

Retiree Health and Pension Benefits Legal Framework

Presentation to the
Public Employees' and Retirees' Benefit
Sustainability Commission

November 10, 2010

**Bonnie A. Kirkland
Assistant Attorney General
Office of Counsel to the General Assembly**

Presentation Outline

- Retiree Health Benefits
 - Background
 - State's obligation
 - Contract Clause Analysis
- Retiree Pension Benefits
 - State's obligation – contractual rights
 - Legal considerations for making changes under the Contract Clause

Retiree Health Benefits

- Background
 - General Assembly provided for health care benefits for public retirees
 - Part of State Employee and Retiree Health and Welfare Benefits Program (State Personnel and Pensions Article (§ 2-502, et seq.))
 - Open to all employees of units of State government, including units with independent personnel systems
 - The Department of Budget and Management (DBM) charged with administration of Program
 - General Assembly created the State Employees and Retirees Health and Welfare Benefits Fund (§ 2-516) Post Retirement Health Benefits Trust Fund (§ 34-101) to help finance health care benefits

State's Obligation to Provide Retiree Health Benefits

- Statutory Provisions/Requirements
 - Secretary required to administer Program for retirees and employees
 - Prescription benefit is required
 - Retiree subsidy based on employee subsidy, but pro-rated (1/16) for years of creditable service
 - Currently financed through annual budget process – same as for current employees

In Sum

- State law creates a general statutory obligation to provide health care benefits to employees and retirees
- Governor and Secretary enjoy relatively unfettered discretion to set benefit levels
- Under Budget Amendment, General Assembly may mandate expenditures in the budget
- General Assembly may amend this statutory obligation, unless constitution limits General Assembly's power to do so
- Federal Constitution (Art. I § 10, cl.1) limits alteration of Program if the amendment is a "law impairing the obligation of contracts"

Contract Clause Analysis

- Does a contractual obligation exist?
 - Strong presumption that statutes do not create contractual rights
 - Must be “adequate expression of an actual intent” of the state to bind itself – look to language and circumstances
- Does the State’s action impair rights under the contract?
 - Even if it does, may not violate Contract Clause – is it reasonable and necessary to serve an important public purpose? *U.S. Trust Co. v. New Jersey*
 - Deference to legislative judgment on reasonableness and necessity *Baltimore Teachers Union v. Mayor and City Council of Baltimore*; *MSTA v. Hughes*

Application of Analysis to Health Benefits Statute

- No express creation of contractual rights
- No promise of particular level of benefits or subsidies to retirees
- No clear and express language that vests retirees with benefits
- No Maryland cases that hold State retiree health care benefits authorized by statute are a contractual right
- Funding subject to annual budget process
- Trust Funds do not create any specific obligation to retirees
- Explicit disclaimer in materials – “This is not a contract”
- Conclusion – no contractual right to retiree health care benefits that would be impaired if the General Assembly were to amend the statute to change the level of benefits or subsidy

Other States

- Limited value – particular constitutional and statutory provisions
- Employment Retirement Income Security Act of 1974 (ERISA)
 - Applies to private employers
 - Distinguishes pension plans from “welfare benefit plans”
 - Employer may voluntarily create vested benefit in retiree health care benefits
- 2005 Opinion of the Attorney General

Pension Benefits

Retirees have a contractual right to pension benefits

- Statutory provisions
 - Membership in pension plan is “condition of employment”
 - Specifically refers to the “vesting” of pension benefits
 - The “payment of allowances and other benefits under this Division II is an obligation of the State”
 - Explicitly guarantees the payment of retirement allowances provided by the pension laws
 - Other obligations of the State – creation and maintenance of reserves, advance funding, crediting of interest to the annuity savings funds, payment of expenses for administration and operation of the systems

Pension Benefits (Cont.)

- Case Law says so
 - *Hughes* case (1984) – assumed without deciding that the Act in question created a contract between the State and its employees and teachers
 - Subsequent cases have recognized contractual rights
 - *Howell v. Anne Arundel County* (1998)
 - *Andrews v. Anne Arundel County* (1996)
 - *Davis v. City of Annapolis* (1994)
 - *Board of Trustees v. Mayor and City Council of Baltimore City* (1989)

Pension Benefits - Modification

- Contract Clause does not impact General Assembly's authority to make changes to benefits payable to "new" employees
- Although contractual, pension benefits are not unalterable
- Legislation that modifies pension benefits already promised to current employees must be considered under the Contract Clause

Modification - Contract Clause (Cont.)

- Has there been a substantial impairment of contract?
 - Contracting parties actual reliance on the abridged right/contract term
 - Did contract indicate that term was subject to impairment?
 - Was right/term subject to regulation in the past?
 - Extent of the modification?
 - Was the abridged term essential in nature to underlying contract?

Modification - Contract Clause (Cont.)

- Examples of reductions constituting substantial impairment
 - 1994 law retroactively repealed a 1989 enhancement, resulting in increase in retirement age from 50 to 60 and decrease in benefits formula from 2.5% to 2%
 - 1994 law applied retroactively to all participants who had retired since 1987, reduced eligibility for and amount of survivor benefits
 - 1961 law retroactively repealed non-contributory police pension plan, to extent law withdrew employees' vested rights to benefits

Modification - Contract Clause (Cont.)

- Examples where no impairment found to have occurred
 - October 15, 1959 law made retroactive to October 1 did not impair contract rights of employees hired on October 12 – never members, never contributed, earned no pension benefits, thus no vested interest
 - 1984 Pension Reform Law gave members 4 options – law did not operate to deny vested rights retroactively
 - Bill that prospectively reduced maximum amount of COLA, but no change in COLA adjustments to benefits earned before effective date of the bill

Modification - Contract Clause (Cont.)

- Courts will construe application of the law prospectively when not clear to avoid impairment of vested rights
 - For injuries suffered prior to enactment of disability ordinance establishing stricter standard, Court concluded contractual rights vested under pre-existing statute (*Davis*)
 - In contrast, for injuries sustained after statute was changed, Court held that rights were based on statute in effect at time of injury (*Saxton*)

Modification - Contract Clause (Cont.)

- If there is a substantial impairment, is the impairment nonetheless permissible as a legitimate exercise of the State's sovereign powers?
 - May be constitutional if reasonable and necessary to serve an important public purpose
 - Maryland Court held that government may unilaterally modify as long changes do not adversely alter the benefits, or if adversely altered, are replaced with comparable benefits (*Davis*)

Modification - Contract Clause (Cont.)

- Standards (*Hughes*)
 - Reasonableness - did contractual obligation have effects that were unforeseen and unintended by legislature when obligations created?
 - Necessity – could a less drastic modification have been implemented? Could State have achieved its goals even without modifications?
- State may not justify impairment simply because it would rather spend money for some other public purpose
- Conclusory recitals alone will not convince a court – detailed, well-documented explanation of the need for the legislation and lack of feasible alternatives will be essential (68 *Op. Atty. Gen.* 366 (1983))