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March 21, 1997

Claude R. Perrier
Executive Director
Maine State Retirement System
46 State House Station
Augusta, ME 04333-0046

Dear Mr. Perrier:

I am writing in response to your inquiry to this Department asking two questions concerning amendments to the Maine State Constitution enacted in 1995 relating to the funding of the Maine State Retirement System. Me. Const. art. IX, §§ 18-A, 18-B. Your first question concerns the case of Parker v. Wakelin, currently pending in the federal courts, which involves a challenge to the constitutionality of amendments to the benefit structure of the Retirement System passed by the Legislature in 1993. If the courts were ultimately to invalidate some or all of the amendments, the unfunded liability of the Retirement System would increase. Your question is whether the Board of Trustees, in this circumstance, would have the discretion to treat that increase as an alteration of the amount of the unfunded liability as of June 30, 1996, which it is required to certify, and therefore amortize it over 31 years under the terms of Section 18-B, or whether the increase must be treated as an experience loss, under Section 18-A, and amortized over a period not to exceed 10 years. Your second question is whether future experience gains such as gains in the market value of assets of the Retirement System must, for purposes of calculating payments which the Legislature will make to the Retirement System, be recognized each year; must be recognized over a period not to exceed 10 years as experience losses must be amortized; or may be recognized within the 31 year period for the retirement of the unfunded liability. For the reasons which follow, it is the Opinion of this Department that the Board may adjust the amount of the unfunded liability as of June 30, 1996 which it is required to certify to reflect a final ruling adverse to the State in Parker v. Wakelin, and that the Board may recognize future experience gains at any time within the 31 year amortization period established by Section 18-B, so long as such recognition is consistent with sound actuarial practices.

I. Parker v. Wakelin Adjustment

As set forth more fully in a prior Opinion of this Department, Op. Me. Att'y Gen. 96-5, in 1995 the Maine Legislature enacted and the voters of the State approved two amendments to the Maine Constitution relating to the funding of the Maine State Retirement System. Me. Const. art. IX, §§ 18-A, 18-B. One of the provisions of these amendments specifies that the actuaries of the Maine State Retirement System and the Board of Trustees shall certify the amount of the System's unfunded liability as of June 30, 1996, and that that amount must be retired by the Legislature through the appropriation of funds over a 31 year period beginning July 1, 1997. Me. Const., art. IX, § 18-B. You have advised this Department that the Board of Trustees intends to certify the amount of the unfunded liability as of June 30, 1996 sometime in advance of July 1, 1997.

The problem which your first question presents derives from the fact that in 1993, the Legislature enacted certain amendments to the benefit structure of the Retirement System which had the effect of reducing its unfunded liability. P.L. 1993, ch. 410, §§ L-12, L-13, L-28, L-31, L-33, L-35, L-37. However, shortly after these amendments became effective, their constitutionality, as applied to the public school teacher-members of the Retirement System, was challenged in the federal courts. Parker v. Wakelin, United States District Court for the District of Maine Civil Docket No. 94-157-P-C. The case was the subject of two extensively briefed pretrial motions, a trial on March 19-21, 1996, and extensive post-trial briefs. On August 1, 1996, the Court issued a Memorandum of Decision and Order, invalidating some of the amendments (those applicable to members of the Retirement System with 10 years of creditable service as of July 1, 1993), but sustaining others. Parker v. Wakelin, 937 F.Supp. 46(D.Me. 1996). The case has been appealed, however, to the United States Court of Appeals for the First Circuit and may well be appealed to the United States Supreme Court. In addition, a second challenge to the 1993 Amendments, on behalf of State employee-members of the Retirement System, has been filed in the federal court. Dzialo v. Perrier, United States District Court for the District of Maine, Civil Docket No. 96-337-P-H. This case has been stayed pending the First Circuit's decision in Parker. It will be some time, therefore, before the final determination of the federal courts in these matters is known.

In view of this uncertainty, the Retirement System's actuaries and the Board of Trustees have decided that, for purposes of determining the amount of the June 30, 1996 unfunded liability which they intend to certify before July 1, 1997, it will be assumed that the 1993 amendments to the benefit structure are constitutional in their entirety. This leaves the problem of how to adjust the amount of the certification in the event that the courts ultimately determine that any of the amendments are unconstitutional, thereby increasing the unfunded liability. Two possibilities present themselves: Such a result might be treated as an "experience loss" within the meaning of Section 18-A, requiring that the increase in the

unfunded liability "must be retired over a period not exceeding 10 years." Alternatively, since the legislative action which is the subject of the lawsuit occurred prior to June 30, 1996, the Board of Trustees, acting upon the calculations of its actuaries, might issue a revised certification of the amount of the unfunded liability as it existed on June 30, 1996, thus permitting the increased amount of that liability to be retired over 31 years under the provisions of Section 18-B. Your question is whether either of these results is required by the Constitution.

Clearly, the increased liability that would result from an ultimate determination adverse to the State in Parker v. Wakelin would have to be dealt with in some manner. In the view of this Department, however, the Constitution does not require that such a determination be treated as an "experience loss"; therefore, it may be the subject of a revised certification by the Board. Both the text of the constitutional amendments and their legislative history are silent as to the manner in which such a judicial determination should be treated, and it cannot be inferred from such silence that such a judgment must be treated as an "experience loss" under Section 18-A rather than be the subject of an adjustment to the amount of the unfunded liability as of June 30, 1996. Moreover, the concept of an "experience loss" contemplates that events subsequent to the June 30, 1996 certification of the unfunded liability are not in accordance with assumptions as to those events made by the Retirement System's actuaries and the Board that were integral to the calculation of the amount of the liability and made at the time of the certification. The case of Parker v. Wakelin involves actions which occurred prior to that date. Thus, a ruling adverse to the State in that case would not involve an assumption that was not borne out by events which occur after that date, and consequently could not give rise to an "experience loss."

Because an adverse ruling is not required to be treated as an experience loss, the only alternative remaining would be for the Board of Trustees to account for the resulting increase in the unfunded liability of the Retirement System by making an adjustment in the amount of that liability which it had certified as of June 30, 1996. The Board would accomplish this, presumably, by consulting with the Retirement System's actuaries for a determination of the amount of the increase in the unfunded liability resulting from the restoration of members' benefits required by the court's decision. The Board would then add this incremental cost to its certified amount of the unfunded liability as of June 30, 1996 for retirement by the Legislature over the 31 year period beginning July 1, 1997.¹

¹ One advantage of this approach is that it avoids treating the adjustment as an experience loss, which would increase substantially payments from the General Fund to the Retirement System in the 10 years following the court's ruling. Instead, since the amount could be spread out over 31 years, the payments by the Legislature to the Retirement System could remain relatively level over that period.

In reaching this conclusion, this Department does not wish to be misinterpreted as suggesting that any other kind of adjustment which the Board of Trustees might wish to make in the future might be treated similarly. The fact that distinguishes an adjustment resulting from an adverse determination in Parker v. Wakelin from any other adjustment that might be forthcoming is that that adjustment relates to events that occurred prior to June 30, 1996. This Department is not aware of any other similar contingency now existing.

II. Future Experience Gains

Your second question concerns the manner in which the Board of Trustees may treat, for purpose of the retirement of the unfunded liability, future experience gains, such as gains in the market value of the assets of the Retirement System, which occur subsequent to July 30, 1996. Three possibilities present themselves here: First, the Board might be required by Section 18-A to recognize such gains in the year in which they occur and thus include them in the calculation of the employer contribution to the "normal cost" of retirement benefits in making its biennial budget request to the Maine Legislature. Second, such gains might be required to be treated as the obverse of "experience losses," within the meaning of Section 18-A, and recognized over a period not to exceed 10 years, in the same manner as experience losses are required to be amortized. Finally, the Board of Trustees might have the ability to recognize such gains at any time during the 31 year period for the retirement of the unfunded liability. Your question is whether the constitutional amendments permit the Board to employ this latter approach, or whether either the first or second method of recognizing gains in the market value of the Retirement System assets is constitutionally required.

In the view of this Department, the constitutional amendments do not require any particular method which the Board must employ in recognizing experience gains. Once again, the text of the constitutional amendments and their legislative history is silent as to the manner in which experience gains are to be recognized. Section 18-A refers specifically to "experience losses," but does not speak in terms about experience "gains," nor does it indicate whether the concept of "experience losses" should be read to mean net losses or gross losses. Similarly, the concept of "the normal cost of all retirement and ancillary benefits," referred to in Section 18-A, is undefined, and therefore cannot be read expressly to require that future gains in the market value of Retirement System assets must be recognized in the year that they occur, and therefore be reflected in the calculation of "normal cost." In view of the lack of any language in the amendments specific to this issue and in the absence of any relevant legislative history, this Department believes that the courts are unlikely to read the constitutional amendments to require that the Board recognize experience gains either as part of the biennial calculation of employer contributions to the "normal cost" of retirement, or as part of the System's

"experience losses." Rather, the courts are likely to accord to the Board considerable discretion in the timing of the recognition of such gains so long as they are recognized within the 31 year period for the retirement of the unfunded liability, and so long as the method which the Board employs in recognizing the gains is consistent with sound actuarial practice.

I hope the foregoing answers your questions.

Sincerely,



ANDREW KETTERER
Attorney General

AK:sw

cc: Governor Angus S. King, Jr.
President Mark W. Lawrence
Speaker Elizabeth H. Mitchell

Senator Mary R. Cathcart
Representative Pamela H. Hatch
Co-chairs, Joint Standing Committee on Labor