County, subject to the Constitution and Public General Laws of this State, shall have full power to enact local laws of said City or County including the power to repeal or amend local laws of said City or County enacted by the General Assembly, upon all matters covered by the express powers granted as above provided, and, as expressly authorized by statute. (Emphasis added)

Charter §101 vests all of the County's legislative powers in the County Council:

All legislative powers which may be exercised by Montgomery County under the Constitution and laws of Maryland, including all law making powers heretofore exercised by the General Assembly of Maryland but transferred to the people of the County by virtue of the adoption of this Charter, and the legislative powers vested in the County Commissioners as a District Council for the Montgomery County Suburban District, shall be vested in the County Council..... (emphasis added)

The Maryland Court of Appeals has consistently restricted the delegation of the legislative power assigned to a county council in a home rule charter county. See *Mugford v. Baltimore*, 185 Md. 266 (1945) (agreement with union to deduct dues from employees was an unlawful delegation of governmental power); *MCEA v. Anderson*, 281 Md. 496, 508 (1977) (arbitration to determine public employees compensation was an unlawful delegation of legislative authority); *Baltimore v. AFSCME*, 281 Md. 463 (1977) (MOU between union and employer could not bind the employer to propose certain budget appropriations for employee salaries). In *Office & Professional Employees v. Mass Transit Administration*, 295 Md. 88, 97 (1982), the Court opined with regard to collective bargaining:

It is established in this State that, absent express legislative authority, a government agency cannot enter into binding arbitration or binding collective bargaining agreements establishing wages, hours, pension rights, or working conditions for public employees.

The express legislative authority for a County to enter into binding collective bargaining agreements must flow from either a public general law enacted by the General Assembly or the County Charter. In this County it derives from the Charter. Charter §510 authorizes the Council

to enact a collective bargaining law with binding arbitration for police officers.³ §510A does the same for career fire fighters, and §511 authorizes the Council to enact a collective bargaining law for other County employees that may include binding arbitration.

The legislative history of the first collective bargaining law for police officers in 1982 (Bill 71-81) indicates that the Council interpreted Charter §510 to authorize arbitration of collective bargaining impasses that binds the Executive, but not the Council. Both the Executive and the police union (Fraternal Order of Police Lodge 35) agreed that §510 required the new collective bargaining law to include interest arbitration of collective bargaining impasses, but disagreed on whether the Council, as well as the Executive, must be bound by an arbitration award. The FOP argued at the Council worksessions that if interest arbitration was not binding on the Council it could not be considered classic interest arbitration. The Council ultimately rejected this argument, and the interest arbitration included in the enacted law did not bind the Council.⁴

The Council enacted a separate collective bargaining law under each of these Charter amendments (Police: County Code §§33-75 through 33-85; County employees: County Code §§33-101 through 33-112; Fire and Rescue employees: County Code §§33-147 through 33-157). Each collective bargaining law provides that the Executive, as the employer, must bargain with the certified employee representative over certain mandatory topics of bargaining. Under each law the Council must approve -- and retains the authority to reject -- any term or condition of a collective bargaining agreement that requires an appropriation of funds or enactment, repeal, or modification of a County law or regulation. **In none of these laws did the Council delegate its legislative power to enact and amend County legislation.** The Executive has a duty under each collective bargaining law to bargain with a certified employee representative; the Council does not.

For example, the collective bargaining agreement executed by the Executive and MCGEO in 2008 provided that “*the parties shall submit legislation* to the County Council that would establish a one-time irrevocable choice between the Retirement Savings Plan (RSP) and the Guaranteed Retirement Income Plan (GRIP) for non-public safety employees hired on or after July 1, 1994.” (*emphasis added*) **The agreement did not bind, and could not have bound, the Council to enact the proposed legislation.** (The Executive submitted this proposed legislation and the Council enacted it as Bill 11-08.)

The Council’s exercise of its legislative power to implement a collective bargaining agreement necessarily includes the power to repeal or amend the same legislation at any point in

³ A recent reported decision by the Court of Special Appeals in *Wicomico County FOP v. Wicomico County*, No. 2034 (February 1, 2010) calls into question the legality of the Montgomery County Charter provisions requiring the Council to enact collective bargaining laws for police and fire with binding arbitration. The Court held that a charter provision requiring the Council to enact a collective bargaining law with binding arbitration violated the Maryland Constitution because it was tantamount to enacting legislation in the Charter. The Court held that the collective bargaining law enacted by the Wicomico Council was therefore invalid. Montgomery County Charter §510 (police) and §510A (fire) each requires the Council to enact a collective bargaining law with binding arbitration.

⁴ This legislative history is detailed on pages 66-70 of Office of Legislative Oversight Report No. 2009-5, released December 2, 2008, written by Leslie Rubin of OLO.

the future. This legislative power exists without regard to whether the law involves a mandatory topic of bargaining under the collective bargaining laws or was enacted to implement a collective bargaining agreement executed by the Executive and an employee representative; nothing in the Charter or the collective bargaining laws limits it in those cases.

2. Would a law limiting the imputed compensation to the calculation of regular earnings for FY10 impair a County employee's contractual rights in violation of the Contract Clause of the United States Constitution?

The Executive agreed with each of the 3 County employee unions during collective bargaining in 2009 to submit legislation to the Council providing for the imputed compensation. Each collective bargaining agreement was transmitted to the Council for approval of items requiring funding or legislation. The Council enacted Expedited Bill 18-09 to implement the imputed compensation. Therefore, it is important to determine if a law limiting this imputed compensation to FY10 only would impair a County employee's contractual rights in violation of the Contract Clause of the United States Constitution (Art. I, §10). In *Parker v. Wakelin*, 123 F.3d 1 (1st Cir. 1997), cert. denied, 140 L. Ed. 2d 813, 118 S. Ct. 1675 (1998), the Court summarized the analysis necessary to determine this question:

The Supreme Court has elaborated an analysis under which a court must first ascertain whether a change in state law has resulted in "the substantial impairment of a contractual relationship." *General Motors Corp. v. Romein*, 503 U.S. 181, 186, 112 S. Ct. 1105, 1109, 117 L. Ed. 2d 328 (1992) (quoting *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244, 98 S. Ct. 2716, 2722, 57 L. Ed. 2d 727 (1978)). Next, the reviewing court must determine whether the impairment is nevertheless justified as "reasonable and necessary to serve an important public purpose." *United States Trust Co.*, 431 U.S. 1 at 25, 97 S. Ct. 1505 at 1519, 52 L. Ed. 2d 92. . . . The first step described above can be further broken down into "three components: whether there is a contractual relationship, whether a change in law impairs that contractual relationship, and whether the impairment is substantial."

In *Bd. of Trustees. v. Mayor & City Council of Baltimore City*, 317 Md. 72, 100 (1989), the Maryland Court of Appeals held that "under Maryland law, pension plans create contractual duties toward persons with *vested* rights under the plans." (*emphasis added*) Therefore, a County retirement plan can create a contractual duty toward an employee with a vested right under the plan. However, a law enacted by the Council during FY10 that limits the imputed compensation to the calculation of regular earnings for FY10 would only apply prospectively. In *Howell v. Anne Arundel County*, 14 F. Supp. 752 (D. Md. 1998), the Court held that a County law decreasing the maximum cost of living adjustment to a County pension that only applied to benefits accrued after the effective date of the law did not violate the Contract Clause because it did not retroactively reduce a member's vested benefits. Similarly, a law enacted in FY10 that limits the imputed compensation to FY10 only does not retroactively reduce a vested benefit. It only affects the calculation of regular earnings for future years. Therefore, the law would not impair a contractual relationship in violation of the Contract Clause.

Even, assuming *arguendo*, if an employee's contractual rights have vested, every modification of a contract does not result in an unconstitutional impairment.⁵ The legislative body always retains the right to make reasonable modifications to vested rights for an important public purpose. In *Baltimore Teachers Union, et al v. Mayor and City Council of Baltimore*, 6 F.3d 1012 (4th Cir. 1993), the Court held that a furlough imposed during a fiscal year did not violate the Contract Clause even though it was a substantial impairment of vested contractual rights because the modifications made by the City were reasonable under the circumstances. The Court relied on evidence of reductions in State funding that caused a budget deficit for the City. The Court held that the City's decision to use furloughs to help balance its budget was a reasonable alternative to more detrimental actions, such as layoffs.

The County's historic reduction in revenue in the past two years and its recent reduction in reserve funds would provide strong factual support for a Court to conclude that a law limiting the imputed compensation to FY10 was a reasonable modification for an important public purpose. The recent decision in *FOP v. Prince George's County*, 645 F. Supp. 2d 492 (D. Md. 2009), holding that a County-imposed furlough violated the Contract Clause underscores the importance of evaluating the facts surrounding the decision to modify a contract. In *FOP v. Prince George's County*, the Court held that the decision to impose furloughs on employees soon after approving pay raises and refusing to dip into a \$230 million reserve fund made the County's decision unreasonable under the circumstances. The facts in *FOP v. Prince George's County* are distinguishable from the facts behind a law which the Council could enact during FY10 that would limit the imputed compensation.

For these reasons, a law limiting imputed compensation to the calculation of regular earnings in FY10 would not violate the Contract Clause in Article I, §10 of the United States Constitution.

⁵ Since the collective bargaining agreement with the FOP and MCGEO each expires on June 30, 2010, a law limiting the imputed compensation to FY10 earnings enacted during FY10 may not even modify an existing contract. However, the collective bargaining agreement with the IAFF expires on June 30, 2011.