

## MAJOR POLICY SHIFTS

A retirement system for teachers and one for other state employees has been in place since 1927. The Maryland Legislature has changed the system names as part of various system reform efforts over time. For clarity and consistency, the current system names, Employees' Pension System and Teachers' Pension System, are used throughout this resource.

### 1984

#### H.B. 991

For EPS and TPS active members, the Maryland Legislature created a new system with three plan options: (1) no employee contribution with a cost-of-living adjustment (COLA) cap of 3%; (2) a 5% employee contribution rate with a 5% COLA cap; or (3) a 7% contribution rate with no limit on COLA. Previously, members could choose to have no employee contribution with a COLA cap of 3% or a 5% employee contribution rate with unlimited COLA.

### 2011

#### H.B. 72

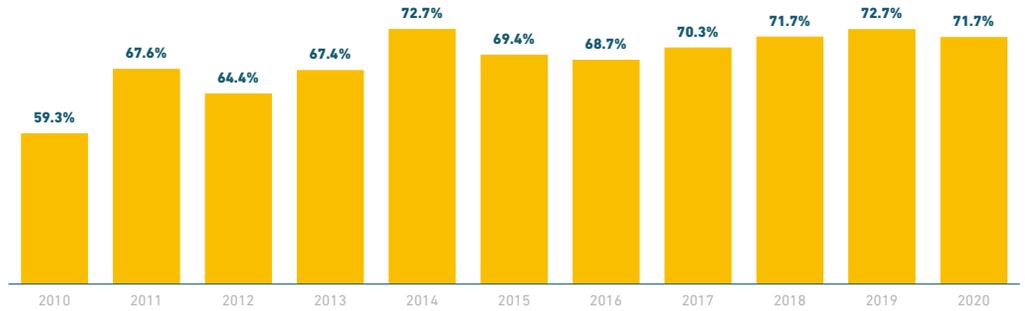
For active EPS and TPS members and new hires, the Maryland Legislature increased employee contribution rates from 5% to 7%.

For active Law Enforcement Officers' Pension System (LEOPS) members and new hires, the Maryland Legislature increased employee contribution rates from 4% to 6% between July 2011 and June 2012, and then to 7% for compensation received on or after July 2012.

For active EPS and TPS members and new hires, the Maryland Legislature reduced the COLA calculation for service credits earned after July 2011 from a cap of 3% to an annual cap of either 2.5% (when the investment fund return meets its assumed actuarial rate) or 1% (when it does not meet the assumed rate).

## FUNDED RATIO

The graphic below covers the following retirement systems: the Employees' Pension System (EPS) and the Teachers' Pension System (TPS), which together comprise the Maryland State Retirement and Pension System.

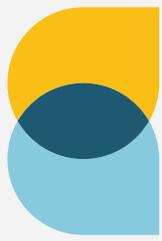


## LEGAL ENVIRONMENT FOR FUTURE POLICY EFFORTS

Legislative efforts confined to new hires are excluded from analysis because they rarely face significant legal challenges.

What are some policy options?	Were there relevant policy shifts for active employees or retirees?	Have there been legal challenges?	What are the legal prospects for future changes?*
<b>INCREASE EMPLOYEE CONTRIBUTIONS</b>	<b>YES</b> H.B. 991 (1984) H.B. 72 (2011)	<b>YES</b> H.B. 991 (1984) survived legal challenge in <i>Maryland State Teachers Association v. Hughes</i> (1984)	<ul style="list-style-type: none"> <li><b>FAVORABLE</b> as to active employees</li> <li><b>N/A</b> as to retirees</li> </ul>
<b>DECREASE OR ELIMINATE COST-OF-LIVING ADJUSTMENTS</b>	<b>YES</b> H.B. 991 (1984) H.B. 72 (2011)	<b>YES</b> H.B. 991 (1984) survived legal challenge in <i>Maryland State Teachers Association v. Hughes</i> (1984)	<ul style="list-style-type: none"> <li><b>FAVORABLE</b> as to active employees who have not met the years-of-service requirement</li> <li><b>UNFAVORABLE</b> as to active, retirement-eligible employees and to retirees</li> </ul>
<b>CHANGE VESTING PERIOD</b>	<b>NO</b>	<b>NO</b>	<ul style="list-style-type: none"> <li><b>FAVORABLE</b> as to active employees who have not met the years-of-service requirement</li> <li><b>UNFAVORABLE</b> as to active, retirement-eligible employees and to retirees</li> </ul>
<b>CHANGE BENEFIT CALCULATION</b>	<b>YES</b>	<b>YES</b> Anne Arundel County Ordinance No. 74-95 (1995) did not survive challenge in <i>Andrews v. Anne Arundel County</i> (1996)	<ul style="list-style-type: none"> <li><b>FAVORABLE</b> as to active employees who have not met the years-of-service requirement</li> <li><b>UNFAVORABLE</b> as to active, retirement-eligible employees and to retirees</li> </ul>

\* **FAVORABLE** indicates that the issue survived litigation in the past and/or there is a permissive legal environment for the change.  
 \* **UNFAVORABLE** indicates that the issue did not survive litigation in the past and/or there is a non-permissive legal environment the change.  
 \* **UNDEVELOPED** indicates that the issue has not been litigated and/or the current legal environment is unclear as to what the outcome would be.



## MARYLAND STATE LAW CONTEXT

### State Provisions

The State of Maryland relies on the federal constitution for its analysis of contract impairment —

**U.S. CONSTITUTION ARTICLE I, SECTION 10:** "No State shall . . . pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contract . . ."

### Key Opinions

#### **CITY OF FREDERICK V. QUINN, 35 MD. APP. 626 (MD. 1977)**

Active city police officers challenged, under breach of contract, the city's replacement of a non-contributory pension plan with a contributory commercial insurance pension plan. The state's highest court, the Maryland Court of Appeals, held that the employees had contractual rights to their pension benefits and that the employees' rights to the "pension benefits they have earned by satisfactory service" cannot be impaired without a showing that the impairment was necessary and reasonable. *City of Frederick v. Quinn*, 35 Md. App. 626 at 631. The city could, however, make reasonable alterations to the benefits provided that "the employee must have available substantively the program that they bargained for, and any diminution thereof must be balanced by other benefits or justified by countervailing equities for the public's welfare." *Id.* The court remanded for the trial court to consider whether the substituted plan "was either necessary or reasonable." *Id.* at 634. The opinion did not elaborate on how the trial court was to assess the necessity, reasonableness, or corresponding benefit.

#### **BOARD OF TRUSTEES OF THE EMPLOYEES' RETIREMENT SYSTEM V. MAYOR AND CITY COUNCIL OF BALTIMORE CITY, 562 A.2D 720 (MD. 1989)**

Trustees of Baltimore City's pension systems challenged, under Article I, Section 10 of the U.S. Constitution (the contract clause), a city ordinance that prohibited investment in any financial institutions or companies that did business with or in South Africa or Namibia. The Maryland Court of Appeals held that there was no unconstitutional impairment of the employees' contractual rights, because the relatively minimal effects of the divestiture did not rise to the level of unconstitutional impairment. *Board of Trustees of the Employees Retirement System v. Mayor and City Council of Baltimore City*, 562 A.2d 722 at 734. Compliance with the divestment ordinance did not jeopardize payment of the defined benefits, and any costs that would be incurred (0.03% of the total fund for the initial cost of divestiture; 0.05% for the ongoing annual cost) were relatively minimal. *Id.*

#### **MARYLAND STATE TEACHERS ASSOCIATION V. HUGHES, 594 F.SUPP.1353 (D.MD. 1984)**

Active employees of the EPS and TPS challenged under Article I, Section 10 of the U.S. Constitution (the Contract Cause) the state's amendments to the COLA provisions of their retirement benefits. A U.S. District Court held that the amendments did not violate the plaintiffs' contractual rights. The existing system had given employees the option of no employee contribution and a 3% COLA limit or a 5% contribution rate and no COLA limit with actual COLA based on the Consumer Price Index (CPI). Under H.B. 991 (1984), the Maryland Legislature required employees to choose one of three options: (1) no contribution and a COLA limited to 3%; (2) a 5% contribution rate with a 5% COLA cap; or (3) a 7% contribution rate and no COLA limit.

The court assumed, without deciding, that the employees had contract rights in the existing system. The court found that the amendments did not impair those rights because the amendments were prospective and did not affect benefits already earned based on years previously worked. The change of COLA calculation only affected benefits earned pro rata during future employment periods. Pensioners did not have a right to "an immutable, unalterable pension plan as to future benefits to be earned pro rata by future employment service." *United States Trust Co.*, 431 U.S. at 26.

The court further reasoned that even if the amendments impaired the plaintiffs' contract rights, they would still be permissible. The amendments served an important and legitimate public purpose, and the harm — at worst a 2% increase in contribution rates in exchange for an unlimited COLA — was not sufficient to override the public benefit. *Maryland State Teachers Association v. Hughes*, 594 F.Supp.1353 at 1368. Maryland was facing serious financial consequences and the unlimited COLA provisions contributed to the financial issues; the amendment was created to address an ongoing problem that the legislature had attempted to address before. *Id.* at 1368. The court further indicated that the state did not need to wait until the pension system was actuarially unsound before making changes. *Id.*

#### **ANDREWS V. ANNE ARUNDEL COUNTY, 931 F. SUPP. 1255 (D.MD. 1996)**

Retirees challenged a county's pension plan amendment that retroactively reduced their pension benefits calculation from 2.5% to 2% of final average earnings for each year of credited service. A U.S. district court held that the amendment was not "reasonable and necessary" and thus did not justify the substantial impairment of the retirees' benefits. The court held that any reduction in retirement benefits constitutes a severe impairment. *Andrews v. Anne Arundel County*, 931 F. Supp. 1255 at 1260. Even though maintaining the actuarial soundness of a pension plan is an important purpose, this was not an emergency situation. The county had failed to show that the change was narrowly tailored to address the problem, and the county had not demonstrated comparable replacement of the benefits that were being taken away. *Id.* at 1267.

#### **HOWELL V. ANNE ARUNDEL COUNTY, 14 F. SUPP. 2D 752 (D.MD. 1998)**

Active employees challenged, under Article I, Section 10 of the U.S. Constitution (the contract clause), a county pension plan's COLA adjustments that changed COLA calculations to benefits earned after the date of the ordinance. The court held that the employees who had not yet satisfied years-of-service or "vesting" requirements under the pension plan did not have contract rights in the existing COLA benefits and did not have standing to sue. *Howell v. Anne Arundel County*, 14 F. Supp. 2d 752 at 755. For employees who had already met the plan's years-of-service requirements, the court held that there was no impairment of contract because the COLA adjustments applied only to benefits on future earnings. There would be no change to the COLA calculation on benefits that the employees had earned prior to the date of the ordinance; the adjustments were prospective and, therefore, permissible under the Contracts Clause. *Id.* at 758.

### FOR MORE INFORMATION

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