

No. 09-2187

In The
United States Court of Appeals
For The Fourth Circuit

Fraternal Order of Police Lodge, No. 89, et al.,

Appellees,

v.

Prince George's County, Maryland,

Appellant.

On Appeal from the United States District Court for the District of Maryland

**AMICUS CURIAE BRIEF OF INTERNATIONAL MUNICIPAL
LAWYERS ASSOCIATION IN SUPPORT OF THE APPELLANT AND
REVERSAL OF THE UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF MARYLAND**

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STATEMENT OF INTEREST OF AMICUS CURIAE¹

The International Municipal Lawyers Association (“IMLA”) is a non-profit, professional organization of over 3500 local government entities, including cities, counties, and special district entities, as represented by their chief legal officers, state municipal leagues, and individual attorneys. Since 1935, IMLA has served as a national, and now international, clearinghouse of legal information and cooperation on municipal legal matters. IMLA’s mission is to advance the responsible development of municipal law through education and advocacy by providing the collective viewpoint of local governments around the country on legal issues before the United States Supreme Court, in the United States Courts of Appeals, and in state supreme and appellate courts.

The appropriate application of the Contract Clause to collective bargaining agreements affects local governments across the country. On May 23, 2008, Vallejo, California filed for bankruptcy primarily due to its inability to fund its collective bargaining agreements. Local governments within this Circuit and across the country will be better served by a fully informed decision regarding the applicability of the Contract Clause in this case.

¹ All parties have consented to the filing of this brief. Fed. R. App. P. 29(a).

SUMMARY OF ARGUMENT

The district court mistakenly applied the Contract Clause of the Federal Constitution and, in turn, mistakenly analyzed Contract Clause jurisprudence. To its credit, the district court correctly ruled that the Employee Furlough Plan (“EFP”) did not violate §16-233 and §16-229 of the Prince George’s County Code. *Fraternal Order of Police v. Prince George’s County*, 645 F. Supp. 2d 492 (D.Md. 2009). Once the district court ruled that the EFP contained no contrary provisions to the County’s existing Collective Bargaining Agreements (“CBAs”), it should have recognized that the CBAs incorporated within them the provisions of § 16-229, that provides for the imposition of a furlough plan. P.G. County Code § 16-229. Although previous CBAs contained a provision prohibiting furloughs, similar provisions are not included in any of the current CBAs. The district court should have concluded that the County’s actions to implement a furlough plan which conformed with §16-229 thereby conformed to the terms of the CBAs that under Maryland law incorporated that existing law.

Should this Court disagree that §16-229 is incorporated in the CBAs, it must still find that the County’s Employee Furlough Plan (“EFP”) is a legitimate and necessary exercise of the County’s sovereign power to protect the health, safety and welfare of its residents. In a desperate economy, local governments are faced with difficult funding decisions that can have both short and long term

consequences. Making those choices more difficult, limitations on taxation and mandated programs constrain local governments in the breadth of their choices. Because of rigorous restrictions on raising revenues and increasing mandates on expenditures, often imposed by state and federal law, local governments like Prince George's County, turn to "best practices" guidelines in order to carefully plan for their existing and future needs. These guidelines support the decisions the County made while they bankrupt the lower court's decision making.

ARGUMENT

I. PRINCE GEORGE'S COUNTY DID NOT VIOLATE THE CONTRACT CLAUSE WHEN IT IMPLEMENTED ITS FURLOUGH PLAN.

A. UNDER MARYLAND LAW AND CONTRACT CLAUSE JURISPRUDENCE, WHEN PARTIES ENTER A CONTRACT, THE CONTRACT INCORPORATES EXISTING LAW; THUS, THE COLLECTIVE BARGAINING AGREEMENTS INCORPORATE THE PROVISIONS OF § 16-229 OF THE PRINCE GEORGE'S COUNTY CODE AND CONTEMPLATE THAT FURLOUGHS MAY BE IMPOSED TO RESOLVE BUDGET SHORTFALLS.

When the district court concluded that the County did not violate § 16-229, the court should have recognized that this decision also informed its decision on the Contract Clause. While the court correctly decided the issue involving § 16-229, it erred in its analysis of the Contract Clause.

The Contract Clause under the United States Constitution provides that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts." U.S. Const. art. I, §10, cl. 1. Unlike federal tax law or other more mysterious areas of the law,

an analysis under the Contract Clause is straightforward and requires the court to follow a three step inquiry in the following progression:

1. A “determination that the [legislation] has the effect of *impairing* a contractual obligation.” *U.S. Trust Co. of New York v. New Jersey*, 431 U.S. 1, 17 (1977)(emphasis added);
2. If the court finds the contractual obligation is impaired, is it a “*substantial* impairment of a contractual relationship.” *Baltimore Teachers Union v. Mayor and City Council of Baltimore*, 6 F.3d 1012, 1015 (4th Cir. 1993)(emphasis in original); and
3. If the impairment is substantial, it “may be constitutional if it reasonable and necessary to serve an important public purpose.” *U.S. Trust*, 431 U.S. at 25.

Applying the first step of the inquiry, if a court finds that a contract has not been impaired, the inquiry ends. There is no need to analyze steps two and three. This is such a case. We explain.

In this case, the district court ignored a basic principle of contract law. In Maryland, the general rule is that parties to a contract are presumed to contract mindful of the existing law and that all applicable or relevant laws must be read into the agreement of the parties just as if expressly provided by them:

It is well-established in Maryland that “laws subsisting at the time of the making of a contract enter into and form a part thereof as if expressly referred to or incorporated in its terms, and the principle embraces alike those provisions which affect the validity, construction, discharge and enforcement of the contract.” *Dennis v. Mayor and City Council of Rockville*, 406 A.2d 284, 287 (Md. 1979); *see also Lema v. Bank of America*, 826 A.2d 504, 516 (Md. 2003) (noting that “parties are presumed to know the law when entering into contracts, and thus, ‘all applicable or relevant laws must be read into the agreement of the parties just as if expressly provided by them,

except where a contrary intention is evident' ” (quoting *Wright v. Commercial & Sav. Bank*, 464 A.2d 1080, 1083 (Md. 1983))).

John Deere v. Reliable Tractor, 957 A.2d 595, 599 (Md. 2008).

This principle of contract incorporation is not new; it has withstood the test of time in Maryland, within the jurisdictional boundaries of this Court, and more generally, nationwide. See *Holmes v. Sharretts*, 180 A.2d 302 (Md. 1962); *Griffith v. Scheungarb*, 146 A.2d 864 (Md. 1959), quoting *Brown v. Smart*, 14 A. 468, 471 (Md. 1888) (“It is a familiar principle often applied in the cases that ‘the laws which subsist at the time and place of making a contract enter into and form a part of it, as if they were expressly referred to or incorporated in its terms; and this rule embraces alike those which affect its validity, construction, discharge, and enforcement.’”); *General Elec. Co. v. Moretz*, 270 F.2d 780 (4th Cir. 1959) (“In Virginia, where the contract was made, and generally in other jurisdictions throughout the country, it is settled that relevant statutes and regulations existing at the time a contract is made become a part of it and must be read into it just as if they were expressly referred to or incorporated in its terms.”); see also *Maryland Cas. Co. v. Continental Cas. Co.*, 332 F.3d 145 (2nd Cir. 2003); *Venator Group Specialty, Inc. v. Matthew/Muniot Family, LLC*, 332 F.3d 835 (5th Cir. 2003); *In re Doctors Hosp. of Hyde Park, Inc.*, 337 F.3d 951 (7th Cir. 2003); *Wheeling Pittsburgh Steel Corp. v. Beelman River Terminals, Inc. v. Variable Annuity Life*

Ins. Co., 373 F.3d 1100 (10th Cir. 2004); *Siemens Power Transmission & Distribution, Inc. v. Norfolk Southern Ry. Co.*, 420 F.3d 1243 (11th Cir. 2005).

This primer on Contract Law also heralds the result under the Contract Clause. Since the earliest cases construing the Contract Clause and in those seminal cases that followed, the Supreme Court uniformly confirms that contracts incorporate subsisting local law into them:

This Court has said that 'the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms. This principle embraces alike those which affect its validity, construction, discharge, and enforcement. * * * Nothing can be more material to the obligation than the means of enforcement. * * * The ideas of validity and remedy are inseparable, and both are parts of the obligation, which is guaranteed by the Constitution against invasion.'

Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 429-30 (1934) (quoting *Von Hoffman v. City of Quincy*, 71 U.S. 535, 550 (1866)).

Thus, under Maryland law and under Contract Clause jurisprudence, § 16-229 was incorporated into the Collective Bargaining Agreements and is as much a part of those agreements as their other terms. Because § 16-229 forms a part of the Collective Bargaining Agreements and because the district court correctly concluded that the County acted properly when it determined that the County did not violate § 16-229 in implementing the furlough plan, there can be no violation of the Contract Clause. Simply, the Contract Clause prohibits governments from

acting to impair existing contracts, but recognizes that government retains the legitimate right under its sovereign powers to regulate contracts prospectively.

As discussed, the Collective Bargaining Agreements incorporated § 16-229 and other existing law into them. § 16-229 lays out the procedure for resolving shortfalls in revenue. It permits the imposition of a furlough plan under any of the following circumstances:

- (1) Where the County Executive determines that an ascertained shortfall in revenue, based upon available projections, during any fiscal year requires the compensation level of a department, agency, or office to be reduced; or,
- (2) Where a reduction in the compensation level of a department, agency or office is effectuated in the County's approved annual expense budget; or,
- (3) Where an appointing authority requests, and the County Executive approves, furloughs for employees under the appointing authority's jurisdiction in order to meet the compensation level funded for the department, agency, or office in the County's approved annual expense budget.

P. G. County Code § 16-229.

§ 16-229 also outlines the steps the County Executive must follow in order to enact a furlough plan:

- The County Executive shall transmit to the County Council a Furlough Plan, in resolution form, which sets forth,
- (1) The circumstance warranting the furlough action;
 - (2) The number of employees to be affected by the furlough action identified by agency, salary, grade and salary schedule;
 - (3) The number of furlough days or hours an affected employee will be required to take;
 - (4) The period of time over which furlough days or hours will be required; and,

(5) The dollar amount of compensation savings expected to result from the Furlough Plan.

P.G. County Code § 16-229.

This provision requires the Executive to transmit a plan “*in resolution form*” that details how the County will implement the furlough. This action does not involve the adoption of new law, but involves implementation of existing law. Essentially, a resolution provides the framework for implementing a law or performing a ministerial function of government.

The general rule applicable to the performance of a ministerial act or the administrative business of a municipality, according to McQuillen [Municipal Corporations], § 15.06, is ‘that where a charter commits the decision of a matter to the council or legislative body alone and is silent as to the mode of its exercise, the decision may be exercised by resolution.’

Mayor and City Council of Havre de Grace v. State Bd. of Health, 198 A.2d 732 (Md. 1964).

Unlike resolutions, ordinances and laws generally establish a permanent rule of conduct and require substantial public involvement in their adoption through the process of public notice and public hearings. Maryland courts have recognized this distinction as have other courts and academics.

5 E. McQuillen, *Municipal Corporations*, § 15.02 (3d ed. 1981) explains the difference between a resolution and an ordinance. A resolution “ordinarily denotes something less solemn or formal than, or not rising to the dignity of, an ordinance.” A resolution passed by a legislative body “deals with matters of a special or temporary character ... [and] generally speaking, is simply an expression of opinion or mind

concerning some particular item of business coming within the legislative body's official cognizance, ordinarily ministerial in character and relating to the administrative business of the municipality.” *Id.*

Inlet Associates v. Assateague House Condominium Ass'n, 545 A.2d 1296 (Md.1988).

Because § 16-229 existed as an integral cog in both the County Code and as part of the CBAs, the County Resolution in this case (CR-82-2008) acted merely to implement § 16-229; it was a ministerial act, not a legislative act. It incorporated none of the procedural formalities of a law or an ordinance; there was no public hearing to accept testimony from proponents or opponents of the measure.

This court dealt with this issue in the context of collective bargaining agreements in *Baltimore Teachers Union, American Federation of Teachers Local 340*, 6 F.3d 1012 (4th Cir.1993). In that case, this court concluded that the city had acted to impair its contracts with its unions and but for the magnitude of the economic crisis affecting the city, it would have violated the Contract Clause.²

² The decision includes an astounding exchange of footnotes in which the majority and the concurrence discuss the applicability of the concept of existing law to the Contract Clause with the majority cavalierly announcing its view that the Contract Clause could invalidate an existing statute. The majority did not support this conclusion with any analysis and seems to have ignored the discussion of the issue by the Justices of the Supreme Court over 160 years previously. See: *Ogden v. Saunders*, 25 U.S. 213 (1827). As Justice Holmes noted: "One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of

In *Baltimore Teachers*, this court discussed, but discounted a provision of the Baltimore City Charter, that like provisions in the Prince George's County Code and Charter demand that the County not incur a budget deficit. *Baltimore Teachers* at 1016. There the court concluded that the evidence was not sufficient to support the city's reliance on that provision of its charter. In the instant case, however, the district court has already properly concluded that the County acted in accord with law when it complied with § 16-229. That conclusion fully supports the parallel conclusion that the Contract Clause was not violated. The cases are distinct both on their law and on their facts.

II. PRINCE GEORGE'S COUNTY DID NOT VIOLATE THE CONTRACT CLAUSE WHEN IT IMPLEMENTED ITS FURLOUGH PLAN BECAUSE IT WAS FACED WITH A DIRE ECONOMIC SITUATION.

A. LOCAL GOVERNMENTS HAVE STRINGENT REQUIREMENTS ON HOW TO UTILIZE DISCRETIONARY FUNDS, ARE REQUIRED TO BALANCE THEIR BUDGET, AND FACE LIMITATIONS ON RAISING REVENUE.

Although this Court should rule that the furlough plan does not implicate the Contract Clause, as discussed above, the record nonetheless reflects that the County enacted a valid, legitimate, and necessary furlough plan in order to protect the overall welfare of the community. In its opinion, the district court stated that

the State by making a contract about them." *Hudson County Water Co. v. McCarter*, 209 U.S. 349, 357 (1908).

“although the County suggests to the Court that it faced dire circumstances and had no other reasonable alternatives, the record suggests otherwise and the County’s actions resemble trappings of doing that which was ‘politically expedient.’” *Fraternal Order of Police*, 645 F. Supp. 2d at 36 (quoting *United States Trust Company of New York v. New Jersey*, 431 U.S. 1, 26 (1977)).

This case is a far cry from *U.S. Trust*, in which the states of New York and New Jersey sought to subsidize public transportation in violation of bond covenants that supported the debt incurred in building and expanding the transportation infrastructure that serve metropolitan New York City. Here, the County is not seeking to run away from its debt obligations to satisfy a different political agenda, it is faced with an extraordinary financial crisis and must choose between hosts of tough choices to balance its budget. The record certainly does not reflect the district court’s view. In reality, local government budgeting is much more complex than the simplistic process described by the court in its analysis and Prince George’s County utilized its limited discretion in a responsible and prudent manner. To understand why this is so, one must look at *both* the various sources of local government revenue *and* the strict spending requirements that apply to local governments under law.

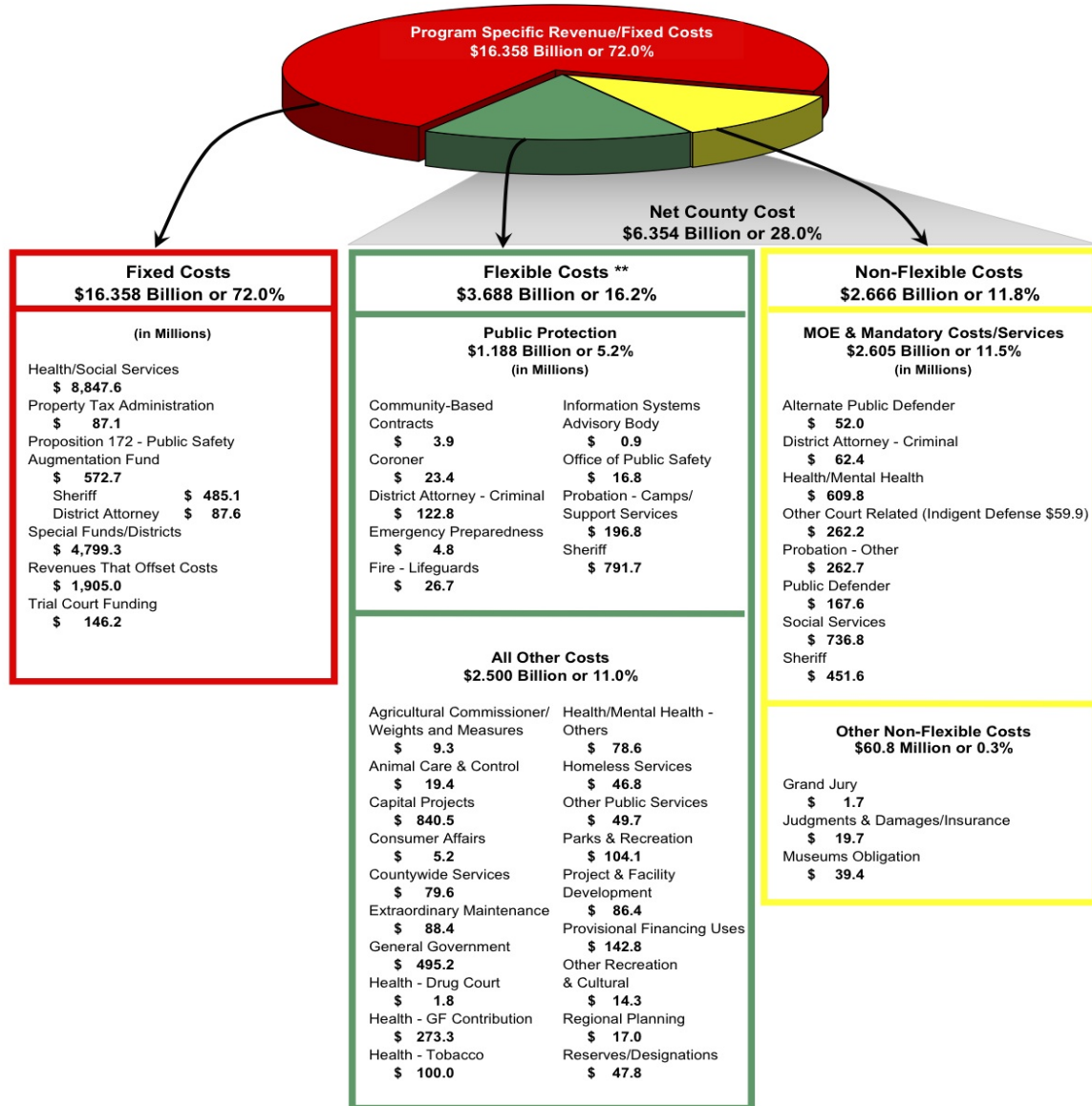
Revenues for local government come primarily from two directions: (1) “above” from the state and federal government, and (2) “below” from citizens

though taxes and user fees, such as property tax, sales tax, and park user fees. A quick glance at the evening news exposes the obvious; sources of revenue for localities are decreasing from above and below. As an example, during the time that Prince George's County was beginning its 2009 budget process, federal budget grants to state and local governments for all programs (other than Medicaid) were proposed to decline by \$18.9 billion, a decrease of 7.4 percent from the previous year. Iris J. Lav et al., Center on Budget and Policy Priorities, *Federal Grants to States and Localities Cut Deeply in Fiscal Federal Budget 1* (Feb. 2008), <http://www.cbpp.org/cms/index.cfm?fa=view&id=1145> (last visited, Dec. 15, 2009). From below, tax revenues for state and local governments in the second quarter of 2009, compared to the second quarter of 2008, were down 12.2 percent, by over \$42 billion. U.S. Census, *Quarterly Summary of State and Local Government Tax Revenue 2* (Sept. 2009), <http://www.census.gov/govs/www/qtax.html> (last visited Dec. 15, 2009). These statistics are not revelatory; in fact, the district court noted similarly that the overall economic decline "was widespread and grew in scope well into 2008, and whether the market has bottomed out remains to be disputed. *Fraternal Order of Police* at 645 F. Supp. 2d at 494. Unfortunately, the district court did not appreciate a similar decline in the flexibility that localities have with spending the revenues received.

B. PRINCE GEORGE’S COUNTY DID NOT HAVE THE BREADTH OF DISCRETION THAT THE DISTRICT COURT ASSUMED AS THE COUNTY’S CHOICES ARE DICTATED BY MANDATORY VS. DISCRETIONARY FUNDING OPTIONS.

In essence, local government spending falls into one of the following two categories: (1) mandatory spending where the amount of spending is determined either by federal, state or local law through formulae, designation or restriction; and (2) discretionary spending where amounts funded are optional. In order to balance its budget, a local government cannot reduce its mandatory costs, but must reduce discretionary spending. As an example, note the chart on the following page showing the 2009-2010 Adopted Budget for the County of Los Angeles.

**County of Los Angeles
2009-10 Adopted Budget
\$22.712 Billion***
Mandated vs. Discretionary Costs



* Excludes major interfund transfers of revenue that would artificially inflate the size of the total County budget.
 ** Flexible Costs include one-time only expenditures and mandatory functions with discretionary service levels.

Los Angeles County, 2009-10 Final Adopted Budget, fig. 1,

http://file.lacounty.gov/lac/cms1_139226.pdf (last visited Dec. 15, 2009).

While Los Angeles County and Prince George's County are separated by a continent, they each must balance their budgets and fund mandatory and discretionary objectives. Like other communities throughout the United States the majority of their expenditures are mandatory and their discretionary options are continually being reduced. In Los Angeles County's case,³ fixed/non-flexible costs total 83.8% of entire adopted budget. *Id.* The remaining 16.2% is where the Los Angeles County must balance its budget; it is this small 16.2% discretionary spending category where the dwindling sources of revenue must be accounted for in order to balance its budget. Prince George's County, as other local governments throughout the United States, faces a similar contraction of its discretionary spending options.

The district court's statement that Prince George's County "failed to exhaust other alternatives" when it made the decision to cut its General Government/Personnel costs by instituting the furlough does not take into account the rigid spending requirements that face localities when they adopt a budget, particularly in situations where the budget must be balanced. Specifically, the

³ Admittedly, Prince George's and Los Angeles Counties will have different percentages of their budgets targeted towards mandatory spending, as will other communities across the country. No uniform percentage exists, as state and local laws vary greatly, but uniformly local governments see their mandatory expenditures increasing while their discretionary options decline. The district

district court noted that one such alternative would be to access money from the Maryland National Capital Parks and Planning Commission (“M-NCPPC”) in lieu of furloughs. Although parks and recreation are listed as discretionary under Los Angeles County’s budget, this is not the situation in Prince George’s County. The district court discussed the options available to the County insofar as a fund balance it considered available from parks and recreation:

The County also acknowledged that the Park Commission had a fund balance of between \$60 and \$80 million. (*Id.* at 26.) Mr. Seeman was asked whether he considered accessing some of that money in lieu of implementing the furloughs. Mr. Seeman responded in the negative and stated, “you have to get agreement from Park and Planning to use that money. We can’t take the money from Park and Planning unless they agree to it.” (Seeman Depo. at 28.) Despite the County’s position, the Court considers this a fourth alternative.

Fraternal Order of Police, 645 F. Supp. 2d at 516.

The district court plain got it wrong. Parks and recreation in Prince George’s County are controlled by the M-NCPPC, a semi-autonomous bi-county agency. M-NCPPC prepares its own operating budget which must be approved by the County Councils of both Montgomery and Prince George’s Counties. Md. Code Ann., art. 28 §2-118. Each County must support the agency’s budget through tax levies. Md. Code Ann., art. 28 §6-107. At the end of a fiscal year, should the agency have an unexpended fund balance, there is a specific process

court did not appreciate some of the mandates faced by the County in relationship to its available options.

that details how these funds are to be dealt with by the agency and by Prince George's County. Md. Code Ann., art. 28, §6-107. Although the district court concluded that Prince George's County was unconstrained in raiding the M-NCPPC's fund balance, the law does not support the court's conclusion.

Similarly, state law explains that a county cannot reduce its funding of a community college after the college's budget has been adopted. Md. Code Ann., Educ. §16-309. The same is true for the school system Md. Code Ann., Educ. §§5-101 through 5-105 and unlike Baltimore City in the early 1990s, Prince George's County does not have control of its schools that might have allowed it to furlough students for a week as in the *Baltimore Teachers* case. Md. Code Ann., Educ. §§4-101 - 4-319. There are other state mandated functions that local governments in Maryland must fund. For example, Prince George's County must fund its Sheriff's office (Md. Code Ann., Cts. & Jud. Proc. §2-309(a-1), (r-1)), its State's Attorney's office (Md. Code Ann., Crim. Proc. §15-401, §15-417), and its courts. It must also fund its Board of Elections (Md. Code Ann., Elec. Law. §2-203) and Board of Liquor License Commissioners (Md. Code Ann., art. 2B, §15-109(r)(1)). Indeed, the Attorney General for Maryland has opined that a county must fully fund its local election board's budget. 76 Op. Md. Att'y Gen. 91-023 (June 12, 1991). In a more recent opinion the Attorney General further exacerbated Prince George's and Montgomery Counties' problems with funding

by determining that they could not use their debt service payments towards school construction to meet their mandated educational funding levels. 94 Op. Md. Att’y Gen. 177 (November 4, 2009).

Unfortunately for local governments, there is still worse news. Not only are state and local governments faced with having to reduce spending from a smaller piece of the pie by only cutting discretionary sources, the slice is getting smaller. At the time Prince George’s County was crafting its 2009 budget, the federal government’s proposed 2009 budget cut discretionary grant to state and local governments by 10.9%, after adjusting for inflation. Iris J. Lav et al., Center on Budget and Policy Priorities, *Federal Grants to States and Localities Cut Deeply in Fiscal Federal Budget 2* (Feb. 2008), <http://www.cbpp.org/cms/index.cfm?fa=view&id=1145> (last visited, Dec. 15, 2009). The types of programs that were to be cut as part of this proposal included: Social Services Block Grant, vocation and adult education, and training and employment services. *Id.* at 3. Programs such as these contribute to the health, safety and welfare of a community, and localities are faced with the ever-increasing tension of balancing its community interests alongside balancing their budgets.

C. “BEST PRACTICES” GUIDE LOCAL GOVERNMENTS WHEN MAKING BUDGET POLICY DECISIONS WHICH THE DISTRICT COURT DID NOT CONSIDER.

The lower court, confused by the breadth of the County’s \$2.6 billion budget, adopted a simplistic approach to the County’s fiscal predicament. Focusing on the County’s Undesignated Fund Balance (UFB) and the County’s Capital Improvement Plan (CIP), the Court concluded that the County should have used its UFB to fund the promised wages or it should have abandoned projects that formed a part of its CIP. While charged with a fundamental, and perhaps, the most important function of democratic society, the court does not have responsibility for the long term fiscal stability of a community, for a plan for its roads, its public infrastructure or for protecting the community’s residents’ health, safety and welfare. Instead, the elected leaders of Prince George’s County are charged with those responsibilities and remain accountable to the voters to implement their will.

Funding decisions in a complex \$2.6 billion budget can be easy to criticize or challenge; yet every decision holds consequence. Saving money on the purchase of salt cannot be tested in advance of the winter storm; only by springtime will that decision appear either prescient or foolhardy. Similarly, decisions to cut back on road maintenance, facility maintenance and capital improvements may solve immediate needs, but at what cost to the future. The Minneapolis bridge collapse evidences how poor maintenance can lead to

catastrophic loss. A decision to buy land today for a highway that is planned for 2020, may seem excessive, until the project is delayed and the roadways it was designed to relieve are clogged and failing. The lower court cavalierly commented that because these decisions do not involve breaking contracts, they do not compete with collective bargaining agreements at the same level of choice. Rather than be guided by a visceral contempt for the decisions that the local government leaders made, this Court should look to “best practices” in government finance.

Local governments must plan not only for the immediate budget cycle, but also for the long-term financial health of the community. The more sophisticated local governments use “best practices” to ensure their long-term financial health, and Prince George’s County utilized best practices as it dealt with this fiscal crisis.

The Government Finance Officers Association (“GFOA”) provides “best practices” recommendations. As to Undesignated Fund Balances, GFOA states:

The adequacy of unrestricted fund balance in the general fund should be assessed based upon a government’s own specific circumstances. Nevertheless, *GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures* In any case, such measure should be applied within the context of long-term forecasting, thereby avoiding the risk of placing too much emphasis upon the level of unrestricted fund balance in the general fund at any one time.

Government Finance Officers Association, *Best Practice: Appropriate Level of Unrestricted Fund Balance in the General Fund (2002 and 2009)*(Budget and CAAFR) 2 (Oct. 2009), http://www.gfoa.org/downloads/AppropriateLevelUnrestrictedFundBalanceGeneralFund_BestPractice.pdf (last visited Dec. 15, 2009)(emphasis added).

In Prince George's County, the FY 2009 Proposed Operating Budget included slightly over \$2.6 billion general fund expenditures. A two month reserve in an undesignated fund balance would require, at minimum, \$433 million.⁴ After the County revised its estimates on September 5, 2008, the Undesignated Fund Balance totaled \$65 million. Obviously, this amount is dramatically below the formulaic best practice, but not necessarily below the level required for best practices.⁵ The Court stated that "the County chose to impair its own contractual obligations even though the [amended budget] calculations presented a picture better than that which was presented . . . and even though the County had considerably more resources at its disposal." *Fraternal Order of Police* at 645 F. Supp. 2d at 512. In reaching this conclusion, the lower court substituted its judgment for that of the elected leaders in Prince George's County. The County acted in a prudent and responsible manner when it decided to heed the advice of

⁴ \$2.6 Billion divided by 12 [months] multiplied by 2 [months] or \$2.6 divided by 6.

⁵ In the GFOA report recommending levels of Undesignated Fund Balances, the GFOA noted that states and the largest local governments could consider reducing

GFOA and to protect its credit rating. Indeed, the Prince George's County Undesignated Fund Balance was \$38 million lower than the Undesignated Fund Balance from the prior year.

D. "BEST PRACTICES" DEMAND THAT LOCAL GOVERNMENTS NOT IGNORE THE IMPORTANCE OF MUNICIPAL BOND RATINGS.

As part of its decision, the district court suggested that the County refused to utilize a larger portion of the Undesignated Fund Balance in order to achieve and maintain its "AAA" bond rating. Again, the lower court substituted its judgment for the considered judgment of the County's elected leaders as they purposefully considered the consequences of a lowered bond rating to the immediate and long range fiscal situation of the County. The importance of municipal bonds and municipal bond ratings cannot be understated when considering the long-term financial stability of a local entity.

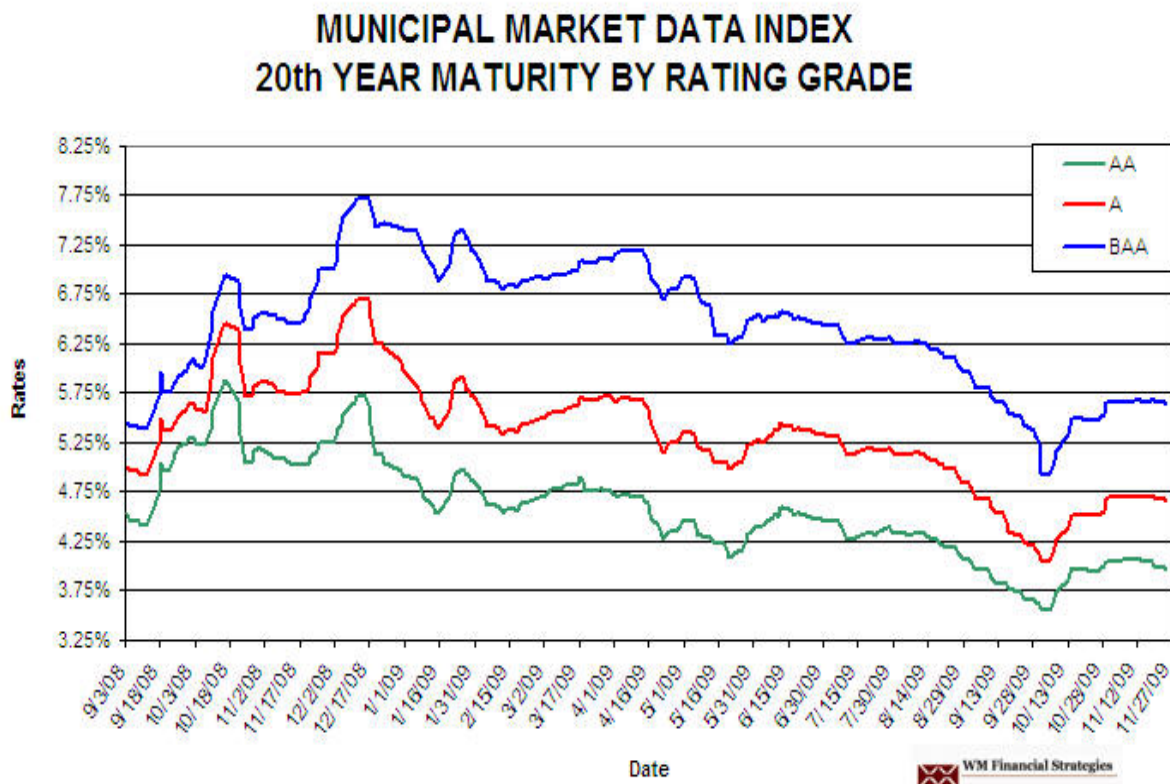
By issuing debt (bonds) in return for an immediate inflow of capital, municipal bonds are an essential method by which the government raises revenue to finance capital projects. The amount of debt issued by local entities is staggering; in fact, the outstanding debt issued through the municipal bond market is approximately \$2.7 trillion. Mark Jewell, *Not the Same Old Municipal Bond*

the levels of fund balance below the two month recommendation because each was better positioned to withstand regularly anticipated economic upheaval.

Market, Boston.com, July 19, 2009, at http://www.boston.com/business/markets/articles/2009/07/19/not_the_same_old_municipal_bond_market. These funds are used for essential projects such as: building schools, utility infrastructure, capital facilities, parks, highways and the other physical improvements that help serve a community. These are projects and services utilized by residents throughout a community on a daily basis. They enable commerce.

The municipal bond market involves many players, each of whom play a separate role in the valuation of a bond issue. Bond rating agencies, such as Moody's, use various factors to determine the amount of risk that corresponds to a particular entity's bond issue. The highest rating by Moody's, "AAA", is considered to have a lower risk, and therefore, generates a lower rate of return for investors. The next highest rating, "Aa", is given to a bond issue that has been calculated by the rating agency to have a slightly higher risk (chance of default), and therefore, investors are enticed to buy a riskier investment with the promise of a higher rate of return. In short, a lower rating means a larger percentage of a local entity's funds will be used to pay investors than a higher rating. The effect of lower credit ratings can be dramatic. A drop in the credit rating may seem small, but when applied to a \$100 million offering, a change of even one basis point changes the amount of interest that must be paid by \$100,000 per year, and over a

20-year bond, the difference becomes \$2 million⁶. To provide context, the following chart reflects the difference in interest rates based on their credit ratings. The chart does not show the difference between a AAA rated bond and a AA rated bond, but it effectively shows how a change in rating has historically affected interest rates (from the chart we see the difference between a AA rated bond and an A rated bond is roughly 75 basis points as of November 27, 2009).



WM Financial Strategies, *Rates of Over – Trends in Municipal Bond Rates*, fig. 5, <http://www.munibondadvisor.com/market.htm> (last accessed Dec. 15, 2009).

⁶ Applying a difference of 75 basis points (as is the case in the chart below) to a \$100 Million bond issue the cost differential adds roughly \$15 Million to the cost of the borrowing.

Changes in the County's credit rating, not only affect new issues (i.e. bonds being offered for the first time), but affect existing debt. As the rating for the debt changes, the price of bonds sold in the aftermarket changes, since the yield for the bonds has already been set (i.e., the amount the government must pay in interest). While the local government does not need to pay more or less for these existing bonds, the bond's value changes. Thus, an investor who has paid \$1,000 for a bond may only be able to sell it for \$950 if the rating falls just a fraction. For investors not looking or able to hold the bonds to maturity, their investment is affected. As a result, bond investors, looking to find stability for their savings, will avoid issuers who show an unwillingness to preserve their credit worthiness. When that happens, the demand for bonds from that issuer declines and the bonds must be sold at higher interest rates to assure their sale. This means that bond issuers, like Prince George's County, must protect their credit, not only because of the specific effect on the interest it pays, but because of the tangential effect a drop in credit has on the market for its bonds.

One need only observe readily available financial information to see how lowered reserves affect ratings, as just recently another rating agency, Fitch's, placed a negative outlook on Prince George's County's bond rating.⁷

⁷ PR-inside.com, "Fitch Rates Prince George's County's (Maryland) \$30 MM GOs 'AA+'; Outlook Negative," Nov. 19, 2009, *available at* <http://www.pr-inside.com/fitch-rates-prince-george-s-county-s-maryland-r1594149.htm>. (last accessed December 17, 2009).

CONCLUSION

The lower court must be reversed because it was wrong when it determined that the Contract Clause was violated in this case. Because § 16-229 formed a part of the Collective Bargaining Agreements and because the Council and Executive implemented existing law, the Contract Clause was not breached. Even if the Clause were considered applicable, the Supreme Court has taught us that the Contract Clause does not prevent governments from acting in their sovereign interest.

Faced with one of the most severe economic challenges since the Great Depression, the elected leaders of Prince George's County faced a daunting challenge to bring its budget in balance. They made choices and hard decisions and they will be held accountable by the voters. The unions will no doubt play an important role in informing the voters of their concerns over what they believe to be a breach of faith and a breach of these Collective Bargaining Agreements, but it is at the polls where those concerns must be assuaged, not in the courthouse.

/s/ Charles W. Thompson, Jr. Date: December 18, 2009

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CERTIFICATE OF SERVICE

I certify that on December 18, 2009, the foregoing document was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by serving a true and correct copy at the addresses listed below by December 21, 2009.

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