

CITY OF BALTIMORE

SHEILA DIXON, Mayor



DEPARTMENT OF LAW

GEORGE A. NILSON, City Solicitor
101 City Hall
Baltimore, Maryland 21202

July 10, 2009

The Honorable President and
Members of the Baltimore
City Council
c/o Karen Randle, Executive Secretary
409 City Hall
Baltimore, MD 21202

RE: City Council Bill 09-0348 – Fire and Police Retirement System-Benefits-Post-Retirement Increases

Dear President and Members

You have requested the advice of the Law Department regarding City Council Bill 09-0348. City Council Bill 348 terminates the current variable benefit provisions at 6/30/08, transfers the V/B assets to the general assets of the system, transfers the V/B liabilities to the regular liabilities of the system, provides a guarantee by the City of all previously granted V/B increases and provides that it is the City's intention to examine the feasibility of establishing post-retirement increase provisions upon the System attaining and maintaining an 85% funded ratio for a minimum of three consecutive years.

Currently, annual variable benefit increases are provided to F&P retirees and beneficiaries when F&P investment performance, as determined each June 30, exceeds 7.5%. Earnings between 7.5% and 10% and one-half of the earnings above 10% on F&P's Annuity Reserve Fund (which contains the contributions of retired members) and Pension Reserve Fund (which contains a combination of past City contributions and investment income for retired members and beneficiaries) are available for payment of the variable benefit. §36A (c). Funds are transferred from the F&P's Annuity and Pension Reserve Funds to a dedicated Paid-Up Benefit Fund used exclusively to support payment of variable benefits. §36A (d). In addition, the F&P law requires transfers to a Contingency Reserve Fund for the purpose of insuring payment of previously accrued benefit increases for any year in which the Paid-Up Benefit Fund is inadequate. Id.



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The legal sufficiency of City Council Bill 09-0348 hinges upon an analysis of whether the law affects a contract right and whether the impact rises to the level of a violation of the U.S. Constitution, Art. I, Section 10, cl 1, known as the Contract Clause. The Contract Clause states that no State shall pass any law impairing the obligation of contracts.

Determining whether a law impinges upon the obligations of contracts involves a three-pronged analysis. See U.S. Trust vs. New Jersey, 431 U.S. 1 (1977) and Allied Structural Steel v. Spannaus, 438 U.S. 234 (1978). First, it must be determined whether a contractual obligation is created by the statute. Second, it must be determined whether the proposed law will substantially impair that contract right. Finally, assuming a substantial impairment, it must be determined whether the proposed law is reasonably necessary to serve a legitimate or important public purpose. See Md. State Teachers Assoc. vs. Hughes, 594 F.Supp.1353 (1984).

With regard to the first prong, it is clear that no contractual obligation is created by statute.

Art. 26, Section 36A(e)(ii) provides:

(e) *Benefit increases to be paid only from Paid-Up Benefit Fund and Contingency Reserve Fund.*

(ii) The granting of any benefit increase under this section is contingent on the performance of the Retirement System's investment funds. The continuation of any benefit increase previously accrued under this section is specifically made contingent on the ability of the Paid-Up Benefit Fund and the Contingency Reserve Fund to provide these benefits in

the future. §§ 37 and 42 to the contrary notwithstanding, any benefit increase provided under this section is not and does not become an obligation of the City of Baltimore. In the event of any conflict between this section and either or both § 37 or § 42, this section prevails.

The plain meaning of this section is that the variable benefit under Section 36(A)(e)(ii), is not guaranteed but rather is contingent on funds being available in the Paid-Up Benefit Fund and the Contingency Reserve Fund and is not an obligation of the City of Baltimore. There is therefore no contractual right to that benefit created by the law.

Not only does no contractual obligation exist, but also, under the second prong of the Contract Clause analysis, there is no substantial impairment of any contract right. While CC 09-

0348 proposes to deprive F&P retirees of post-retirement increases, the bill balances that impairment by the prospect of a new post-retirement increase that will : (1) provide a new guarantee by the City of all previously accrued benefit increases under the current law and (2) preserve the actuarial soundness of the F&P. These features provide for a continuation of benefits already received and certainty as to the City's ability to maintain existing benefits in the future. Although they are different, they will operate to ultimately preserve the system for current and future retirees.. In this economic environment, this can not be considered a substantial impairment when the alternative is a system that cannot even support payment of basic benefits. The diminution in the F&P post-retirement benefit proposed by CC 09-0348 is intended to preserve the integrity of F&P by enhancing its actuarial soundness and is reasonably balanced by the countervailing benefits. See City of Frederick v. Quinn, 35 Md.App. 626 (1977). Consequently, there is no substantial impairment of any contract right.

Finally, even if the benefit change is City Council Bill 09-0348 was considered substantial, it is reasonably necessary to serve a legitimate and important public purpose. The City's actuary has noted that variable benefits have had detrimental effects on the City's contribution and the F&P Board has been regularly admonished regarding the growing cost of the current structure and its exacerbation by low market rates of interest, and volatile investment performance. The actuary now estimates that the current variable retirement benefit will annually cost the City \$61 million.

The Director of Finance has also maintained that the City cannot afford to preserve the current variable benefit structure and that it is a contributing factor to the continued escalation of the City's pension costs. CC 09-0348 is the culmination of the City's efforts to shore up its escalating annual contribution to F&P so as to preserve the City's financial stability. The court in MSTA v. Hughes, 594 F. Supp 1353(D.Md. 1984), aff'd No. 84-2213(4th Cir. Dec. 5, 1985) noted even if the Plan is currently actuarially sound :

[T]his court observes that neither *Baker v. Baltimore, supra*, nor *City of Frederick v. Quinn, supra*, requires as a matter of State law that the legislature wait until a pension system is actuarially unsound before making changes in that system. Certainly, there is no such federal constitutional requirement. Such a requirement would jeopardize the pension benefits of current and future retirees, would require that the trustees of the Retirement Systems abdicate their role as fiduciaries, and would impose an irrational limitation on the legislature's police power. A pension system need not be actuarially unsound before a legislature may move to change the system and the benefits it provides its members. *Id.*, at 1368.

The passage of this Bill will serve a legitimate and important public purpose of preserving the City's

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pension system for current and future retirees before the system becomes unstable and is a valid exercise of the City's sovereign powers. As stated by the finance Director in his bill report "this legislation will provide the necessary correction and will avoid a financial hit of an additional \$61.5 million to the General Fund in Fiscal 2011, the likes of which would cripple future City services. To sustain that hit and to sustain basic City services, the City would be required in Fiscal 2011 to increase the property tax rate approximately 19.3 cents, or about 8.5% using Fiscal 2010 assessment values." "The Mayor and City Council of Baltimore have a fiduciary responsibility to the taxpayers of Baltimore to take urgent and emergency measures to avoid the catastrophe that will ensue if the variable benefit is not halted."

For the above-stated reasons, the passage of CC 098-0348 would not unconstitutionally impair the pension rights of F&P members and retirees. First, §36A(e)(ii) has specifically exempted F&P variable benefits from any contract protection. Second, CC 08-0220 would balance any deprivation to F&P members and retirees of current post-retirement increases by providing a guarantee of variable benefits already granted and preserving the system as a whole from becoming financially unsound and jeopardizing the provision of even basic benefits to its current and future members thereby avoiding substantial impairment even if a contract right existed. Lastly, City Council Bill 220 would not violate the Contract Clause because, if passed into law, it would serve the legitimate public interest of improving F&P's actuarial soundness and, ultimately, the financial condition of the City.

Accordingly, City Council Bill 09-0348 is consistent with the authority of the City Council. The Law Department, therefore, approves the City Council Bill 09-0348 for form and legal sufficiency.

Sincerely yours,



Elena R. DiPietro

Chief Solicitor

cc: Honorable Stephanie Rawlings-Blake
Angela Gibson, City Council Liaison
George A. Nilson, City Solicitor
Abe Schwartz, Fire and Police System
Ashlea Brown, Assistant Solicitor
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