THE LEGAL STATUS OF PENSION AND RETIREE MEDICAL BENEFITS FOR MARYLAND PUBLIC EMPLOYEES
INTRODUCTION

Employees of state and local governments in Maryland are often offered traditional pension benefits, as well as retiree medical coverage, as part of their compensation. These benefits are garnering significant attention as it becomes clear, in Maryland and elsewhere, that many of these pension plans have not set aside sufficient funds to pay benefits, and that retiree medical costs are often not funded in advance. The lack of sufficient funding can place significant fiscal strain on state and local governments and, in turn, on state and local taxpayers. At the same time, efforts to modify the benefits are a significant concern for employees who have planned around the availability of such benefits. Given the importance of this issue for all stakeholders, this brief examines the legal protections afforded such benefits in the state of Maryland.

SUMMARY

It is well established under Maryland law that accrued pension benefits may not be changed absent extraordinary circumstances. In other words, pension changes may not have a retroactive effect, and must preserve any benefit earned through the date of the change. Prospective changes can, however, be made, as long as those changes are “reasonable.” Further, changes can be freely made with respect to participants who have not yet satisfied the minimum service requirement to become entitled to a benefit under the plan (commonly referred to as becoming “vested”).

The rules for retiree medical changes are more fact-specific. The general rule is that retiree medical benefits are not legally protected and can be changed at any time and for any reason. The employer can, however, take action that changes that result, for example, by explicitly promising employees those benefits for a specified period of time. In addition, because retiree medical benefits are often offered at the local, rather than state, level, such benefits are often included in collective bargaining agreements. Where a collective bargaining agreement provides for such benefits, it is the terms of the agreement that govern. While collective bargaining agreements are typically effective only for a limited duration, the contract may provide that the promise of retiree medical benefits survives the expiration of the agreement.
PENSION BENEFITS

To prevent a state or local government from changing pension benefits, such benefits must be entitled to legal protection. Maryland, like a majority of states, finds pension benefits are entitled to legal protection on the basis that they are part of a contract between the employer and employee. Finding that such benefits are contractual is legally significant because it allows a participant to enforce his or her contractual rights in state court.2

In addition, states are prohibited under the Contracts Clause of the U.S. Constitution from impairing the obligations of contract. If a state or local government takes legislative action that impairs a pension contract, a participant may file suit in either state or federal court alleging that the benefit changes are unconstitutional. Prior to holding a benefits change unconstitutional, however, there are several steps the court must work through. First, the court must find that a contract exists that protects the precise benefits at issue. If a contract exists, the next question the court must answer is whether the contract has been substantially impaired by the government action. Changes that are not substantial impairments are permissible under the Constitution. And even if the change is found to be a substantial impairment, the government may nevertheless make the change where doing so is reasonable and necessary to serve an important public purpose. The subparts below explore these legal standards in more detail, beginning with the issue of when and to what extent pension benefits are considered contractual under Maryland law.

When are Pension Benefits Protected by Contract in Maryland?

Regardless of whether pension changes are challenged in state or federal court, the first step is establishing whether a contract exists that protects the benefits at issue. Historically, pension benefits for state and local workers were not entitled to any legal protection. Instead, they were considered gifts from the government, which could be taken away at any time and for any reason. Beginning in the 1970s, Maryland courts explicitly rejected this position, referring to the so-called “gratuity” approach as “absurd.”3 Instead, Maryland courts have found pension benefits to be contractual, with such status attaching as benefits are earned.4 The contract with respect to pension benefits is not a formal, written contract, but rather is part of an implied contract that is accepted through performance of services.5

Just as an employer is contractually obligated to pay a salary that is promised when an employee accepts an offer of employment and performs work, so too is an employer contractually obligated to pay pension benefits that are earned as a result of the employee’s work. The functional result of these holdings is that the pension benefit that has been earned through services already performed is entitled to legal protection in Maryland. There are no reported cases where a Maryland state court has allowed retroactive changes to these accrued benefits.

There is more freedom, however, to make changes to the rate of future benefit accrual. The Maryland Court of Special Appeals has held that “reasonable” changes can be made to the rate of future benefit accrual.6 The court has stated that a change is reasonable where it enhances the plan’s ability to satisfy its obligations to pay benefits (referred to as enhancing the “actuarial soundness” of the plan”) “without serious detriment to the employee.”7 While no specific test is provided regarding what constitutes a serious detriment to the employee, the court explained that any detriment “must be balanced by other benefits or justified by countervailing equities for the public’s welfare.”8

Presumably, this rule would allow plans to change future benefit accruals where doing so improves the plan’s funding status while not significantly reducing benefits for participants. However, there are no reported cases in Maryland state courts applying this reasonableness test or otherwise limit-
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...ing the ability of the government to make changes to future benefit accruals.9

It should also be noted that under Maryland law, only participants who have met a plan’s minimum service requirement have standing to challenge benefit changes and, as a result, changes can be freely made for those who have not yet satisfied such requirements.10 For example, if a plan requires employees to work for five years to become entitled to a pension benefit, the earned benefits of an employee who has not yet satisfied that service requirement are completely unprotected. In this example, an employee with three years of service would have an accrued benefit based on salary and years of service to date, but that accrued benefit is unprotected and can be freely changed by the employer. The same general rule applies to specific plan benefits, like disability provisions. Such specific benefits can be changed with respect to any participant before the time he or she has become entitled to them by satisfying all relevant requirements.11

Federal Constitutional Claims

A participant who has a contractual right to his or her pension benefit may file suit in state court seeking to enforce those contractual rights. In addition, a participant who has contractual rights to his or her pension benefits may be able to allege that the change to pension benefits violates the Contracts Clause of the U.S. Constitution, which prevents a state from passing a law that impairs the obligation of contract. Such constitutional claims may be pursued in either state or federal court.12

While many Maryland pension changes have been litigated in federal court on Contracts Clause grounds, a recent holding raises the possibility that the federal courts in Maryland will no longer decide such cases. In Cherry v. Mayor and City Council of Baltimore, a case involving pension modifications, the Federal Court of Appeals for the Fourth Circuit held that there is no Contracts Clause claim where the state action merely breached one of its contracts or otherwise modified a contractual obligation. Instead, there is only a federal cause of action where the government “has erected a legal barrier” that prevents the plaintiffs from recovering damages for any breach.”13 It is possible, therefore, that federal courts in Maryland will no longer hear Contracts Clause challenges to pension changes, requiring plaintiffs to instead proceed in state court.14 Nevertheless, given the substantial role Contracts Clause claims have played in the development of the law in Maryland, as well as the possibility that the analysis may be persuasive to state courts, it is reviewed below.

The first step in determining whether a plaintiff has alleged a viable Contracts Clause claim is to determine whether and to what extent a contract exists. Although the cause of action is a federal one, it is the law of the state that determines the existence of a contract.15 As a result, federal courts look to the Maryland decisions described in the preceding section to hold that a contract exists that protects those pension benefits for vested participants that have already been earned through work performed.

Things become more complicated, however, when a federal case involves prospective changes to the pension benefit formula, impacting only future benefits that have not yet been earned. In characterizing Maryland state law regarding the formation of a contract that protects benefits not yet earned, federal courts have come to differing conclusions. One court found that Maryland state law does not protect benefits that have not yet been earned,16 while another found that Maryland law protects such benefits only against unreasonable changes.17 Regardless, federal courts have held that even if Maryland state law protects future benefit accruals, the Contracts Clause does not. The Contracts Clause only prohibits a state from making retroactive changes.18 The federal district court in Maryland has stated that attempting to contract for future benefits based on future service would be “void ab initio as a surrender of an essential element of the State’s sovereignty.”19 As a result, it seems clear that there is no viable constitutional claim where pension changes do not impact benefits that have already been earned.20

A participant who has a contractual right to his or her pension benefit may file suit in state court seeking to enforce those contractual rights.
Once the issue of whether and to what extent a contract exists has been established, the next inquiry is whether the contract has been substantially impaired. When it comes to pension benefits, the federal district court in Maryland has found that any diminution in already-earned benefits is likely to be substantial. To determine the degree of impairment, the primary measure is "the reliance which the aggrieved party placed on the contractual obligation." Any reduction in pension benefits is likely to be a significant impairment given that "individuals plan their lives based upon their [pension benefits]." In addition, because the affected individuals may no longer be working, they may be already living on a reduced income, and thus a decrease in pension benefits might have an even greater impact than a reduction in salary for an active employee.

If the change is found not to be a substantial impairment, the change is permitted as it does not violate the Contracts Clause. If, however, the change is found to be a substantial impairment, it may nevertheless be permissible if it is reasonable and necessary to achieve an important public purpose. In analyzing whether the change is reasonable and necessary, the degree of impairment is taken into account; the more severe the impairment, the more scrutiny the court applies.

Courts have acknowledged that enhancing the actuarial status of a pension plan is an important public purpose, as is maintaining the financial integrity of the government. One federal court stated that, in determining whether a change was reasonable and necessary, a pension plan does not need to wait to make changes until it is in crisis (i.e., until it is actuarially unsound). Most pension plan changes designed to address underfunding are therefore likely to satisfy this element.

The next part of the test is more difficult. A substantial impairment is only permissible where it is the least drastic means of achieving the policy goal. The government cannot impair benefits where a more moderate course is available. This does not mean, however, that plaintiffs can defeat any pension change by arguing that the government could have simply increased taxes or cut other government spending. Instead, "The Court defers to the legislature's decision to impair its contract with Plaintiffs rather than shift the burden to other government programs or raise taxes." Courts will not take on the role of "super legislatures," but at the same time the government cannot impair a contract simply "because it would rather spend the money for some other public purpose." It is important to note that, while courts will give legislative policy choices some deference, the federal district court has found changes fail the reasonable and necessary test where they impact only a narrow class of beneficiaries instead of distributing the burden of underfunded pension plans more broadly.

RETIREE MEDICAL BENEFITS

Retiree medical benefits are protected under a different legal framework than pension benefits for several reasons. First, retiree medical benefits do not accrue in the same manner as pension benefits. When an individual works for a year in a pension-eligible position, he or she accrues a specific pension benefit related to that year's service. But that same employee does not earn or accrue a specific retiree medical benefit over that same year. Instead, retiree medical benefits are typically based on status; an employee only becomes entitled to retiree medical benefits once he or she has worked the requisite number of years and retired on or after a specific age. Because retiree benefits are not earned over time, they do not automatically create a contract as the employee performs services. Instead, retiree medical benefits are typically based on status; an employee only becomes entitled to retiree medical benefits once he or she has worked the requisite number of years and retired on or after a specific age.

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As a result, benefits for Maryland state employees who are entitled to retiree medical benefits through statute do not enjoy contractual protection for such benefits. Instead, such benefits remain subject to future legislative changes.
The second distinguishing factor is that retiree medical benefits are much more commonly provided pursuant to a formal, written contract than are pension benefits. Retiree medical benefits are frequently provided at the local level, and therefore are subject to a collective bargaining agreement. Where that is the case, a court will review the actual contract language to determine what changes, if any, can be made.

Finally, the legal protections for retiree medical benefits are substantially similar for public employees as they are for private employees. While benefits provided by private employers are generally governed by a detailed federal statute that does not apply to governmental employers, that federal statute does not provide any specific protections for retiree medical benefits. As a result, for both public and private employers, the question of whether employers can modify retiree medical benefits is determined under general contract principles. As a result, this section will include not just cases involving state and local employees in Maryland, but also those involving private employers in Maryland.

**Contract Interpretation**

To date, Maryland cases concerning the ability of a state or local government entity to modify retiree medical benefits have been based on interpretations of collective bargaining agreements. A court’s starting point in a case involving contractual rights to retiree medical benefits is to determine if a contract exists. If it does, as in cases involving collective bargaining agreements, the court’s role is limited to enforcing the contract as written. Where the contract language is ambiguous, the court will allow extrinsic evidence in an attempt to determine what the parties mutually intended. In one Maryland case where the collective bargaining agreement provided that the county’s contribution toward retiree medical insurance “shall remain in effect until the retiree becomes eligible for Medicare,” the court upheld the arbitrator’s decision that the retirees’ right to the contribution continued through the date of such eligibility and did not expire with the collective bargaining agreement. While not deciding the case on the merits, the Maryland Court of Appeals (the state’s highest court) noted that the arbitrator’s interpretation was consistent with Maryland’s theory of contract interpretation.

In a case involving a private employer, the court found that even though the collective bargaining agreement stated that the employer would continue retiree medical coverage “for the duration of this Agreement,” a different provision in the agreement that created a trust to pay retiree medical expenses provided evidence that the parties intended the right to retiree medical benefits to continue beyond the expiration of the collective bargaining agreement. Of particular relevance to the court’s decision was the fact that the trust language contained detailed provisions regarding changes to retiree medical benefits based on rising costs (thereby suggesting a duration longer than the term of the collective bargaining agreement). Additionally, those trust provisions had originally included a durational limit tied to the expiration of the agreement that was deleted at the request of the union.

In general, where retiree medical benefit eligibility is linked to an event “that would almost certainly occur after the expiration of the agreement,” the parties have signaled their intent for retiree medical benefits to continue after expiration of the collective bargaining agreement. Additionally, those trust provisions had originally included a durational limit tied to the expiration of the agreement that was deleted at the request of the union.

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**The Role of Arbitration**

Another issue that has frequently been litigated in the context of retiree medical benefits specified in collective bargaining agreements is whether disputes concerning such benefits must be submitted to arbitration. In particular, courts have addressed whether the parties can be required to arbitrate retiree medical care disputes once the
The relevant collective bargaining agreement has expired. The Maryland Court of Appeals has held that arbitration clauses survive the expiration of a collective bargaining agreement when the dispute concerns rights that vested during the life of the agreement. Further, because arbitrability in such circumstances depends on an interpretation of the contract to determine if the underlying right to the benefit has vested, the arbitrator should initially determine whether the dispute is appropriate for arbitration.

If the parties are required to arbitrate, the next issue that can arise is what role, if any, the court can play in reviewing either arbitrability or the arbitration award itself. Arbitration is a “favored” method of resolving disputes under Maryland law. As a result, the courts’ role in the arbitration process is limited. In determining arbitrability, a court’s role is limited to determining only whether a valid arbitration agreement exists. A court must not consider the merits of the dispute. As a result, where the merits determine arbitrability, it must be the arbitrator’s decision that governs. In reviewing an arbitration award, a court can only set aside an award 1. where there is fraud or misconduct, bias, prejudice, corruption, or lack of good faith on the part of the arbitrator; 2. if it was not within the scope of issues submitted to arbitration; or 3. where it involved a mistake so gross as to result in manifest injustice.

**Enforcement**

One final issue that has arisen in the context of retiree medical benefits in Maryland is whether the court has the power to enforce an arbitration award that requires a government to appropriate funds. In one recent case, Baltimore County attempted to avoid enforcement of the arbitrator’s and courts’ decisions by arguing that judicially-ordered enforcement, which would require a county appropriation for the required retiree medical contributions, violated separation of powers and exceeded judicial authority. While that argument was rejected by both the Maryland Court of Special Appeals and the Maryland Court of Appeals on technical grounds, the Court of Appeals noted that, even if the argument were not dismissed on technical grounds, the County would not have succeeded on the merits because the necessary funds were available in a trust established by the county specifically to pay for retiree medical care. The court acknowledged that the outcome may have been different had the county not had a source of appropriated funds from which to make the ordered payment. Therefore, it is possible that where an arbitrator’s award depends on a governmental appropriation, and there are no alternative funds available, retirees may be unable to secure the appropriate remedy.

**Recent Supreme Court Decision Regarding Retiree Medical Contracts**

One of the frequently litigated issues with respect to retiree medical benefits provided through collective bargaining agreements is how courts should interpret retiree medical provisions that do not contain specific durational language. For example, the agreement might provide that “individuals retiring with at least ten years of service during the term of this agreement shall be entitled to continue their medical coverage at active employee rates.” The agreement itself, however, is of limited duration—often three years. Courts have struggled with the issue of whether, in the absence of specific durational language for retiree medical benefits, such provisions should be interpreted to expire with agreement, or whether they should be held to survive the expiration of the collective bargaining agreement. While this type of litigation is common nationwide, there are no reported cases addressing this issue in Maryland, in either state or federal court.

For many years, there was a split among federal courts regarding the proper default that should be used where retiree medical benefits are provided for in a collective bargaining agreement between a union and a private employer and the duration of such benefits is not explicit. In 2015, the United States Supreme Court ruled that it is contrary to ordinary principles of contract interpretation to
presume in the face of ambiguous language that retiree medical benefits were intended to continue beyond the expiration of the collective bargaining agreement. The parties are free to reach a different result by including specific language that provides that certain provisions survive termination of the agreement, but “when a contract is silent as to the duration of retiree benefits, a court may not infer that the parties intended those benefits to vest for life.”

Despite the fact that the United States Supreme Court has ruled on this issue, it is critical to note that the decision is not binding on state courts. The Supreme Court binds state courts only on matters of federal law, and cases involving disputes over state and local retiree medical benefits are governed by state law. States can certainly cite the Supreme Court decision as highly persuasive authority, but they can come to conclusions different than that reached by the Supreme Court. While the Maryland Court of Appeals has cited the Supreme Court decision in a retiree medical case, it neither endorsed nor rejected the Supreme Court’s holding. As a result, it is unknown at this time whether the Supreme Court precedent will have any significant effect on legal protections for retiree medical benefits in Maryland.

**Practical Application**

With respect to pension benefits, Maryland stakeholders should be aware that benefits that have already been earned are strongly protected. This protection applies to any benefits the employee has already earned, including any cost of living adjustments. While it is not impossible to modify such benefits, the government will have to satisfy an exacting standard to justify such changes.

Changes to the rate of future pension accruals, for example by changing the pension formula going forward, appear to be permissible as long as the changes are considered reasonable. Because enhancing the actuarial soundness is considered a reasonable change, this would appear to allow state and local governments to make prospective changes that enhance plan funding.

For retiree medical benefits, changes can be made unless there is a specific contract in place regarding such benefits, as in the case of a collective bargaining agreement. Where a collective bargaining agreement provides for retiree medical benefits, its terms should be reviewed to determine the duration of such benefits. Changes to benefits cannot be made where doing so would violate the terms of the contract. Where the contract is ambiguous regarding duration, or where there is a dispute regarding the correct interpretation, it will often be an arbitrator who will decide the merits of the dispute, with the court having very limited power to review such decisions.

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1. Some public employees are particularly vulnerable to benefit changes because they do not participate in Social Security. Nearly all public employees in Maryland are eligible for Social Security, with the exception of certain local employees. See Maryland Department of Budget and Management, http://www.dbm.maryland.gov/employees/Pages/SocialSecurityAdministrator.aspx.
3. Ibid. at 629.
4. Ibid.
5. In some instances, instead of implying the existence of a contract from the surrounding circumstances, the statute specifically provides that benefits shall be considered contractual in nature. See, e.g., Board of Trustees of Employees’ Retirement System of Baltimore v. Mayor and City Council of Baltimore, 562 A.2d 720 (Md. 1989).
10. Ibid.
12. Where such claims are filed in state court, the governmental defendant has a right to move the case to federal court if it desires. See 28 U.S.C. §§1441 et seq.
14. The state law claims in Cherry v. Mayor and City Council of Baltimore are currently pending in state court.
20. See Ibid.
22. Ibid.
31. Ibid.
35. Ibid.
36. Most private employer benefits are governed by the Employee Retirement Income Security Act of 1974 (ERISA).
37. Also included are cases involving private employers in the Federal Court of Appeals for the Fourth Circuit, which includes Maryland. While some of these cases involve private employers in other states, their precedent would be binding on federal cases brought in Maryland, and are included for that reason.
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40. Baltimore County Fraternal Order of Police Lodge No. 4 v. Baltimore County, 57 A.3d 425 (Md. 2012).
42. Ibid. at 441 (citing Keffer v. H.K. Porter Co., 872 F.2d 60, 62-62 (4th Cir. 1989)).

46. Ibid.
47. Ibid. (citing Board of Education v. Prince George's County Educators' Association, 522 A.2d 931, 938-39 (Md. 1987)).
49. Ibid.
50. Ibid.
51. For a highly detailed look at these enforcement issues, see Amy B. Monahan, When a Promise is Not a Promise: Chicago-Style Pensions, 64 UCLA L. Rev. 356 (2017).
53. Ibid. (internal citations omitted).
54. Baltimore County v. Fraternal Order of Police, Baltimore County Lodge No. 4, 144 A.3d 1213 (Md. 2016).

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