Issue Papers
2007 Legislative Session

Department of Legislative Services 2006

Issue Papers

2007 Legislative Session

Presentation to the

Maryland General Assembly

Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland

December 2006

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December 2006

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Prior to each session, staff of the Department of Legislative Services, Office of Policy Analysis, prepare an information report on issues. This document is a compilation of the issue papers arranged by major topic. The information reflects the status of the items as of December 1, 2006.

Following each paper is an identification of the staff who worked on a particular topic. If you should need additional information, please do not hesitate to contact the appropriate staff person.

We trust this information will be of assistance to members of the General Assembly.

Sincerely,

Karl S. Aro
Executive Director

KSA/mll

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Operating Budget

Economic and Revenue Outlook

The Maryland economy continues to grow at a moderate pace but is expected to slow somewhat under the weight of the contracting housing market. Weak year-to-date performance and slower economic growth result in a forecast of less than 5 percent general fund revenue growth over the next two years.

Economic Outlook

The Maryland economy marked its second consecutive year of healthy growth in 2005. Employment rose by 1.5 percent, improving on the 1.2 percent pace in 2004. Wage and salary income grew 5.6 percent, on par with the 5.7 percent growth in 2004. Total personal income, however, grew slower in 2005 but still at a healthy pace of 6.3 percent. In 2004, total personal income grew 7.2 percent, boosted by the one-time Microsoft dividend that was paid out in the fourth quarter. This payment, along with higher interest rates, helped to lift income from dividends, interest, and rent by 10.6 percent in 2004 (after falling in both 2002 and 2003). In 2005, dividends, interest, and rent income were up 6.1 percent. Employer-paid benefits that are included in personal income, such as pensions and health insurance, also grew slower in 2005 relative to 2004, as did the business income of individuals.

The data available for 2006 present a somewhat mixed picture of the Maryland economy. Through August, employment is up 1.5 percent but growth has slowed as the year has progressed. Employment grew 1.6 percent in the first quarter, slowing to slightly less than 1.5 percent in the second quarter. Personal income growth, however, has accelerated significantly from the 2005 pace. For the first half of the year, total personal income in Maryland is up 6.7 percent. Wage and salary income is up 7.9 percent compared to growth of just 5.7 percent in 2005.

The overall economic outlook is not materially different from the December 2005 forecast that was the basis of the revenue projections from the Board of Revenue Estimates (**Exhibit 1**). Although employment growth is expected to be slower in 2006 than previously forecast, this is mostly due to a downward revision to 2005 employment data that was released in March 2006. Expected personal income growth in 2006 is slightly higher due to the strong year-to-date data. In 2007, the national and Maryland economies are expected to slow as higher interest rates and the significant contraction in the residential real estate market act as a drag on economic growth. Economic growth is expected to rebound in 2008, and the impact of the U.S. Department of Defense's Base Realignment and Closure process, which is expected to bring over 15,000 net direct and indirect jobs to Maryland, will begin to be felt in 2009.

Exhibit 1
Maryland Economic Outlook
Forecasted Year-over-year Percentage Change

Calendar	Employment		Personal Income	
Year	Dec. 2005	Oct. 2006	Dec. 2005	Oct. 2006
2003	0.4%	0.3%	3.8%	3.8%
2004	1.1%	1.2%	6.8%	7.2%
2005	2.0%	1.5%	6.3%	6.3%
2006E	2.0%	1.6%	6.4%	6.6%
2007E	1.6%	1.2%	5.5%	5.6%
2008E	1.8%	1.6%	5.3%	6.0%
2009E	1.8%	1.8%	5.3%	6.1%

Source: December 2005 is from the Board of Revenue Estimates. October 2006 is from the Department of Legislative Services. Figures for 2005 are estimates in the December 2005 columns.

Revenue Outlook

Actual fiscal 2006 general fund revenues exceeded the estimate by $46.5 million, or 0.4 percent. General fund revenues totaled $12.4 billion in fiscal 2006, an increase of 7.3 percent over 2005. Excluding one-time revenues, ongoing revenues grew by 8.6 percent in fiscal 2006. The major revenue sources generally came in very close to the estimates. The personal income tax grew 9.5 percent over 2005 but was below the estimate by $6.6 million. The underperformance in the income tax was mainly in payments with returns and payments from fiduciaries. The sales tax exceeded the estimate by $4.6 million, growing by 7.2 percent. The corporate income tax was one of the strongest performers, growing 21.7 percent and exceeding the estimate by $8.5 million. The lottery exceeded the estimate by $9.1 million and grew 5.4 percent over 2005, thanks to strong sales in the Mega Millions and Instant games.

Among the smaller revenue sources, the most important was interest earnings, which grew by 152.3 percent over 2005 and exceeded the estimate by $28.5 million. The large ($1.2 billion) balance coming out of fiscal 2005, combined with higher interest rates and strong revenue growth, helped push interest earnings to their highest ever level. The only revenue source that significantly underperformed in 2006 was the estate tax, which was due to a sharp drop in payments from large estates in the second half of the year. Estate and inheritance tax revenues were $24 million below the estimate but still grew by 21.2 percent over 2005.

Fiscal 2007 has gotten off to a relatively slow start. Total general fund revenues through October are up just 2.7 percent over the same period last year, and all the major revenue sources

have exhibited weak growth. General fund revenues from the personal income tax are up just 3.3 percent, and the lottery is down 1.7 percent compared to year ago levels. In the case of the income tax, the weakness is primarily in withholding. For the lottery, sales are weak for all games but especially for the Mega Millions game, which benefited from large jackpots in the same time period last year. In addition, legislation enacted in 2005 raised the commission for lottery agents from 5.0 percent of sales to 5.5 percent starting in fiscal 2007, which will reduce revenues by $7.6 million on an annual basis.

Corporate income tax revenues are down 5.5 percent, which reflects weak quarterly payments. Sales tax revenues are up just 2.7 percent, due in part to the tax-free week for apparel under $100, which took place in August. Also impacting general fund sales tax revenues is an increase in the credit that vendors receive for collecting the sales tax. This credit was halved for fiscal 2003-2006 but returns to its full level in fiscal 2007, taking about $18 million out of the general fund on an annual basis. On the plus side, estate and inheritance tax revenues are up 28.3 percent, which reflects sizable payments from large estates.

The small overattainment in fiscal 2006 combined with the weak year-to-date performance and the expectation of slowing economic growth results in a general fund forecast of less than 5.0 percent for both fiscal 2007 and 2008 (**Exhibit 2**). The Department of Legislative Services (DLS) projects that general fund revenues in fiscal 2007 will be $23 million lower than the current estimate and will grow 4.0 percent over fiscal 2006. DLS projects that general fund revenues in fiscal 2008 will grow by 4.5 percent over fiscal 2007.

Exhibit 2
Maryland General Fund Revenue Forecast
Fiscal 2007 and 2008
($ in Millions)

	FY 2007				FY 2008	
	Current Official Estimate	**DLS Oct. 2006**	**$ Diff.**	**% Change 2007/2006**	**DLS Oct. 2006**	**% Change 2008/2007**
Personal Income Tax	$6,579	$6,551	-$28	5.7%	$6,944	6.0%
Sales and Use Tax	3,502	3,488	-14	4.0	3,654	4.8
Corporate Income Tax	686	620	-66	-0.6	644	3.9
Lottery	483	480	-3	-0.1	503	4.8
Other	1,665	1,753	88	1.3	1,726	-1.5
Total	**$12,915**	**$12,892**	**-$23**	**4.0%**	**$13,471**	**4.5%**

Source: Board of Revenue Estimates; Department of Legislative Services

Operating Budget

Budget Outlook: Déjà Vu?

By the end of fiscal 2007, nearly all the $1.4 billion general fund cash balance existing at the end of fiscal 2006 will have been utilized to support ongoing spending. After application of the nearly $173 million remaining balance in fiscal 2008, a cash deficit of $413.0 million is estimated. By fiscal 2009, the State will again be facing a cash deficit that is estimated to be approximately $1.6 billion. Given a recent softening of revenues, it appears unlikely that revenue growth will increase at a rate necessary to address these pending fiscal challenges.

Recent History of Ongoing Revenues Compared to Spending

Exhibit 1 illustrates ongoing general fund revenue and spending trends since the recession of 2001. Revenues declined in fiscal 2002 and 2003, and the State undertook efforts to restrain spending growth. Addressing the decline in revenues was particularly difficult in recent years as it occurred during implementation of the Bridge to Excellence in Public Schools Act (Chapter 288 of 2002) which mandated an increase in K-12 education spending of over $1 billion between fiscal 2003 and 2008. Economic recovery began in earnest in fiscal 2004 and continued into fiscal 2005 and 2006. Coupled with continued cost containment actions, structurally balanced budgets were produced in both years. In a business sense, fiscal 2006 ended with a $336 million structural surplus.

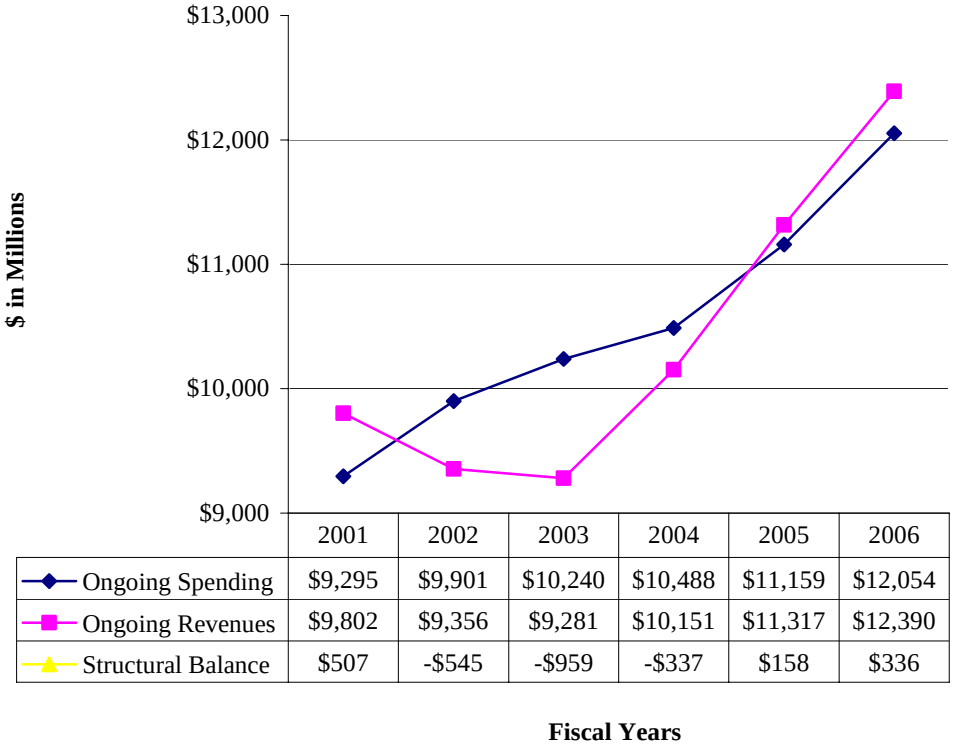
Fiscal Stability Deteriorates in the Near Term

The fiscal picture in 2007 and 2008 shows signs of fiscal stress, as spending growth outpaces revenue in both years. As shown in **Exhibit 2**, ongoing spending grew 11.0 percent in fiscal 2007 compared with ongoing revenue growth of 4.0 percent. As mentioned above, much of the spending growth was driven by the local education aid increases mandated by the 2002 Bridge to Excellence in Public Schools Act. Although the budget will remain balanced on a cash basis, this divergence between revenue and spending results in a projected structural deficit of nearly $500 million in fiscal 2007. For fiscal 2008, similar growth trends are being estimated by the Department of Legislative Services (DLS) which has projected ongoing revenue growth of 4.5 percent compared with slightly more than 10.0 percent growth in ongoing spending.

Exhibit 2 further illustrates the "roller coaster" effect of general fund revenue sources and the lag effect that results from the formal budget process which requires time to process and adjust to revenue swings which occur during the State's business cycle. For example, following the recession of fiscal 2001, general fund revenue fell nearly 5 percent which was followed by another decrease of nearly 1 percent in fiscal 2003. Cost containment actions slowed the growth

in spending, and stronger revenue growth in 2004 through 2006 erased the structural deficit. However, as noted above, expected spending growth exceeding 10 percent in fiscal 2007 and 2008 will again cause structural deficits.

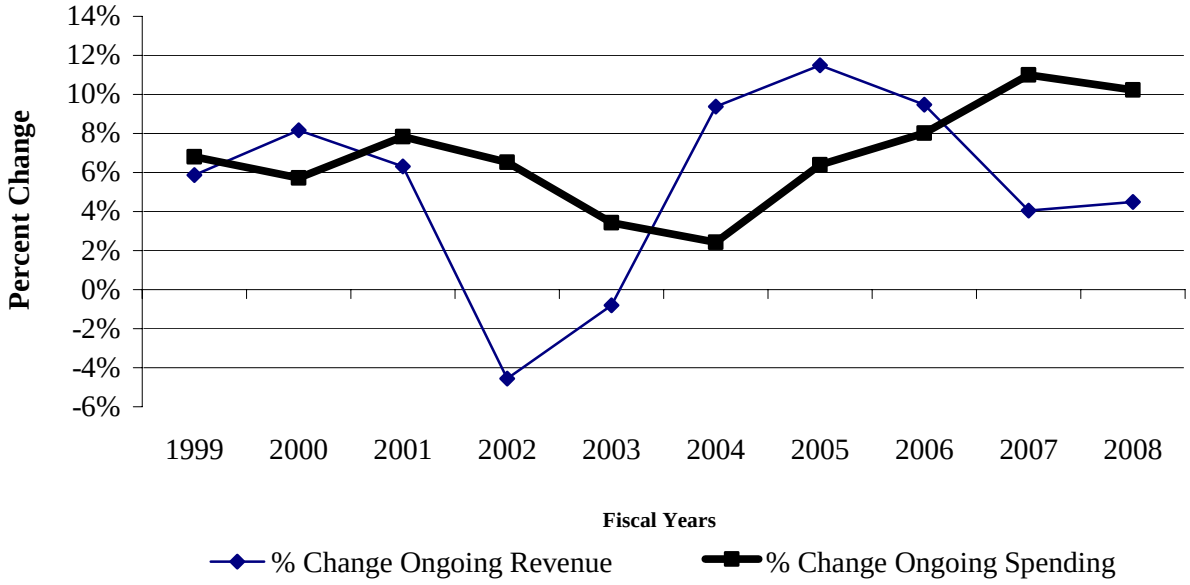
Exhibit 1
Ongoing Revenues Compare Favorably with Ongoing Spending in the Short-term
Fiscal 2001-2006



	2001	2002	2003	2004	2005	2006
Ongoing Spending	$9,295	$9,901	$10,240	$10,488	$11,159	$12,054
Ongoing Revenues	$9,802	$9,356	$9,281	$10,151	$11,317	$12,390
Structural Balance	$507	-$545	-$959	-$337	$158	$336

Source: Department of Legislative Services

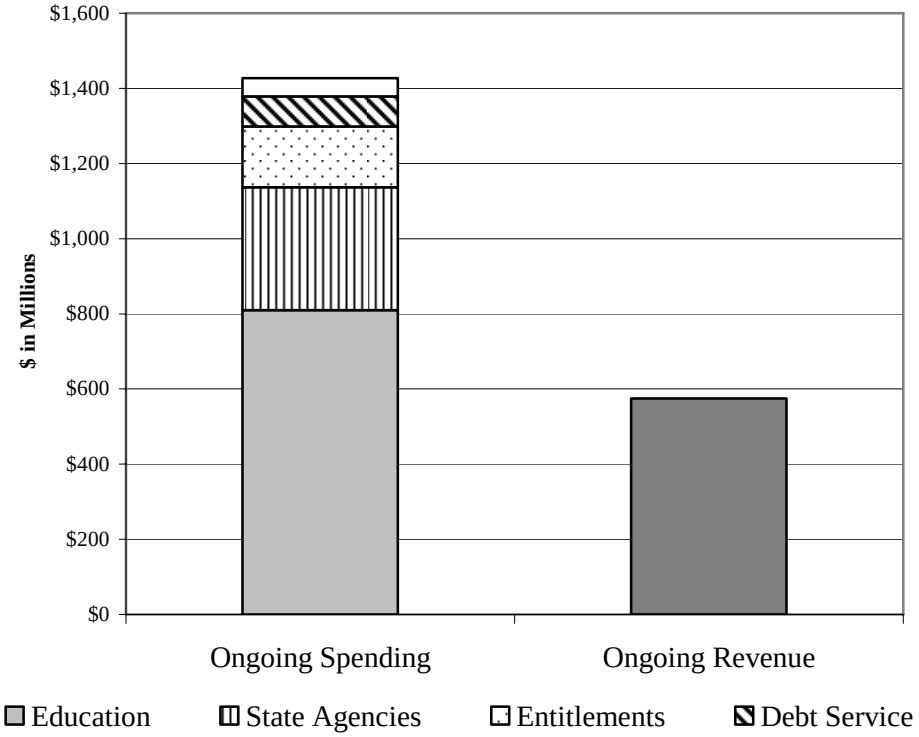
Exhibit 2
Annual Percent Change in General Fund Revenues and Spending
Fiscal 1999-2008



Source: Department of Legislative Services

Exhibit 3 further illustrates the underlying factors driving a growing structural budget problem that again is expected to exceed $1.2 billion by fiscal 2008. Baseline spending costs in fiscal 2008 are estimated to be over $1.4 billion while new ongoing revenue is only estimated to provide just under $600.0 million. Spending on local education and library aid is expected to be as much as $800.0 million, which alone outpaces expected growth in general fund revenue. Other spending growth will occur as the result of ● recently enacted pension enhancements for teachers and State employees; ● Medicaid enrollment, rate, and provider increases; ● debt service payments resulting from the reduction in the State's share of the property tax rate; ● support for higher education; ● employee increments and other personnel expense growth; and ● a variety of lesser increases for entitlement, aid, and State agency operating expenses. While the fiscal 2008 budget is expected to be balanced on a cash basis, doing so requires a nearly $900.0 million draw from the Rainy Day Fund.

Exhibit 3
General Fund Spending Growth vs. Ongoing Revenue Projections
Fiscal 2007-2008



Source: Department of Legislative Services

Fiscal 2008 through 2012 Forecast: A Mix of Good and Bad News

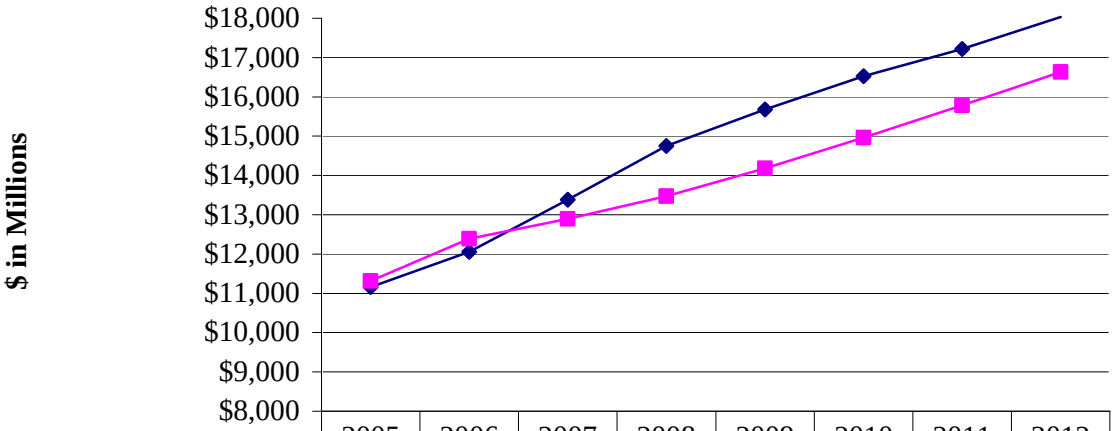
Based on DLS forecast of revenues and spending through fiscal 2012, the State's structural deficit reaches a high of nearly $1.6 billion in fiscal 2010 as the implementation of the education aid increases is completed and continued growth occurs in entitlements and other mandated commitments such as the retirement enhancement and addressing an unfunded liability for retiree health insurance. Revenue growth in the out-years of the forecast is projected to slightly outpace spending which serves to modestly reduce the structural deficit to just under $1.4 billion by fiscal 2012. **Exhibit 4** demonstrates the structural imbalance between ongoing revenue and spending during the 2005-2012 period. Detail on the revenue and spending elements of the long-term forecast are shown in **Exhibit 5**. The forecast anticipates that throughout the period, the State will be able to maintain at least a 5.0 percent balance in the Rainy Day Fund, due in part to required appropriations of the lesser of $50.0 million or the

amount needed to achieve a 7.5 percent balance. The level of balance requirement was modified by legislation passed at the 2006 session.

Exhibit 4

Projected Spending Outstrips Projected Revenue as Education Funding Growth Is Fully Implemented

Fiscal 2005-2012



	2005	2006	2007	2008	2009	2010	2011	2012
Ongoing Spending	$11,159	$12,054	$13,380	$14,749	$15,677	$16,525	$17,216	$18,029
Ongoing Revenues	$11,317	$12,390	$12,891	$13,471	$14,178	$14,963	$15,783	$16,634
Structural Balance	$158	$336	-$489	-$1,278	-$1,499	-$1,562	-$1,433	-$1,395

Fiscal Years

Source: Department of Legislative Services

Exhibit 5
General Fund Projections
Fiscal 2007-2012

	Leg. Approp. FY 2007	Baseline FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	Annual Growth Rate FY 07-08	Avg. Annual Growth Rate FY 08-12
Individual Income	$6,551	$6,944	$7,394	$7,898	$8,431	$8,990	6.0%	6.7%
Sales and Use	3,488	3,654	3,845	4,044	4,255	4,467	4.8%	5.2%
Lottery	480	503	518	534	551	568	4.8%	3.1%
Other	2,373	2,370	2,421	2,487	2,546	2,609	-0.1%	2.4%
One-time	150		0	0	0	0	n/a	n/a
Subtotal	**$13,042**	**$13,471**	**$14,178**	**$14,963**	**$15,783**	**$16,634**	**3.3%**	**5.4%**
Adjustments:								
Balance	$1,362	$238	$0	$0	$0	$0	-82.6%	-100.0%
Rainy Day Fund Transfer	0	860	46	42	42	7	n/a	-70.0%
Transfers	6	17	24	24	9	0	180.1%	-100.0%
Total Revenues	**$14,409**	**$14,585**	**$14,248**	**$15,029**	**$15,833**	**$16,641**	**1.2%**	**3.4%**
Expenditures								
Debt Service	$0	$81	$112	$112	$122	$125	n/a	11.6%
Local Aid Education\Libraries	4,535	$5,345	5,620	5,879	6,082	6,305	17.9%	4.2%
Local Aid Other	499	548	577	613	651	692	9.7%	6.0%
Entitlements	2,536	2,698	2,904	3,125	3,340	3,570	6.4%	7.2%
State Operations/Reversions	5,568	5,895	6,211	6,490	6,822	7,138	5.9%	4.9%
Deficiencies	59	0	0	0	0	0	n/a	n/a
Subtotal	**$13,197**	**$14,566**	**$15,424**	**$16,219**	**$17,016**	**$17,829**	**10.4%**	**5.2%**
Capital	$136	$86	$89	$88	$86	$86	-36.4%	0.0%
Multi-year Commitments	183	183	253	306	200	200	n/a	2.2%
Reserve Fund	656	163	50	50	50	50	-75.2%	-25.6%
Total Expenditures	**$14,172**	**$14,998**	**$15,815**	**$16,663**	**$17,352**	**$18,166**	**5.8%**	**4.9%**
Surplus (Shortfall)	**$238**	**-$413**	**-$1,568**	**-$1,634**	**-$1,519**	**-$1,524**		
Ongoing Revenues vs. Operating Expenses	**-$489**	**-$1,278**	**-$1,499**	**-$1,562**	**-$1,434**	**-$1,395**		
Revenue Stabilization Fund								
Ending Balance	$1,408	$674	$709	$749	$790	$833		
As a Percent of Revenues	10.9%	5.0%	5.0%	5.0%	5.0%	5.0%		
Ratio of Operating Revenues to Expenditures	0.96	0.91	0.90	0.91	0.92	0.92		

Source: Department of Legislative Services

Unfunded Liabilities Remain to Be Addressed

In addition to the spending demands outlined above, the State will need to address a number of unfunded liabilities. Chief among these is the unfunded retiree health liability that, as the result of new accounting standards, will be required to be included on the State's financial statements beginning in fiscal 2008. These accounting standards will require governmental employers to value and report liabilities for Other Post-employment Benefits which include retiree health care benefits. A valuation of the State's retiree health liabilities performed in 2005 estimated an unfunded actuarial liability exceeding $20 billion. To begin addressing the normal costs associated with these liabilities, $100 million was appropriated in fiscal 2007. The DLS forecast assumes another $100 million will be provided in fiscal 2008 and $200 million annually in fiscal 2009 through 2012. It should be noted, however, that these funds will not address the $20 billion unfunded actuarial liability and that full actuarial funding of retiree health liabilities has been estimated to require between $1.1 and $1.6 billion in increased contributions by the State.

At the same time, funding for the Maryland State Retirement System will increase as a result of the pension enhancement for teachers and State employees adopted at the 2006 session. Finally the State has an unfunded workers' compensation liability in excess of $200 million.

Conclusion

The State's fiscal position has rebounded from the economic downturn of the early 2000s when general fund revenue fell precipitously and required extraordinary cost containment and fund balance transfers to maintain operations. However, spending commitments, chiefly in the area of local education aid, exceed projected revenue growth and cause the structural deficit to approach $1.3 billion by fiscal 2008. Large unfunded liabilities for retiree health insurance, retirement, and workers' compensation will only increase the fiscal challenges ahead. The magnitude of the problem clearly suggests that it cannot be resolved sustainably without material adjustments to revenues or spending.

For further information contact: David B. Juppe Phone: (410) 946/(301) 970-5530

Operating Budget

Transportation Trust Fund Overview

While the Transportation Trust Fund's fiscal 2006 ending cash balance exceeded expectations by $139 million, overall transportation tax and fee revenues are anticipated to be lower than expected in fiscal 2007 and remain relatively constant in fiscal 2008. This, along with modest revenue growth beyond fiscal 2008, will likely create additional debt issuances and a reduced capital program through fiscal 2012.

Fiscal 2006 Closeout

The Transportation Trust Fund (TTF) generated $2.8 billion from all fund resources in fiscal 2006. The TTF end of the year cash fund balance totaled $239 million, which exceeded expectations by $139 million. Lower than expected expenditures, largely from the capital program, resulted in a higher than expected closing fund balance. Capital expenditures were $157 million less than projected due to unexpected federal fund attainment as well as cash flow changes in ongoing projects. In addition, operating expenditures came in $9 million lower than anticipated.

Lower expenditures were partly offset by lower revenue attainment from taxes and fees. Titling tax revenues came in $23 million less than anticipated; a strong first quarter due to manufacturer rebates was offset by weaker sales for the remainder of the year due to increased interest rates and rising gas prices. In addition, $35 million in fiscal 2006 revenue assumed from the projected sale of the World Trade Center in Baltimore was not attained because the building was not sold.

Fiscal 2007-2012 Transportation Trust Fund Forecast

Revenues

Exhibit 1 shows the Department of Legislative Services' (DLS) fiscal 2007-2012 TTF forecast. The forecast details the expected trends in revenue attainment, debt issuance, and capital expenditures. Overall revenues are expected to flatten in fiscal 2007, which will have implications for debt issuances and the capital program.

Over the six-year period, DLS estimates total taxes and fees will total roughly $10.4 billion, with an average annual growth rate of 2 percent. Compared to the September 2006 forecast, this represents a decline of roughly $350 million over the six-year period. DLS estimates that revenues will essentially flatten in fiscal 2007 and 2008. In particular, the titling tax is estimated to decline by 0.5 percent in fiscal 2007 as rising interest rates and higher gas

prices cause a reduction in vehicle sales. In fiscal 2007 and 2008, estimates of total tax and fee revenues have been reduced by $56 million and $68 million, respectively.

Debt Financing

Debt issuances by the Maryland Department of Transportation (MDOT) are limited by a total debt outstanding cap of $2 billion and by two coverage tests that require the prior year's pledged taxes and the net income of MDOT to be two and a half times greater than the maximum debt service in a given fiscal year. In fiscal 2006, MDOT issued debt totaling $100 million and received a bond premium of $4 million.

In fiscal 2007, a debt issuance of $235 million is expected; flattening revenues will require a debt issuance of $425 million in fiscal 2008 in order to maintain the capital program. The large debt issuance in fiscal 2008, coupled with the expected revenue attainment, will constrain MDOT's ability to issue debt in the out-years under the net income coverage test.

In fiscal 2012, DLS estimates the debt outstanding will total almost $1.7 billion, which would be within the statutory debt outstanding limit but at the maximum allowed under the net income test.

Operating and Debt Service Expenditures

Operating and debt service expenditures are the first draw on TTF revenues. Over the six-year period, operating and debt service expenses roughly total $10.2 billion. When comparing the growth of taxes and fees to operating expenditures, expenditures are growing faster than revenues. The average annual growth rate for expenditures totals roughly 4 percent compared to annual revenue growth of 2 percent. The flattening of revenues and higher operating expenditure growth over the six-year time period will reduce the size of the capital program.

Capital Expenditures

The capital program will lower over the six-year period due to the expected revenue attainment and the constraints on the amount of debt MDOT will issue. Federal aid will also be reduced in order to pay for the GARVEE debt service associated with the InterCounty Connector, further reducing the size of the capital program.

DLS estimates that the overall capital program will total $7.5 billion from fiscal 2007 to 2012. According to the most recent DLS forecast in November 2006, the special and federal fund capital program will be $655 million less compared to the September forecast. The capital program in fiscal 2007 and 2008 can be maintained due to the cash balance in fiscal 2007, higher bond issuances in fiscal 2008, and additional federal aid that was not originally included in the January 2006 forecast. In fiscal 2009-2012, the capital program will decline due to smaller bond sales and the lower revenue attainment.

Exhibit 1
Department of Legislative Services
Transportation Trust Fund Forecast
Fiscal 2007-2012
($ in Millions)

	Actual FY 2006	Current Year FY 2007	Estimate FY 2008	Estimate FY 2009	Estimate FY 2010	Estimate FY 2011	Estimate FY 2012
Opening Fund Balance	**$245**	**$239**	**$106**	**$100**	**$100**	**$100**	**$100**
Closing Fund Balance	**$239**	**$106**	**$100**	**$100**	**$100**	**$100**	**$100**
Net Revenues							
Taxes and Fees	$1,614	$1,626	$1,665	$1,710	$1,760	$1,789	$1,832
Operating and Miscellaneous.	465	450	454	470	477	490	523
Transfers btw. TTF and GF	50	0	0	0	0	0	0
MdTA Transfer	5	13	-30	-30	-30	0	0
Net Revenues Subtotal	**2,134**	**2,089**	**2,089**	**2,150**	**2,207**	**2,279**	**2,355**
Bonds Sold	100	235	425	220	100	65	40
Bond Premiums	4	0	0	0	0	0	0
Total Revenues	**$2,238**	**$2,324**	**$2,514**	**$2,370**	**$2,307**	**$2,344**	**$2,395**
Expenditures							
Debt Service	$141	$118	$137	$157	$166	$175	$195
Operating Budget	1,303	1,392	1,467	1,513	1,572	1,634	1,701
State Capital	800	947	916	700	569	534	499
Total Expenditures	**$2,244**	**$2,457**	**$2,520**	**$2,370**	**$2,307**	**$2,343**	**$2,395**
Debt							
Debt Outstanding	$1,078	$1,246	$1,602	$1,746	$1,766	$1,741	$1,669
Debt Coverage – Net Income	5.5	4.5	3.0	2.7	2.5	2.5	2.5
Local Highway User Revenues (HUR)	**$561**	**$561**	**$571**	**$586**	**$602**	**$612**	**$624**
Transferred to General Fund	49	0	0	0	0	0	0
Net HUR to Counties	**$513**	**$561**	**$571**	**$586**	**$602**	**$612**	**$624**
Capital Summary							
State Capital	$800	$947	$916	$700	$569	$534	$499
Net Federal Capital (Cash Flow)	721	746	720	592	493	392	362
Subtotal Capital Expenditures	**$1,521**	**$1,693**	**$1,636**	**$1,292**	**$1,062**	**$926**	**$861**
GARVEE Debt Service	0	0	46	52	85	84	84

Source: Department of Legislative Services

Operating Budget

Federal Funds Outlook

The U.S. Congress has passed just 2 of the 12 appropriations bills needed to continue funding federal government programs and obligations beyond November, and it is unclear as to when Congress will act on those remaining bills and what will ultimately be provided for Maryland. The Department of Homeland Security appropriation bill that Congress has passed provides less funding for Maryland in federal fiscal 2007.

Bulk of Federal Fiscal 2007 Budgeting Planned After General Election

Before adjourning prior to the November election, the U.S. Congress passed just 2 of the 12 appropriations bills needed to fund the government; the two that passed fund the Department of Defense and the Department of Homeland Security. The remaining appropriations bills have all passed the House, but the Senate has not completed its work on them. In fact, the defense appropriation also contains the continuing resolution (CR) that funds the rest of the federal government. A CR continues funding at current levels for agencies covered under it until an appropriations bill becomes law. The CR under which most of the federal government is currently operating expires on November 17.

Department of Homeland Security Appropriation

Federal funding for the Department of Homeland Security (DHS) Office for Domestic Preparedness increased from $3.1 billion in federal fiscal 2006 to $3.2 billion in federal fiscal 2007, a 2 percent increase. Despite the increase in overall federal funding for DHS, Maryland, along with every other state and territory, saw a decline in funding for the State Homeland Security Grant Program and the Law Enforcement Terrorism Prevention Program.

State Homeland Security Grant Program

State Homeland Security Grant Program (SHSGP) funding is allocated to states to assist in the preparation for and mitigation of potential terrorist attacks. In federal fiscal 2006 and 2007, each state receives 0.75 percent of the total appropriation, and the remaining funds are distributed based on the risk level of each state, as opposed to the previous formula that was based on population. The states received a total of $525 million in SHSGP grants in federal fiscal 2007, a 58 percent reduction from 2006 funding levels. The 0.75 percent base decreased from $4.1 million per state in federal fiscal 2006 to $3.9 million per state in federal fiscal 2007 (a 4.5 percent reduction). The remaining $315 million will be distributed based on a state-specific risk assessment performed by the Secretary of Homeland Security.

Law Enforcement Terrorism Prevention Program

States appropriate Law Enforcement Terrorism Prevention Program (LETTP) funding for information sharing among law enforcement units, reducing the vulnerability of potential targets, intervention activities, and threat recognition. The formula used to determine state allocations is identical to that used for SHSGP. Federal fiscal 2007 spending dropped from $3.0 to $2.8 million per state, a 6.2 percent decline. The remaining $225 million for LETTP will be distributed to the states based on the DHS risk assessment.

Future of Remaining Appropriations Bills Uncertain

Because Congress will have limited time when it returns after the November elections, speculation is that Congress will pass another CR to fund the federal government through at least part of December. After that, Congress will have two options: pass each of the remaining appropriations bills and combine them into some sort of omnibus bill; or pass another CR and leave the budget to the next Congress. Congress may combine the bills into an omnibus bill, and the final result will differ little from the federal fiscal 2006 appropriation, although it is possible that the omnibus bill will contain an across-the-board budget reduction.

Capital Program

Debt Affordability

The Capital Debt Affordability Committee recommended a general obligation bond debt limit totaling $810 million for fiscal 2008. This represents a $120 million increase from the $690 million limit recommended in fiscal 2007. Twenty million of the increase is the result of the 3 percent annual escalation formula adopted by the committee last year, and $100 million of the increase was recommended by the committee for the purpose of expanding the capital program.

Capital Debt Affordability Process

State law requires the five-member Capital Debt Affordability Committee (CDAC) to review the size and condition of all tax-supported debt on a continuing basis to help ensure that the State's tax-supported debt burden remains affordable. The committee is composed of the Treasurer, the Comptroller, the Secretaries of Transportation and Budget and Management, and a public member. Chapter 445 of 2005 also added as nonvoting members the chairs of the Capital Budget Subcommittees for the Senate Budget and Taxation Committee and the House Committee on Appropriations.

Tax-supported debt consists of general obligation (GO) debt, transportation debt, Grant Anticipation Revenue Vehicles (GARVEEs), bay restoration bonds, capital leases, Stadium Authority debt, and bond or revenue anticipation notes (BANs/RANs). The committee makes annual, nonbinding recommendations to the Governor and the General Assembly on the appropriate level of new GO and academic revenue debt for each fiscal year. The committee does not make individual recommendations on the levels of capital leases, transportation debt, bay restoration bonds, or Stadium Authority debt but does incorporate the anticipated levels of these types of debt in its analysis of total debt affordability.

The committee's benchmarks for determining whether State debt is affordable are as follows: (1) total tax-supported debt outstanding should not exceed 3.2 percent of Maryland personal income; and (2) total debt service on tax-supported debt should not exceed 8.0 percent of revenues. The committee's analysis of debt affordability for the fiscal 2007 through 2012 period indicates that debt outstanding and debt service ratios will remain within the affordability limits for this period as indicated in **Exhibit 1.**

Exhibit 1
Affordability Ratios
Fiscal 2007-2012

Fiscal Year	Projected Debt Outstanding as % of Personal Income	Projected Debt Service as % of Revenues
2007	2.83%	5.44%
2008	2.88%	5.84%
2009	3.05%	6.08%
2010	3.10%	6.33%
2011	3.13%	6.49%
2012	3.09%	6.65%

Source: *Report of the Capital Debt Affordability Committee on Recommended Debt Authorizations*, October 2006

Recommended New Debt Authorizations

The committee has recommended $810 million in new GO debt authorization for fiscal 2008, which is $120 million more than was authorized in fiscal 2007. Of the $120 million total increase, $20 million represents a 3 percent annual increase resulting from an automatic escalation formula adopted by the committee last year. The remaining $100 million increase was recommended by the committee for the purpose of expanding the capital program. The recommendation also includes a planned $3 million for tobacco buyout financing, as required by Chapter 103 of 2002. By the end of fiscal 2008, the committee estimates that total GO debt will be just over $5.4 billion.

The University System of Maryland (USM), Morgan State University, and St. Mary's College have the authority to issue debt for academic facilities as well as debt for auxiliary facilities. Proceeds from academic debt issues are used for facilities that have an education-related function, such as classrooms. Debt service for these bonds is paid with tuition and fee revenues. For the 2007 session, CDAC has recommended $30 million for academic facilities on USM campuses which is $5 million more than the 2006 recommended amount.

Transportation bonds are limited obligation instruments, the proceeds of which fund highway and other transportation-related projects. Debt service on these bonds is funded from motor vehicle fuel taxes, titling and registration fees, a portion of the corporate income tax, and other Maryland Department of Transportation (MDOT) revenues. Total outstanding transportation debt is projected to reach over $1.4 billion in fiscal 2008. The department also anticipates issuing the first GARVEE bonds in fiscal 2008. MDOT projects that $356 million in GARVEEs will be outstanding at the end of fiscal 2008. The State pledges anticipated federal revenues to support the GARVEEs debt service.

The Bay Restoration Fund was created in 2004 to provide grants for Enhanced Nutrient Removal pollution reduction upgrades at the State's major wastewater treatment plants. The fund has several revenue sources and expends funds for both operating and capital program purposes. The Maryland Department of the Environment indicates that it intends to issue $50 million in bay restoration bonds backed by revenue generated under this program in fiscal 2008.

Capital leases for real property and equipment are secured by the assets leased and are paid with appropriations made to the agencies using the leased items. Debt outstanding for leases is expected to be $221 million at the end of fiscal 2008.

Finally, Stadium Authority debt is also limited obligation debt and represents bonds sold for the construction of the Camden Yards baseball and football stadiums, the Baltimore and Ocean City convention centers, the Hippodrome Theater, and the Montgomery County Conference Center. The facilities' debt service is supported by lottery revenues and other general fund sources. Stadium Authority debt outstanding is expected to be $300 million at the end of fiscal 2008.

Capital Program

Capital Funding Requests Exceed Resources

Although adjustments to the Capital Debt Affordability Committee forecast will add $975 million in additional authorizations over a five-year period beginning with the 2007 session, general obligation bond funding requests will still exceed the projected limits by $443 million in fiscal 2008 and by almost $2.1 billion over the five-year forecast period.

General Obligation Bonds

The Capital Debt Affordability Committee (CDAC) has recommended a $810 million limit on the amount of new general obligation (GO) debt authorizations by the 2007 General Assembly to support the fiscal 2008 capital program. The recommendation is $120 million higher than the authorizations subject to the GO limit for fiscal 2007 and includes $3 million for tobacco buyout financing as required by law (Chapter 103 of 2002 as amended by Chapter 47 of 2006).

Despite the increased authorizations provided in the five-year forecast period, GO bond funding requests exceed the projected limits by $442.8 million for fiscal 2008 and by almost $2.1 billion during the forecast period. **Exhibit 1** provides a summary of the GO bond requests for the next five years.

Exhibit 1

GO Bond Requests: Fiscal 2008-2012

($ in Millions)

	Fiscal Years						Category
	2008	2009	2010	2011	2012	Total	Totals
State Facilities							$712.6
Board of Public Works	$142.3	$194.4	$91.5	$133.1	$126.7	$688.0	
Military	9.5	3.6	0.9	2.6	0.0	16.6	
Dept. Disabilities	1.6	1.6	1.6	1.6	1.6	8.0	
Health and Social Services							$527.7
Health and Mental Hygiene	$67.5	$103.8	$91.7	$17.9	$38.2	$319.1	
University of MD Medical System	12.5	22.5	20.0	15.0	25.0	95.0	
Senior Citizen Activity Center	1.3	1.5	1.5	1.5	1.5	7.3	
Juvenile Justice*	6.3	55.0	10.0	5.0	5.0	81.3	
Private Hospital Grant Program	5.0	5.0	5.0	5.0	5.0	25.0	
Environment							$258.7
Natural Resources	$13.0	$13.0	$13.0	$13.0	$13.5	$65.5	
Agriculture**	5.1	7.5	7.5	8.0	8.0	36.1	
Environment	27.3	28.0	27.5	26.0	26.0	134.8	
MD Environmental Service	3.8	3.7	4.7	4.8	5.3	22.3	
Education							$1,453.3
Education	$0.0	$0.7	$50.5	$0.0	$0.0	$51.2	
MD School for the Deaf	1.5	4.2	1.6	1.1	0.0	8.4	
Public School Construction***	277.9	277.6	277.9	280.0	280.3	1,393.7	
Higher Education							$2,562.9
University System of MD****	$281.8	$211.1	$242.0	$281.4	$269.5	$1,285.8	
Baltimore City Comm. College	1.4	23.9	35.9	23.9	1.0	86.1	
St. Mary's College	2.0	7.2	25.5	1.4	45.9	82.0	
Morgan State University	23.8	92.6	81.4	77.1	69.5	344.4	
Community Colleges	125.1	163.5	125.2	101.6	173.8	689.2	
Southern MD Higher Educ. Center	0.0	1.2	13.4	0.8	0.0	15.4	
Private Facilities Grant Program	12.0	12.0	12.0	12.0	12.0	60.0	
Public Safety							$581.1
Public Safety	$79.5	$51.8	$79.6	$97.2	$97.4	405.5	
State Police	21.2	21.4	24.6	11.0	0.0	78.2	
Local Jails	37.3	31.8	14.6	12.3	1.4	97.4	
Housing and Economic Development							$81.5
Economic Development	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	
Housing and Comm. Development	10.5	8.0	8.0	9.0	9.0	44.5	
Canal Place	0.0	0.0	0.0	1.7	0.0	1.7	
Historic St. Mary's City	1.6	1.2	8.0	6.8	1.3	18.9	
Planning	1.4	4.4	1.3	1.4	7.9	16.4	
Legislative Initiatives	15.0	15.0	15.0	15.0	15.0	75.0	$75.0
Miscellaneous	62.6	49.4	29.0	12.0	3.5	156.5	$156.5
Subtotal Request	**$1,249.8**	**$1,416.6**	**$1,320.4**	**$1,179.2**	**$1,243.3**	**$6,409.3**	**$6,409.3**
Tobacco Transition Program	3.0	3.0	5.0	0.0	0.0	11.0	$11.0
Total Request	**$1,252.8**	**$1,419.6**	**$1,325.4**	**$1,179.2**	**$1,243.3**	**$6,420.3**	**$6,420.3**
Debt Affordability Limits	**$810.0**	**$835.0**	**$860.0**	**$890.0**	**$920.0**	**$4,315.0**	

*Updated figures for the Department of Juvenile Services capital request are unavailable – the figures above are based on the 2006 *Capital Improvement Program.*

**The Department of Agriculture request does not include the Tobacco Transition Program.

***The Interagency Committee on School Construction received requests in excess of $470 million for fiscal 2008; however, the amount included in the request to the Department of Budget and Management reflects base funding of $250 million plus 12 percent attributable to construction escalation.

****In addition to the GO bond request, the University System of Maryland has requested academic revenue bond funding of $30 million for fiscal 2008 and $25 million annually for fiscal 2009 through 2012.

Note: Numbers may not sum to total due to rounding.

Source: Department of Budget and Management

General Fund Support for the Capital Program Recently on the Rise

General obligation bond funds have traditionally been supplemented with State general and special fund capital appropriations pay-as-you-go (PAYGO) funds authorized in the annual operating budget. The use of operating funds to finance capital projects and programs can reduce debt issuance and enable the State to avoid Internal Revenue Service limits on the use of tax-exempt bonds for "private activity" purposes such as economic development and housing programs. Restrictions imposed under the federal Tax Reform Act of 1986 generally prevent the use of tax-exempt bond proceeds to finance environmental, housing, and economic development revolving loan programs. Funding for these items is therefore typically requested from general and special PAYGO funds. Additionally, repayment to counties for school construction costs already incurred (forward funded construction) must be made with PAYGO or other alternatives to tax-exempt debt. PAYGO may also be used to fund any capital project based on fund availability.

Exhibit 2 shows the fiscal 2002 though 2007 general fund capital PAYGO appropriation and PAYGO general fund estimates according to the 2006 CIP for fiscal 2008 through 2011. Exhibit 2 demonstrates that the State's recent fiscal problems severely curtailed the use of PAYGO general funds beginning with the fiscal 2002 budget.

Exhibit 2
General Fund PAYGO*
Fiscal 2002 through 2007 Appropriations
Fiscal 2008 through 2011 CIP Estimates
($ in Millions)

Function	FY 02** Approp.	FY 03*** Approp.	FY 04 Approp.	FY 05 Approp.	FY 06 Approp.	FY 07 Approp.	FY 08-11 Planned
State Facilities	$18.4	$0.0	$0.0	$0.0	$0.6	$22.6	40.0
Health/Social	5.0	0.0	0.0	0.0	3.0	0.0	0.0
Environment	26.7	10.6	0.0	0.0	0.0	15.1	35.2
Education	93.4	3.0	0.0	0.0	0.0	0.0	0.0
Higher Education	95.0	0.0	0.0	0.0	1.9	19.1	0.0
Public Safety	1.7	0.0	0.0	1.0	0.0	0.0	0.0
Housing	29.4	14.4	0.7	0.0	0.0	40.0	65.4
Econ. Development	39.6	20.5	8.7	0.0	0.0	8.9	60.0
Local Projects	15.6	0.5	0.0	0.2	0.0	30.1	0.0
Total	**$324.8**	**$49.0**	**$9.4**	**$1.2**	**$5.5**	**$135.8**	**$200.6**

*Figures exclude general fund appropriations made to the Heritage Tax Credit Fund.
**Reflects the embargo/reversion of $324 million of fiscal 2002 appropriations to the State general fund.
***Reflects the embargo/reversion of $760,000 of fiscal 2003 appropriations to the State general fund.
Source: Department of Budget and Management

The policy of forgoing the use of PAYGO general funds to support the State's capital program resulted in the use of GO bond funds to support traditional PAYGO programs in recent years. For fiscal 2004 through 2006, a total of $118.2 million in GO bond funds were provided to support programs traditionally funded with PAYGO general funds. The limited use of PAYGO general funds also resulted in the issuance of $60.0 million of taxable GO debt in the two 2005 and first 2006 State GO bond sales in order to avoid exceeding federal private activity limits. The Department of Legislative Services has calculated the additional cost of the $60.0 million of issued taxable debt to be $2.6 million over the term of the bonds.

In order to reduce borrow costs and provide for a more efficient capital program, the Spending Affordability Committee (SAC) recommended that, for the fiscal 2008 budget, the State appropriate general funds for capital programs and projects that would otherwise require the issuance of taxable bonds. As an incentive, SAC excluded such appropriations from the affordability calculation. In addition, the 2006 Maryland Consolidated Capital Bond Loan (MCCBL) includes the deauthorization of $20.8 million in previously authorized debt that would have required future issuances of taxable bonds. Most of the deauthorized funds were replaced with one-time general funds appropriations in the fiscal 2008 budget. While the State's 2006 CIP programs identify some use of general PAYGO funds in future budgets, it remains unclear whether another SAC exclusion will be provided or if it is included, whether it will result in the inclusion of any general fund PAYGO in the fiscal 2008 budget introduced by the Governor.

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Revenues and Taxes

Comparative Tax and Revenue Rankings

Total State and local government revenues collected in Maryland are relatively low compared to other states.

Overall State and Local Government Revenues

As reflected in **Exhibit 1**, compared to other states, total State and local government revenues collected in Maryland are not generally high. Maryland ranks eighteenth highest in total State and local government revenues when measured on a per capita income basis and near the lowest, forty-eighth, in revenues collected as a percentage of total personal income of residents. Maryland relies more than most states on taxes and less on nontax sources of revenue when measured on both a per capita basis and a percentage of personal income basis.

Exhibit 1
Maryland State and Local Government Revenues
2003-2004

	MD Rank % of Total	MD Rank Per Capita	MD Rank % of Personal Income
Total Revenues	**N/A**	**18**	**48**
Taxes	3	7	26
Intergovernmental from Federal Government	41	38	46
Charges and Utilities[1]	46	46	49
Miscellaneous[2]	36	35	46

[1]Charges include higher education tuition, fees and auxiliary revenues, public hospital revenues, sewer and trash collection, highway tolls, and other user charges and fees. Utilities include gross receipts of publicly owned utilities (water, gas, electric, and transit).
[2]Miscellaneous revenues include interest earnings, net lottery revenues, liquor store revenues, rents, royalties, fines and forfeitures, special assessments, sale of property, and other.

Note: For the rankings, 1 indicates the highest and 51 the lowest.

Source: 2004 Census of Government, U.S. Bureau of the Census (July 2006)

State and Local Tax Revenues Compared to Nearby States

Exhibits 2 and **3** compare Maryland's State and local tax revenues to other states in the region. Exhibit 3 compares revenues for Maryland and the other states on a per capita income basis, but only looking at per capita revenues ignores the relative revenue-raising capacity of each state. For example, a wealthier state with the same income, property, and sales tax rates as a less wealthy state would raise more tax revenue per person than the less wealthy state simply because residents have more income to spend and more valuable property. Consequently, measuring tax burdens on a per capita basis alone provides an incomplete picture. To account for the relative revenue raising capacity of each state, the percentage of personal income measurement is also provided for comparison in Exhibit 2.

Maryland ranks twenty-sixth among all states in overall State and local tax revenues as a percentage of personal income and seventh in overall tax revenues on a per capita basis. Maryland's reliance on the income tax is high (third as both a percentage of personal income and on a per capita basis) compared to other states, at least in part reflecting the statewide local "piggyback" income tax.

Generally, Maryland ranks in the bottom half of all states with respect to property taxes, corporate income taxes, and sales taxes measured on a percentage of personal income basis. Maryland ranks eighteenth in property taxes, sixteenth on corporate income taxes, and forty-third on sales taxes measured on a per capita basis.

Exhibit 2
Maryland State and Local Tax Revenues
Comparison to Selected States
2003-2004 Tax Revenues as a Percentage of Personal Income

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales & Selective Taxes[1]	License Fees	Other Taxes[2]	All Taxes
District of Columbia							
Percent	3.6%	3.7%	0.6%	4.1%	0.6%	1.4%	14.0%
Rank	17	4	5	18	13	3	1
New Jersey							
Percent	5.0%	2.1%	0.5%	2.7%	0.3%	0.3%	10.9%
Rank	3	34	8	43	38	28	11
Maryland							
Percent	**2.7%**	**3.8%**	**0.3%**	**2.5%**	**0.3%**	**0.7%**	**10.1%**
Rank	**35**	**3**	**31**	**45**	**43**	**12**	**26**
Virginia							
Percent	2.9%	2.7%	0.2%	2.7%	0.3%	0.5%	9.2%
Rank	32	15	42	44	40	18	46
Delaware							
Percent	1.5%	2.8%	0.7%	1.3%	3.0%	0.7%	10.1%
Rank	50	14	3	50		10	29
Pennsylvania							
Percent	3.0%	2.5%	0.4%	3.1%	0.6%	0.7%	10.4%
Rank	26	19	10	41	11	11	20
North Carolina							
Percent	2.4%	3.0%	0.3%	3.6%	0.4%	0.2%	10.0%
Rank	41	9	18	28	28	36	32
West Virginia							
Percent	2.1%	2.3%	0.4%	4.6%	0.4%	0.9%	10.6%
Rank	42	26	12	12	30	7	15
U.S. Average	**3.3%**	**2.2%**	**0.4%**	**3.7%**	**0.4%**	**0.4%**	**10.4%**

[1]Includes the general sales tax along with selective taxes such as excise taxes on alcohol and tobacco products, motor fuel taxes, titling taxes, admissions and amusement taxes, insurance premium taxes, public utility gross receipts taxes, and others.

[2]Includes inheritance/estate and gift taxes, documentary and stock transfer taxes, severance taxes, and other taxes.

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47).

Source: 2004 Census of Government, U.S. Bureau of the Census (July 2006)

Exhibit 3
Maryland State and Local Tax Revenues
Comparison to Selected States
2003-2004 Tax Revenues on a Per Capita Basis

	Property Tax	Personal Income Tax	Corporate Income Tax	Sales & Selective Taxes[1]	License Fees	Other Taxes[2]	All Taxes
District of Columbia							
Amount	$1,856	$1,894	$304	$2,082	$306	$713	$7,154
Rank	4	1	3	2	2	3	1
New Jersey							
Amount	$2,099	$852	$218	$1,126	$136	$123	$4,555
Rank	1	17	6	29	26	25	4
Maryland							
Amount	**$1,082**	**$1,490**	**$102**	**$981**	**$101**	**$259**	**$4,016**
Rank	**18**	**3**	**16**	**43**	**38**	**9**	**7**
Virginia							
Amount	$1,031	$992	$56	$969	$102	$192	$3,342
Rank	22	11	39	44	37	15	24
Delaware							
Amount	$546	$998	$262	$475	$1,063	$263	$3,608
Rank	44	10	5	49	1	8	17
Pennsylvania							
Amount	$1,010	$832	$135	$1,042	$206	$221	$3,447
Rank	25	19	10	37	8	12	20
North Carolina							
Amount	$713	$880	$98	$1,048	$122	$67	$2,929
Rank	39	15	20	36	29	38	32
West Virginia							
Amount	$540	$589	$100	$1,186	$99	$226	$2,740
Rank	45	34	19	23	39	11	41
U.S. Average	**$1,084**	**$733**	**$115**	**$1,228**	**$140**	**$141**	**$3,440**

[1]Includes the general sales tax along with selective taxes such as excise taxes on alcohol and tobacco products, motor fuel taxes, titling taxes, admissions and amusement taxes, insurance premium taxes, public utility gross receipts taxes, and others.

[2]Includes inheritance/estate and gift taxes, documentary and stock transfer taxes, severance taxes, and other taxes.

Note: For the rankings, 1 indicates the highest. Rankings are out of 51 except for the personal income tax (out of 44) and the corporate income tax (out of 47).

Source: 2004 Census of Government, U.S. Bureau of the Census (July 2006)

Revenues and Taxes

Effects of Revenue Measures Enacted Over the Last Term

A variety of revenue measures were enacted during the 2003-2006 legislative term, generating significant general and special fund revenues primarily from fee increases and tax compliance. A few revenue reductions were adopted during the 2006 session.

Revenue Summaries

Measures to enhance or reduce revenues generally take the form of legislation, with changes to the State property tax being a notable exception. During strong economic times in the 1990s and early in this decade, most changes resulted in State revenue reductions. To address the economic downturn that began with the 2001 recession, changes made during the 2002 through 2005 sessions generated additional revenues, mainly through the State property tax, fees, and tax compliance measures. Recognizing an unanticipated accumulated general fund balance, revenue measures passed during the 2006 session primarily focused on revenue reductions.

Exhibit 1 shows the estimated annual fiscal impact of revenue changes passed during the 2003-2006 legislative term. As the exhibit shows, annual total revenue impacts range from a low of $360.1 million in fiscal 2004 to a high of $911.6 million in fiscal 2005. In fiscal 2006 and 2007, annual special fund revenues constitute a significant portion of the new revenues, with 64 percent in fiscal 2006 and 71 percent in fiscal 2007 going to special funds.

Exhibit 1
Fiscal Impact of Revenue Measures by Fund Type
Fiscal 2004-2007
($ in Millions)

Fund Type	2004	2005	2006	2007	Cumulative Total
General Fund	$169.4	$430.4	$327.5	$209.7	$1,137.0
Special Fund	190.7	481.2	578.5	522.2	1,772.6
Total	**$360.1**	**$911.6**	**$906.0**	**$731.9**	**$2,909.6**

Source: Department of Legislative Services

As a point of comparison, over the fiscal 1996-2003 period, major revenue changes resulted in a net cumulative revenue decrease of about $2.5 billion, most of which was in general funds. The phased-in personal income tax reduction enacted in 1997 had the greatest impact, reducing general fund revenues by $2.2 billion over a six-year period from fiscal 1998 to 2003. Measures that reduced revenues were partially offset by $400.0 million in tobacco tax revenue increases in 1999 and 2002.

Exhibit 2 summarizes the revenue measures enacted during the 2003-2006 legislative term and also shows the fiscal impact in total funds.

Exhibit 2
Significant Revenue Measures
($ in Millions)

	FY 2004	FY 2005	FY 2006	FY 2007	Four-year Cumulative Totals
2003 Session					
State Property Tax	$170.8	$185.1	$205.0	$132.0	$692.9
Tax Compliance Measures	97.1	46.9	41.5	39.0	224.5
Corporate Filing Fees	38.4	49.9	49.9	49.9	188.1
Income Tax on Non-Resident Property Sales	23.1	30.5	35.1	21.9	110.6
Land Records Fees	18.8	18.8	18.8	18.8	75.2
Miscellaneous Fees	6.0	6.1	6.3	6.4	24.8
Heritage Tax Credit Caps	3.5	20.6	15.8	2.2	42.1
Subtotal, 2003	**$357.7**	**$357.9**	**$372.4**	**$270.2**	**$1,358.2**
2004 Session					
Delaware Holding Co. Legislation and Settlement		$235.4	$45.8	$55.0	$336.2
Motor Vehicle Administration Fees		170.3	173.3	175.8	519.4
Decoupling from Federal Tax Provisions	$2.4	47.5	45.6	48.0	143.5
Minimum County Income Tax Rate for Nonresidents		38.6	27.8	29.5	95.9
HMO/MCO Premium Tax		27.7	80.0	82.0	189.7
Reducing the Sales Tax Vendor Discount by Half		16.6	17.5	0	34.1
Chesapeake Bay Restoration Fee (Flush Tax)		10.0	66.8	74.0	150.8
Miscellaneous Fees		12.2	11.4	13.0	36.6
Tax Compliance Measures		2.8	0.4	0.4	3.6
Heritage Tax Credit Caps		-7.4	-9.4	-9.1	-25.9
Subtotal, 2004	**$2.4**	**$553.7**	**$459.2**	**$468.6**	**$1,483.9**
2005 Session					
Withholding on Lump Sum Retirement Distributions			$25.0	$3.0	$28.0
Decoupling from Federal Tax Provisions			18.0	16.5	34.5
Tax Compliance Measures and Other Tax Changes			12.8	10.5	23.3
Withholding Rate Changes			8.0	3.4	11.4
Drinking Driver Program Fee			7.6	7.6	15.2
Miscellaneous Fees			5.3	4.1	9.4
Tax Credits/Exemptions			-2.4	-3.1	-5.5
Increased Lottery Commissions			0	-7.6	-7.6
Sales Tax Free Period			0	-5.6	-5.6
Subtotal, 2005			**$74.3**	**$28.8**	**$103.1**
2006 Session					
Property Tax Credit Enhancements				-$18.1	-$18.1
Tax Reductions for Veterans/Veterans Organizations				-14.7	-14.7
Estate Tax Reduction for Certain Estates				-8.6	-8.6
Tax Credit/Refund Measures				-2.0	-2.0
Sales/Excise Tax Exemptions				-0.3	-0.3
Repeal of Income Tax Credit for Public Utilities				6.0	6.0
Surcharge on Certain Motor Vehicle Convictions				2.4	2.4
Tax Compliance Measures				0.4	0.4
Miscellaneous Fees/Assessments				0.2	0.2
Subtotal, 2006				**-$34.7**	**-$34.7**
Totals	**$360.1**	**$911.6**	**$906.0**	**$731.9**	**$2,909.6**

Note: Numbers may not add to total due to rounding.

Source: Department of Legislative Services

2003 Session

During the 2003 session, $360 million in new revenues were generated for fiscal 2004. Tax compliance measures and corporate filing fee increases accounted for 81 percent of the general fund revenues. Almost all the additional special fund revenues were related to increases in the State property tax and land records fees.

2004 Regular and Special Sessions

In 2004, legislation generated an additional $278 million in general funds for fiscal 2005, based on measures that increased general fund revenues by $286 million and offset by measures that reduced general fund revenues by $8 million. Approximately 64 percent of the net increase was related to the Delaware Holding Company (DHC) legislation and one-time revenues from the DHC settlement period. Seventeen percent was related to decoupling from federal tax changes. About 14 percent was the result of imposing the lowest county income tax rate on nonresidents. The offsetting reduction in general fund revenues was primarily related to the Maryland Heritage Structure Rehabilitation Tax Credit.

Legislation also generated an additional $276 million in special funds. DHC legislation contributed about 20 percent of the net increase, and over half of the net increase in special funds (62 percent) was related to increased fees imposed by the Motor Vehicle Administration. Eleven percent was the result of imposing the insurance premium tax on certain health maintenance organizations (HMOs) and managed care organizations (MCOs).

Although the impacts of the HMO/MCO premium tax and Chesapeake Bay restoration/wastewater facilities surcharge (flush tax) enacted in 2004 were first seen in fiscal 2005, the revenues from these measures increase substantially in fiscal 2006 and beyond.

2005 Session

Legislation in 2005 generated an additional $60 million in net general fund revenues for fiscal 2006. The measure with the largest impact in fiscal 2006 (41 percent of the net total) was imposing income tax withholding on lump-sum retirement distributions. The second largest impact (23 percent) came from decoupling from federal tax provisions.

Special fund revenues increased primarily through two sources: a new fee imposed on participants in the Drinking Driver Monitor Program and decoupling from federal tax changes. These and other measures increased special fund revenues in fiscal 2006 by $16.6 million but were offset by measures that reduced special fund revenues by $2.7 million, primarily the result of exempting the State from the motor fuel tax.

Two measures enacted in 2005 decrease general fund revenues in fiscal 2007. Increasing lottery agent commissions from 5.0 to 5.5 percent will cost $7.6 million annually beginning in fiscal 2007, and a one-time sales tax free shopping period in 2006 will cost $5.6 million in fiscal 2007.

2006 Regular and Special Sessions/Board of Public Works Property Tax Rate Reduction

Legislation passed during the 2006 regular and special sessions reduced total general fund and special fund revenues by approximately $34.7 million for fiscal 2007. Significant revenue reductions passed in 2006 include enhancements to the Homeowners' Property Tax Credit and Renters' Tax Credit programs ($18.1 million), reducing income and sales taxes paid by certain veterans and veterans' organizations ($14.7 million), and reducing the Maryland estate tax paid by certain estates ($8.6 million).

Special fund revenues generated from surcharges imposed on certain motor vehicle convictions, tax compliance measures, and other fee/assessment increases offset the overall revenue decrease by about $3.0 million. In addition, the repeal of the corporate income tax credit for property taxes assessed on the operating real property of a public utility increased special fund revenues by $6.0 million in fiscal 2007.

In addition to legislation passed during the 2006 session, the Board of Public Works reduced the State property tax rate from 13.2 to 11.2 cents per $100 of assessment for the tax year beginning July 1, 2006, thereby reducing special fund revenues for fiscal 2007 by an estimated $97.0 million.

Revenues and Taxes

Video Lottery Terminals

While Maryland spent the last legislative term debating, but not enacting, legislation to legalize video lottery terminals (VLTs) in the State, several nearby states are either expanding VLT facility operations or, in the case of Pennsylvania, opening its first VLT facility.

Video Lottery Terminal Legislation in Maryland

While legislation to legalize expanded gambling in the State had been introduced each year since at least the early 1990s, the issue gained far greater attention with Governor Robert L. Ehrlich's introduction of VLT gambling legislation in 2003. The Ehrlich Administration offered VLT legislation in each year of the 2003-2006 legislative term, but despite the Senate and House of Delegates each passing VLT legislation during the term, no consensus could be reached and all legislative efforts ultimately failed.

Video Lottery Terminal Operations in Nearby States

New York

VLT gambling at racetracks continues to expand in New York, albeit at a pace that has been slower than expected since VLT gambling was first authorized in 2001. Seven VLT racetrack facilities are now operating after three more facilities opened in 2006 – Tiago Downs; Vernon Downs; and Yonkers Raceway, the state's first VLT racetrack facility near New York City. Yonkers Raceway began limited operations in October 2006 with 1,870 VLTs, and the facility expects to have a total of 5,500 VLTs by the end of the year. In its first three weeks of operations, the facility accounted for approximately one-third of total state VLT racetrack revenues. In fiscal 2006, five VLT facilities generated a total of $328.8 million in net revenues, of which $167.5 million was used to fund public education initiatives.

Pennsylvania

Pennsylvania has begun implementing legislation enacted in 2004 that authorizes up to 14 VLT racetrack and nontrack facility licenses and a maximum statewide total of 61,000 VLTs. Of the 14 licenses, 7 are reserved for racetracks, 5 are for nontrack locations, and 2 are for resort locations.

In fall 2006, the Pennsylvania Gaming Control Board awarded conditional VLT licenses to six racetrack facilities. Four of the licensees anticipate commencing operations by early 2007,

with Pocono Downs in Wilkes-Barre expected to be the first facility to start operations in November 2006.

Exhibit 1 lists the tracks that have received conditional licenses, the estimated number of VLTs and annual expected revenue from each facility after prize payouts, and the anticipated opening date, either in a permanent or temporary facility.

Exhibit 1
Licensed Pennsylvania VLT Racetrack Facilities
(as of November 2006)

Track/Location	Expected Opening Date	# of VLTs	Expected Win per Day	Annual Revenue Estimate (in millions)
Pocono Downs/Wilkes-Barre	November 2006	2,000	$180	$131.4
Philadelphia Park/NE Philadelphia	December 2006	3,000	272	297.8
Chester Downs/Chester	January 2007	2,750	236	236.9
Presque Isle/Erie	February 2007	2,000	161	132.7
The Meadows/Greater Pittsburgh	Spring 2007	3,000	108	118.3
Penn National/Greater Harrisburg	Early 2008	3,000	170	186.2
Totals		**15,750**	**$192**	**$1,103.3**

Source: Pennsylvania Gaming Control Board; Department of Legislative Services

The Gaming Control Board's estimates are lower than applicant and previous state government estimates and take into account competition from facilities that have yet to be licensed – the board has characterized its estimates as "very conservative."

The board is scheduled to vote by the end of the year on awarding permanent licenses to the six racetracks and an additional six licenses to nontrack/resort applicants. Five applicants are vying for two available licenses in the Philadelphia area, with each facility projected to operate 3,000 VLTs and construction proposals ranging from $250 to $410 million. Three applicants are seeking one available license in the Pittsburgh area, and five applicants are seeking to locate the other two nontrack licenses in Gettysburg, the Lehigh Valley, and/or the Poconos. One resort license, with a maximum of 500 VLTs, is likely to be awarded to a location in southwestern Pennsylvania. To date, there is only one applicant for a resort license.

The seventh and final racetrack license will be awarded only after the Pennsylvania Harness Racing Commission issues a final harness racing license, which is expected to be awarded to a track to be built in the Pittsburgh area. The board has yet to announce a timetable for awarding the second resort license.

Delaware

Delaware VLT revenues are both a large source of revenue for the state and heavily dependent on out-of-state patrons. VLT revenues to the State totaled $215 million, or approximately 7 percent of total state general fund revenues, in fiscal 2006. It is estimated that up to one-third of VLT patrons at Delaware Park near Wilmington come from Pennsylvania and that up to 40 percent of VLT patrons at Dover Downs come from Maryland. Delaware officials recently estimated that Pennsylvania's authorization of VLT gambling could reduce Delaware's VLT revenues by $5 million in fiscal 2007 and $32 million annually in future years once all the VLT facilities in the Philadelphia area are in operation.

In response to these revenue concerns, the Delaware General Assembly passed the Video Lottery Competitiveness Act of 2006 that expands VLT gambling by increasing the maximum number of VLTs authorized at each of the state's three VLT racetrack facilities from 2,500 to 4,000 and expands the hours of VLT operations to 24 hours a day, except on Sundays and certain holidays.

Harrington Raceway and Dover Downs have responded by expanding their facilities; Dover Downs plans to spend over $50 million in order to double its number of hotel rooms to 500 (its hotel occupancy rate is currently approximately 98 percent), increase its casino size by 75 percent, and create an 8,000 square-foot spa facility. Harrington Raceway plans to spend $35 million to roughly double the size of its facility, with an initial addition of 200 VLTs. **Exhibit 2** provides information on the number of VLTs and total net VLT proceeds after payouts to gamblers at the Delaware facilities in fiscal 2006.

While the Delaware General Assembly rejected a proposed constitutional amendment that would have authorized two casinos in Wilmington and table games at the state's three existing VLT facilities, Delaware did, however, join Rhode Island and West Virginia in launching CASHOLA, the first multijurisdictional progressive jackpot VLT game.

West Virginia

In 2006, the West Virginia General Assembly also considered expanding gambling in response to the authorization of VLTs in Pennsylvania. For the second year in a row, however, the House Judiciary Committee failed to pass legislation that would have authorized table games at the state's four racetrack facilities, pending local voter approval. While VLT revenues at facilities other than Charles Town have decreased in the past two years, Charles Town is expanding its facilities by adding approximately 800 VLTs and constructing a hotel facility.

Exhibit 2 provides information on the number of VLTs and total net VLT proceeds after payouts to gamblers at the West Virginia facilities in fiscal 2006.

Exhibit 2
Delaware and West Virginia VLT Racetrack Revenues
Fiscal 2006

	Net Proceeds	Change over FY 2005	VLTs	Win per Day
Delaware:				
Delaware Park	$277.9	2.1%	2,526	$301
Dover Downs	203.2	5.3	2,513	222
Harrington	120.6	11.1	1,584	209
Delaware Total	**$601.7**	**4.9%**	**6,624**	**$249**
West Virginia:				
Mountaineer	$252.3	-1.0%	3,163	$219
Wheeling	196.8	3.7	2,314	233
Tri-State	62.9	-3.9	1,742	99
Charles Town	430.2	11.9	4,172	283
West Virginia Total	**$942.3**	**5.3%**	**11,391**	**$227**

Source: West Virginia, Delaware State Lotteries

Revenues and Taxes

Taxation of Electric Utilities

Legislation enacted in 1999 significantly changed the State and local taxation of electric utilities. Since then, the transfer of ownership of electric generating plants in the State and recent legislation regarding changes to electric restructuring and the Public Service Commission have led to alterations in how utility taxes are assessed.

1999 Electric Utility Tax Reform

To address the tax implications of the restructuring of the electric utility industry in the State in anticipation of retail electric competition, legislation enacted in 1999 significantly reformed the State and local taxation of electric utilities. To provide equity in the taxation of competing providers of electricity, Chapters 5 and 6 of 1999 included a major revision of the State taxes imposed on electric utilities. The former State gross receipts tax on electric utilities was replaced with a "combination tax" consisting of a gross receipts tax imposed only on revenues from the transmission and delivery of electricity and a separate tax based on kilowatt hours of electricity delivered for final consumption in the State. The 1999 legislation also imposed the State corporate income tax on electric utilities for the first time.

To enhance the ability of in-state electric generating facilities to compete with out-of-state generating facilities in a competitive interstate electricity market, the 1999 legislation also provided significant relief from local property taxes for electric generating facilities in the State. The major feature of the 1999 utility tax reform was a 50 percent property tax exemption for personal property (machinery and equipment) used in generating electricity. The legislation provided for an annual State grant to the affected counties (*i.e.*, those where the electric power plants are located) to partially reimburse the counties for the cost of this exemption. The property tax exemption was expected to save the electric utilities (primarily the Baltimore Gas and Electric Company (BGE) and Pepco, the two utilities owning most of the electric generating plants in the State at the time) roughly $45 million annually in property taxes, and the annual grant from the State to the affected counties totaled $30.6 million.

To provide relief from the disparity between utility and nonutility generators of electricity in the taxation of real property, the 1999 legislation also provided a credit against the newly imposed State corporate income tax for 60 percent of the total property taxes paid by a public utility on operating real property used to generate electricity for sale.

Transfer of Ownership of Electric Generating Plants

Since 1999, most of the electric generating plants in the State have been sold to unrelated parties or transferred to unregulated affiliates of the public utilities. With the exception of the plants formerly owned by BGE, which were transferred to its affiliate Constellation Energy Group in 2000 but continued to be treated as part of the BGE operating unit for property tax purposes, the power plants in the State that have been sold or transferred by public utilities have been reclassified for property tax purposes as nonutility property. As a result, the method of property tax assessment for these properties has changed.

Public utility operating property is valued for property tax purposes using the "unit valuation method," under which the operating unit of the public utility is valued as a whole, based on the overall earning capacity of the operating unit, and the "unit value" of the operating unit is divided between operating real property and operating personal property and then apportioned among the counties and municipal corporations based on the location of the property. Nonutility property, on the other hand, is subject to assessment in the same manner as other commercial and industrial property, with a separate assessment of the real property of each power plant by the local assessment office and a central assessment of personal property by the State Department of Assessments and Taxation (SDAT).

The method of assessment used to value a generating plant can have a significant impact on the property taxes imposed on the plant, but factors other than the assessment method can determine which method results in higher or lower taxes. On one hand, the operating real property of a public utility is taxed at a higher rate than the rate applicable to real property if owned by an ordinary taxpayer. On the other hand, sales of generating plants have established the market value for generators, leading to significantly higher assessments than the previous value for those plants under the unit valuation method.

Notwithstanding the transfer of BGE's plants to Constellation Energy Group in 2000, SDAT has continued to assess those plants as part of the BGE operating unit, based on the continuation of the competitive transition charge paid by BGE customers and a continued connection between electricity generation and distribution during the transition to customer choice. SDAT indicated earlier this year that it intended to review the classification of the former BGE plants and that it was likely that these plants would no longer be considered part of the BGE operating unit as of January 1, 2007. However, the department has not yet determined what effect removing the BGE plants from the operating unit would have on the assessable base for property tax purposes.

Recent Legislative Activity

Utility Tax Grants to Counties/Personal Property Tax Exemption

Governor Robert L. Ehrlich's budget submissions for both fiscal 2005 and 2006 proposed to cut funding for the State grants to counties provided in the 1999 electric utility tax reform, contingent on the enactment of separate legislation that would have repealed the grants. Legislation was also introduced in 2004 and 2005 that would have repealed the 50 percent property tax exemption for personal property used in generating electricity. All these proposals failed.

2006 Special Session – Public Service Commission and Electric Restructuring Legislation

The comprehensive electric restructuring and Public Service Commission legislation enacted in the 2006 special session (Chapter 5) included two provisions relating to the taxation of electric utilities.

First, Chapter 5 repealed the credit allowed against the corporate income tax for 60 percent of the total property taxes paid by a public utility on its operating real property used to generate electricity. When this income tax credit was enacted, all four of the State's investor-owned electric utilities owned generation facilities in the State and were eligible for this credit. However, because the power plants other than those owned by BGE have been sold or transferred to unregulated entities, only BGE remained eligible for this income tax credit.

In addition, Chapter 5 prohibits SDAT from changing the current method of valuation of power plants in the State for property tax purposes before May 1, 2007. The legislation requires SDAT to study the current valuation of power plants in the State for property tax purposes and any proposed change to the valuation of power plants; to consider the potential fiscal impact to the State, counties, and electric companies; and to study whether the current method or any proposed change provides an adequate and equitable determination of the value of power plants in a restructured electric industry. SDAT must report to the Governor and the General Assembly on its findings and recommendations by December 31, 2006.

Revenues and Taxes

Taxation of Retirement Income

A variety of proposals to provide additional income tax relief for retirees have been introduced in recent years. Legislation to expand the income tax subtraction modification for certain military retirees was enacted in 2006.

Maryland Tax Treatment of Pension Income

Maryland income tax law currently provides a pension exclusion subtraction modification for individuals who are at least 65 years old or who are totally disabled. Under this subtraction modification, up to a specified maximum annual amount of taxable pension income ($22,600 for 2006) may be exempt from tax. The maximum exclusion allowed is indexed to the maximum annual benefit payable under the Social Security Act and is reduced by the amount of any Social Security payments received; this is known as the "Social Security offset."

Given that Social Security benefits are exempt from Maryland income tax, even though they are partly taxable for federal income tax purposes, the Social Security offset works to equalize the tax treatment of individuals who receive their retirement benefits from different sources by reducing the amount of the allowable exclusion by the amount of Social Security benefits received.

One important feature of the current pension exclusion is that it is limited to income received from an "employee retirement system." Eligible employee retirement systems are retirement plans established and maintained by an employer for the benefit of its employees and qualified under sections 403, 410(a), or 457 of the Internal Revenue Code. These include defined benefit and defined contribution pension plans, 401(k) plans, 403(b) plans, and 457(b) plans. However, individual retirement accounts (IRAs), Keogh plans, and simplified employee pension plans are not considered employee retirement system plans for purposes of the pension exclusion.

Military Retirement Income

For several years, the General Assembly has considered various legislative initiatives that would provide income tax benefits to active duty and retired military personnel. In the 2006 session, both the Senate and the House of Delegates passed legislation with respect to the taxation of military retirement income and compromise legislation was ultimately enacted.

As amended and initially passed by the Senate, Senate Bill 22 of 2006 would have allowed an individual to subtract from taxable income the first $5,000 in military retirement income if the individual was 60 years of age or older and the first $2,500 if the individual was

under 60 years of age. The proposal also would have increased the additional income tax exemption amount allowed for individuals age 65 and older and blind individuals from $1,000 to $2,400 if the individual met specified income requirements.

As amended and initially passed by the House, Senate Bill 22 would have allowed an individual to subtract from taxable income the first $10,000 in military retirement income if the individual was 55 years of age or older. In addition, an individual could have subtracted from taxable income the first $7,500 in retirement income resulting from service as a federal, State, or local law enforcement officer, firefighter, or emergency medical services personnel if the individual was 55 years of age or older. For both subtractions, individuals would have been required to meet specified income requirements in order to qualify.

As ultimately enacted, Senate Bill 22 (Chapter 226) only expanded the existing military retirement income subtraction modification by allowing a subtraction from taxable income for the first $5,000 of military retirement income. The income must have resulted from service in an active or reserve component of the U.S. armed forces, membership in the Maryland National Guard, or from service of certain members of the Commissioned Corps of the Public Health Service, the National Oceanic and Atmospheric Administration, or the Coast and Geodetic Survey. Chapter 226 repealed the existing military retirement income subtraction modification, which had provided a $2,500 subtraction modification to individuals at least 55 years old who were active duty enlisted members at the time of retirement and met specified income limits.

Tax Treatment of Pension Income in Surrounding States

Delaware provides that individuals under age 60 can exempt up to $2,000 in pension income, with individuals age 60 and older allowed to exempt up to $12,500 in pension income and eligible retirement income. Eligible retirement income includes dividends; capital gains; interest; income from an IRA, 401(k), or Keogh plan; and net rental income from real property.

The ***District of Columbia*** exempts up to $3,000 in pension income resulting from military service or from DC or federal government service if the individual is age 62 years or older.

Pennsylvania exempts 100 percent of retirement income.

Virginia does not exempt pension income; however, individuals age 65 years or older can deduct up to $12,000 regardless of the income source. The $12,000 deduction is reduced dollar-for-dollar by the amount that federal adjusted gross income minus federal taxable Social Security and railroad benefits exceeds $50,000 for single taxpayers and $75,000 for married taxpayers. Individuals who were age 65 before January 1, 2004, can claim the full deduction regardless of income.

West Virginia provides a deduction for up to $2,000 in pension income from the West Virginia Teachers' or Public Employees' Retirement Systems and federal and military retirement systems regardless of age or income. West Virginia public safety pensions are totally exempt. In addition, each taxpayer age 65 or older can deduct up to $8,000 of income regardless of the income source.

Personnel

State Pension Contribution Rates and Investment Performance

The State Retirement and Pension System (SRPS) earned a 10.4 percent investment return in fiscal 2006; however, poor returns in prior years combined with pension enhancements for State employees and teachers enacted in 2006 have caused the funded status of the system to drop from 87.8 percent in fiscal 2005 to 83.3 percent in fiscal 2006. As a result, State contributions to the pension system will increase by $195 million in fiscal 2008. At the same time, the SRPS board voted for the second consecutive year to recommend changing the system's corridor funding methodology, which if adopted by the General Assembly, would increase State pension contributions by an additional $162 million in fiscal 2008.

State Pension Contribution Rates Increase Significantly

The lingering effects of poor investment performance during fiscal 2001-2003 combined with significant pension enhancements enacted for teachers and State employees in 2006 have resulted in an increase in pension contribution rates for teachers and State employees of more than 20 percent in fiscal 2008. Additionally, the funded status of the system in the aggregate has decreased from 87.8 percent in fiscal 2005 to 83.3 percent at the end of fiscal 2006.

As shown in **Exhibit 1**, the employer contribution rate for teachers will increase from 9.71 percent of payroll in fiscal 2007 to 11.60 percent in fiscal 2008, while the contribution rate for State employees will increase from 6.83 in fiscal 2007 to 8.86 in fiscal 2008. Based on projected payroll, the State Retirement and Pension System's (SRPS) actuary estimates that total State pension contributions will increase $195.0 million from $762.1 million in fiscal 2007 to $956.9 million in fiscal 2008.

Exhibit 1
State Pension Contribution Rates
Fiscal 2007 and 2008

Plan	FY 2007 Rate (%)	FY 2007 ($ in Millions)	FY 2008 Rate (%)	FY 2008 ($ in Millions)	Actuarial Funding Level*
Teachers	9.71%	$510.5	11.60%	$635.7	84.2%
Employees	6.83	194.9	8.86	260.6	80.6
State Police	13.83	11.2	15.44	13.0	98.2
Judges	42.43	15.0	44.12	16.5	77.6
Law Enforcement Officers	40.60	30.6	41.74	31.1	62.8
Aggregate	**9.18%**	**$762.1**	**11.10%**	**$956.9**	**83.3%**

* Level at the end of fiscal 2006.
Note: Contribution rates and funding levels reflect State funds only, excluding municipal contributions.

Source: Segal Co.

Pension Enhancement Adds to Retirement System Liabilities

Chapter 110 of 2006, which enhanced pension benefits for members of the Teachers' Pension System (TPS) and Employees' Pension System (EPS), accounts for a large part of the increase in pension contribution rates. The SRPS actuary estimates that the pension enhancement legislation increased the State's contribution rate for TPS by 1.6 percentage points and for EPS by 1.18 percentage points; other systems were not affected by the enhancement.[1] This brings the total first-year cost of the enhancement to approximately $121 million, just below the projected cost of $122 million.

SRPS Investment Performance Remains Strong, but Past Losses Linger

SRPS investments earned 10.4 percent returns for fiscal 2006, the third consecutive year of strong investment returns for the system. Total system assets reached $34.4 billion at the end of fiscal 2006, a new fiscal year high that surpassed the previous high of $33.1 billion at the end of fiscal 2000. The 10.4 percent return is an increase from the 9.5 percent investment return in fiscal 2005 and exceeds the system's actuarial target of 7.75 percent, which is used by the State's actuary to calculate contribution rates. Investment returns in excess of the target rate result in

[1] Members of the Teachers' Retirement System and Employees' Retirement System who opted for Selection C also received the enhanced benefits.

lower State pension contributions, while returns below the target result in higher contribution rates to make up the difference between the target and actual returns.

Unfortunately, three years of strong returns have not been enough to overcome three years of poor performance from fiscal 2001-2003. To protect the system from sharp spikes in investment returns in any given year, the system uses a smoothing mechanism that calculates an actuarial rate of return, which is a dynamic five-year average of investment returns. Poor investment returns from fiscal 2001-2003 continue to weigh down the actuarial rate of return, which was 6.7 percent this year. Because this rate remained below the actuarial target of 7.75, it was another factor behind the significant increase in the State's fiscal 2008 pension contribution rates.

Corridor Funding Method Restrains Growth in Contribution Rates

Since fiscal 2003, the contribution rates for the two largest systems, the employees' and teachers' systems, remained fixed from year to year as long as the funded status (ratio of assets to liabilities) for these systems remained in a "corridor" of 90 to 110 percent. As Exhibit 1 shows, both systems are currently outside their respective corridors; the employees' system first fell out of the corridor in fiscal 2005, and the teachers' system followed suit in fiscal 2006. Under the corridor method, the contribution rates for both systems are now adjusted upwards but only by 20 percent of the difference between the prior year's rate and the true actuarial rate for the coming fiscal year. The 2006 pension enhancement is not subject to the corridor method.

Absent the corridor, the contribution rate for the teachers' system would have been 12.78 percent instead of 11.60 percent; the rate for the employees' system would have been 12.27 percent instead of 8.86 percent. In budgetary terms, the corridor method will save the State $162 million for fiscal 2008, according to the SRPS actuary. However, by about 2013, contribution rates under the corridor will begin to surpass the full actuarial rates to make up for the underfunding of the pension system during the prior years. In October 2006, a majority of the SRPS board of trustees voted for the second consecutive year to recommend that the State abandon the corridor and resume full actuarial funding of the pension system.

Personnel

State Workforce and Payroll

Fiscal 2007 is the fifth consecutive year in which limits have been placed on the number of regular and contractual State positions; however, no additional reductions beyond those taken by the General Assembly were required. This mechanism continues to serve as a constraint on State spending for total employee compensation as full-time equivalent positions have decreased by 1,833 since fiscal 2002. The State will spend over $5.8 billion on its regular employee workforce in fiscal 2007.

Budgeted Positions

Regular Positions

Section 39 of the fiscal 2007 budget bill (Chapter 216 of 2006) established a limit of 52,432 regular full-time equivalent (FTE) positions that may be filled in the Executive Branch. This number does not include higher education institutions, the Maryland Aviation Administration, and the Maryland Port Administration. Section 38 also provided that between June 30, 2006, and January 21, 2007, positions may not be added in the executive service, management service, or commission plan, either through the Board of Public Works or through transfer from one agency to another. Primarily due to the use of the Executive Branch position caps, implemented in fiscal 2003, and the resulting position abolitions, the regular total nonhigher education Executive Branch workforce has decreased from 56,961 positions in fiscal 2002, prior to the utilization of position caps, to 53,329 positions in the fiscal 2007 working appropriation.

As shown in **Exhibit 1**, 86 percent of the decrease is attributable to five agencies: the Department of Human Resources; the Department of Health and Mental Hygiene; the Maryland Department of Transportation; the Department of Natural Resources; and the Department of Labor, Licensing, and Regulation. Exhibit 1 also shows that six areas of State government experienced an increase in the size of their workforce since fiscal 2002. These areas included the Legislative and Judicial branches, executive and administrative control agencies, legal agencies (primarily the Office of the Public Defender), the Maryland State Department of Education and other public education agencies, and higher education. Overall, however, the State's workforce has decreased by 1,833 FTE positions since fiscal 2002.

Fiscal 2007 Additions and Abolitions

The Department of Budget and Management was not required to abolish any additional positions in order to reach the 52,432 position cap in fiscal 2007; the General Assembly approved the deletion of 67 new positions and 7.5 existing positions during the 2006 session, all

but 15 of which were in the Executive Branch. As shown in **Exhibit 2**, since the beginning of fiscal 2007, 496 positions have been added, 456 of which are in higher education institutions.

Exhibit 1
Regular Full-time Equivalent Positions
Fiscal 2002 Actuals to 2006 Working Appropriation

Department/Service Area	FY 2002 Actual	FY 2007 Wkg. Approp.	Change
Legislative Branch	730	744	14
Judicial Branch	3,010	3,397	388
Executive Branch			
Human Resources	8,273	7,021	(1,251)
Health and Mental Hygiene	8,536	7,656	(880)
Transportation	9,538	9,021	(518)
Natural Resources	1,629	1,369	(261)
Labor, Licensing, and Regulation	1,706	1,475	(231)
Public Safety and Correctional Services	11,663	11,503	(160)
General Services	793	636	(157)
Housing and Community Development	449	316	(133)
Financial and Revenue Administration	2,158	2,026	(133)
Police and Fire Marshal	2,590	2,472	(118)
Budget and Management	524	442	(82)
Environment	1,028	951	(77)
Agriculture	480	436	(45)
Juvenile Services	2,123	2,080	(43)
Business and Economic Development	324	292	(32)
Retirement	194	189	(5)
Executive and Administrative Control	1,619	1,664	45
Legal	1,381	1,586	205
MSDE and Other Education	1,955	2,198	243
Nonhigher Education Executive Branch Subtotal	**56,961**	**53,329**	**(3,632)**
Higher Education	21,386	22,783	1,397
Total	**82,087**	**80,254**	**(1,833)**

Source: Department of Budget and Management; Department of Legislative Services

Exhibit 2
Regular Full-time Equivalent Positions
Fiscal 2006 Legislative to Working Appropriation

Department/Service Area	2007 Legislative Appropriation	BPW and Other Changes	2007 Working Appropriation
Legislative Branch	744	-	744
Judicial Branch	3,397	-	3,397
Executive Branch			
Legal	1,586	-	1,586
Executive and Administrative Control	1,661	3	1,664
Financial and Revenue Administration	2,026	-	2,026
Budget and Management	443	(1)	442
Retirement	189	-	189
General Services	636	-	636
Transportation	9,021	-	9,021
Natural Resources	1,369	-	1,369
Agriculture	436	-	436
Health and Mental Hygiene	7,656	-	7,656
Human Resources	7,021	-	7,021
Labor, Licensing, and Regulation	1,475	-	1,475
Public Safety and Correctional Services	11,475	28	11,503
MSDE and Other Education	2,191	7	2,198
Housing and Community Development	316	-	316
Business and Economic Development	292	-	292
Environment	951	-	951
Juvenile Services	2,079	1	2,080
Police and Fire Marshal	2,472	-	2,472
Nonhigher Education Executive Branch Subtotal	**53,291**	**38**	**53,329**
Higher Education	22,327	456	22,783
Total	**79,760**	**494**	**80,254**

Source: Department of Budget and Management; Department of Legislative Services

Higher Education

Chapters 239 and 273 of 2004 provides the University System of Maryland and Morgan State University with autonomy from the General Assembly to establish staffing levels absent specific legislative constraints, as did Chapter 401 of 2003 for St. Mary's College. By the end of October 2006, the fiscal 2007 impact of these bills has been to add 470.8 FTE positions at the University System of Maryland and 12.5 FTE positions at St. Mary's College. In contrast, Morgan State University has decreased its workforce by 27 FTE positions. Higher education and other position changes attributable to the "Rule of 50" (Section 32, Chapter 216 of 2006), through which agencies are limited to the addition of 50 State-funded positions after the beginning of the fiscal year, with Board of Public Works approval, are noted in Exhibit 2.

Regular and Contractual Average Compensation and Total Expenditures

Regular Positions

The budgeted expenditure per regular FTE position in fiscal 2007 is approximately $72,420, 25.7 percent more than in fiscal 2002, of which $50,863 is attributable to salaries, $2,190 to other earnings (*e.g.*, overtime, shift differential, reclassifications), $10,380 to health insurance, and $8,987 to other fringe benefits. Other fringe benefits include retirement benefits, variable fringes (*i.e.*, Social Security and unemployment compensation), and miscellaneous fringe benefits (*e.g.*, workers' compensation, tuition reimbursement). While the number of regular positions has decreased since fiscal 2002 by 1,833 or 2.2 percent, as demonstrated in **Exhibit 3**, funding devoted to regular employee compensation has increased 22.9 percent. Other than salaries, the largest component of this increased spending is health insurance, with the State spending approximately $349 million more for employee and retiree health care in fiscal 2007 than it did five years earlier, a 71.2 percent increase. In all, the State is spending $5.8 billion for its regular employee workforce.

Contractual Positions

The budgeted expenditures per contractual FTE position in fiscal 2007 is approximately $45,784, 7.9 percent more than in fiscal 2002. Unlike regular positions, contractual positions do not include health insurance, pensions, or other benefits, with the exception of Social Security, unemployment compensation, and workers' compensation.

As shown in Exhibit 3, from fiscal 2002 to 2007, the number of contractual FTE positions has increased by 138, or 1.5 percent. Section 39 of the 2007 budget also implements a position cap for Executive Branch contractual positions of 2,797 FTE positions. This is the fifth year in which contractual position caps have been used and have served to constrain spending in this area. Spending for contractual positions has increased by $30 million, or 7.9 percent, since fiscal 2002.

Exhibit 3
Fiscal 2002 Actuals to Fiscal 2007 Legislative Appropriation
($ in Millions)

	FY 02 Actuals	FY 07 Leg. Approp.[1]	Change	Growth Rate
Regular Employees				
Full-time Equivalent Positions	82,087	80,254	-1,833	-2.2%
Regular Salary	$3,458	$4,082	$624	18.0%
Other Earnings (Overtime, Shift Differential, etc.)	138	176	38	27.5%
Total Salary	**$3,596**	**$4,258**	**$662**	**18.4%**
Health Insurance	$487	$833	$346	71.2%
Pensions/Retirement	240	312	72	30.0%
Variable Fringes (Social Security, Unemployment)	259	299	40	15.4%
Other Fringes	114	108	-6	-5.2%
Other	35	3	-31	-90.9%
Total Regular Payments	**$4,729**	**$5,812**	**$1,083**	**22.9%**
Contractual Employees				
Full-time Equivalent Positions	8,907	9,045	138	1.5%
Contractual Salary	$160	$186	$26	16.2%
Total Fringes	12	14	2	15.0%
USM Contractual	211	214	3	1.2%
Total Contractual Payments	**$384**	**$414**	**$30**	**7.9%**

[1] Turnover is distributed among regular salaries, pensions/retirement, and variable fringes in fiscal 2007. Turnover was also distributed to health insurance in fiscal 2002.

Source: Department of Budget and Management; Department of Legislative Services

Personnel

Retiree Health Care Liabilities Will Be a Significant Fiscal Challenge

Beginning in fiscal 2008, new accounting standards will require the State to account for liabilities associated with State employee retiree health care on its annual financial statements. The most recent valuation indicated that the State's retiree health liabilities exceed $20 billion. Compliance with the new standards would require the State to contribute an additional $1.1 to $1.6 billion each year towards funding these liabilities. Similarly, a survey of four large counties in Maryland indicates that their combined retiree health liabilities could be as much as $6.5 billion. As the State prepares to set aside a small amount of the required funding in fiscal 2008, a Blue Ribbon Commission has been charged with making recommendations on how to address this significant fiscal challenge.

Background on Governmental Account Standards Board Statement 45

Maryland currently funds the costs of State retiree health benefits on a pay-as-you-go (PAYGO) basis in the State budget each year. However, based on new standards established by the Governmental Accounting Standards Board (GASB), governmental employers will be required to account for liabilities associated with the employers' commitment to what is referred to as Other Post Employment Benefits (OPEB) such as retiree health insurance. Moreover, under these standards, Maryland will be required to account for these OPEB liabilities on its balance sheets in fiscal 2008.

The benefits to be valued for the purposes of OPEB liabilities are the retiree health benefits. The financial reporting under GASB 45 provides that employers must commission an actuarial valuation of OPEB liabilities every two years. Once a valuation is done, an Annual Required Contribution (ARC) amount will be calculated that represents the annual payment by the employer that would be necessary to fund the normal costs accrued for that year (liability for current and future benefits earned by employees in that year) in addition to an amount that represents the amortization of any unfunded OPEB liabilities (benefits earned to the date of the valuation). For financial accounting purposes, GASB 45 requires that a commitment by a governmental employer to provide retiree health care benefits be treated in the same manner as pension benefits are currently treated.

2005 Task Force and Actuarial Valuation of Retiree Health Liabilities

Chapter 298 of 2005 created the Task Force to Study Retiree Health Care Funding Options and required the task force to commission an actuarial valuation through the Department of Budget and Management (DBM) of the liabilities associated with GASB 45. In compliance

with the provisions of Chapter 298, in the summer of 2005, DBM contracted with AON Consulting to conduct the State's actuarial valuation.

The actuarial valuation completed by AON indicated that the State's liabilities with respect to retiree health care under GASB 45 were very significant. Specifically, the liabilities estimated for the actuarial accrued liability for retiree health benefits, defined as benefits earned as of the valuation date of July 1, 2005, were approximately $20.4 billion. AON also estimated that the $20.4 billion liability amortized over a 30-year period plus other specified costs required under the GASB standards would result in an ARC amount of $1.96 billion.

Recommendations of the Task Force

The task force was cognizant that Maryland's AAA debt rating stems from the State's historical fiscal prudence. Although the bond rating agencies have indicated that these new liability disclosures are not likely to result in any immediate changes in bond ratings, it is clear that this issue will be one that the agencies will be watching. As a result, although the task force recognized additional study was required, it also recommended that the State begin to set aside some funds for the purposes of prefunding a portion of the liabilities.

Begin by Funding Normal Cost

The task force recommended that the State set a goal of funding normal costs for retiree health benefits beginning in fiscal 2008, the first year the liabilities will appear on the State's financial statements. To accomplish this goal, the task force recommended that the State set aside approximately one-half of the total funds required to meet this goal in both the fiscal 2007 and 2008 budgets. The estimated normal/service cost for fiscal 2008 was $650 million, of which it is estimated that the State would already be paying approximately $320 million for current retiree health PAYGO costs. Of the remaining $329 million necessary to meet normal costs, $209 million would be general funds, with federal and special funds making up the remaining $120 million. In response to the recommendation of the task force, the Governor included $100 million in the fiscal 2007 budget for the Dedicated Purpose Account for retiree health care liabilities.

Establishment of a Blue Ribbon Commission for Additional Study

The task force also recommended that legislation be introduced establishing a Blue Ribbon Commission to further study the issue. In response, Chapter 433 of 2006 established the Blue Ribbon Commission to Study Retiree Health Care Funding Options. The membership of the commission includes legislators, elected officials and appointees of the Executive Branch, and members of the public with expertise in either funding retiree health benefits, the economics of affordable retiree health care programs, or investing pension fund assets.

Chapter 433 charges the commission with continuing the study of the many challenges facing the State with regard to the GASB 45 standards, taking into account the fiscal, workforce,

and bond rating implications. To accomplish this goal, Chapter 433 also directed the commission to contract with an actuarial consulting firm to provide ongoing services to the commission throughout its two-year existence. In October 2006, the commission hired Buck Consultants to conduct a second valuation and provide ongoing services to the commission throughout its existence. It is anticipated that Buck Consultants will have completed the new valuation in December 2006 and will present its findings to the commission in January 2007.

Liabilities for Retiree Health Benefits in Maryland Local Governments

As a governmental employer, Maryland is not alone with respect to the OPEB liabilities to be recognized under GASB 45. Any local governmental employer who provides a commitment for retiree health care benefits subsidies is in a similar position. A survey of Baltimore County, Howard County, Montgomery County, and Baltimore City indicated that each of these governmental employers is facing substantial actuarial accrued liabilities for retiree health benefits that total as much as $6.5 billion in the aggregate. Baltimore City estimates that its accrued liability ranges from $1.5 to $2.5 billion. Baltimore County and Montgomery County both reported liabilities of $2 billion; however, Montgomery County's liability is based on the 2003 valuation and includes employees of the Washington Suburban Sanitary Commission. The county is in the process of conducting a second valuation. Howard County reported a liability of $477 million and added that this liability includes not only Howard County employees, but also employees of the Howard County Board of Education, Howard County Community College, and Howard County libraries.

Each of these counties also indicated that they have also begun prefunding their retiree health care liabilities. Baltimore City has set aside $5 million from its fiscal 2006 budget surplus and included $5.4 million in its fiscal 2007 budget. Baltimore County has set aside $60 million, while Montgomery County has begun prefunding by setting aside $40 million. Finally, Howard County indicated that its fiscal 2006 budget included an appropriation of $30 million to be set aside for its liability.

Personnel

Employee Health Insurance Update

Changes made by the Governor and the General Assembly to the State employees' and retirees' health insurance and prescription drug plans in fiscal 2005 and 2006 have resulted in significant savings to the State.

Background

The State offers a variety of health plans, many on a pre-tax basis, to State employees, retirees, and the qualifying dependents of each. Eligible individuals may choose from among two preferred provider options (PPOs), three point-of-service (POS) plans, and three health maintenance organization (HMO) plans for their medical coverage. In addition, the State also offers insurance coverage for mental health/substance abuse, prescription drugs, dental, term life, accidental death and dismemberment, and long-term care. For retirees, statute provides that the State will contribute the same subsidy provided to active employees for retirees who have at least 16 years of creditable service. The State does not contribute for term life, accidental death and dismemberment, or long-term care coverage.

Fiscal 2007 Budget for Employee and Retiree Health Plans

The fiscal 2007 budget as proposed by the Governor overestimated the State's cost of providing the health insurance package to its employees and retirees. As a result, the fiscal 2007 allowance for employee and retiree health, dental, mental health, and other insurances was reduced by $58.0 million. Of that amount, $51.5 million was transferred to the Dedicated Purpose Account to be used to defray future costs associated with retirement benefits; $6.0 million was restricted to only fund an enhanced general salary increase (increasing the average general salary increase from 2.0 to 2.2 percent); and $500,000 was restricted for a comprehensive salary and benefits survey of nonhigher education Executive Branch classifications.

Notwithstanding the use of State health insurance funds for other purposes, it appears that that program changes made during fiscal 2005 and 2006 had an even larger impact on enrollee behavior than anticipated, resulting in additional savings.

Changes to the Health and Prescription Plans in Fiscal 2005

In fiscal 2005, a number of changes to health insurance plans were implemented, including increasing all primary and specialist doctor's office visit copayments to $15 and $25,

respectively, and emergency room hospital charge copayments (for nonemergency situations) and emergency physician charge copayments to $50.

Changes to the Health and Prescription Plans in Fiscal 2006

Beginning in fiscal 2006, copayments in the prescription drug plan increased from $3/$5/$10 to $5/$15/$25, with two copayments required for a 90-day supply. However, a $700 cap was placed on the total amount of annual family copays that would have to be made. Programmatic changes were also made to the prescription drug plan by including industry standard tiers, a smaller network, prior authorization and managed quantities for some types of prescriptions, step therapy, and 30 days for the first supply of a maintenance drug. The programmatic changes also provided for a voluntary mail order option within the prescription drug benefit plan. Legislation enacted in 2006 required that in fiscal 2007, the maximum copayment for a 90-day supply ordered through the mail order option would be $20.

In addition, the POS health insurance premium was increased from 15 to 17 percent. As a result, the State contributes toward the cost of employee and retiree coverage as follows: 80 percent for PPO plans, 83 percent for POS plans, 85 percent for HMO plans, and 80 percent for the prescription plan.

Prior Year Changes Show Results in Fiscal 2007

Fiscal 2007 cost estimates, based on fiscal 2005 and 2006 actual claims expenditures, are approximately $41.6 million lower than anticipated during the 2006 session, demonstrated in **Exhibit 1**. Although fiscal 2007 costs are not certain, and will ultimately depend on employee behavior which is still adjusting to the new program structure, the overbudgeted amount ultimately will somewhat offset future enrollee and State costs.

Exhibit 1
State's Share of Health Insurance Costs
($ in Millions)

	FY 2005	FY 2006	FY 2007	% Change FY 06-07
Medical/Dental	$459.5	$493.7	$530.8	7.5%
Prescription	242.7	210.3	228.1	8.5
Administration	5.6	5.6	5.9	5.0
Increased Workforce Participation			7.6	
Total	**$707.9**	**$709.6**	**$772.5**	**8.9%**
Fiscal 2007 Appropriation			**$814.1**	
Surplus			**$41.6**	

Source: Department of Budget and Management; Department of Legislative Services

Personnel

Special Committee on State Employee Rights and Protections

During the 2005 interim, the Legislative Policy Committee appointed a Special Committee on State Employee Rights and Protections to examine numerous matters regarding the State Personnel Management System (SPMS) and terminations and separations of at-will employees. In the fall of 2006, the committee concluded its proceedings and issued a final report including recommendations for changes to SPMS. Implementation of a number of the committee's recommendations will require legislation, while other recommendations can be implemented through regulatory and policy changes.

Background

The Special Committee on State Employee Rights and Protections was established by resolution of the Legislative Policy Committee during the 2005 interim. The 12-member special committee consisted of an equal number of senators and delegates, with 8 members from the Democratic Party and 4 members from the Republican Party. The committee was charged with examining allegations of abuse and illegalities within SPMS with respect to terminations and separations of at-will employees under the current and previous administrations. Over the next year, the committee met and heard presentations from the Department of Legislative Services on the history and structure of SPMS, the number and status of at-will State employees, and the number of separated State employees. Notably, with the assistance of the outside counsel hired by the committee, testimony and sworn statements were received from former State employees and from officials of the current Administration regarding the dismissal of at-will State employees. Each individual who testified before the committee was placed under oath to tell the truth. Where necessary, the committee used its subpoena power with respect to certain witnesses who appeared before it and to secure certain documents from various State agencies.

The committee concluded its work in the fall of 2006 and issued a final report that included several findings, conclusions, and recommendations. A separate "Minority Report" was issued by the Republican members.

Findings and Conclusions

The committee found that in January 2003, the Administration issued a strong directive to change the State workforce, and units of State government were pressured into reviewing all at-will positions with the goal of considering replacing personnel with employees dedicated to carrying out the Administration's policies. In breaking with its traditional role of coordinating appointments to boards and commissions, positions for which political party affiliation are often appropriate, the Governor's Appointments Office was placed in charge of the effort to replace

at-will State employees, and the Governor delegated hiring and firing authority to his Secretary of Appointments. Most significantly, the committee found that separations and terminations of at-will employees under the current Administration occurred that were arbitrary or inconsistent with improving government or, in other cases, illegal because the separations were based on political considerations in violation of employees First Amendment constitutional rights and State law.

The committee further found there were random separations of competent at-will employees for no valid reason and that terminations were carried out in an inconsistent manner. The committee found that, in some instances, employees were unreasonably barred from being considered for other State positions, a practice authorized by the Governor's Appointments Office. Furthermore, some State officials did not know the law with respect to who had the authority to terminate employees or whether political considerations could be used. Finally, the committee concluded that there are ambiguities and inconsistencies in State law regarding protections for employees.

Recommendations

In response to its findings, the committee made the following recommendations:

1. Clarify the law to emphasize that only the lawfully designated appointing authority of a State employee may terminate that employee.

2. Implement management service reforms including providing additional protection to employees in the management service up to a certain grade level, but not to the full extent of protections afforded to skilled or professional service employees; amending the law to provide that personnel actions for management service employees shall be made without regard to the employee's political affiliation, belief, or opinion or *any other_nonmerit factor*; providing that the appointing authority is required to give a terminated management service employee the reason for the termination; and in the appeal process, placing the burden on the employee to prove that the reason was arbitrary, capricious, illegal, or in violation of the employee's constitutional rights.

3. Implement special appointment reforms including clarifying which special appointments are patronage positions and requiring that employees be notified of that status; and amending the law to provide that personnel actions for special appointments must be made without regard to the employee's political affiliation, belief, or opinion unless the Secretary of Budget and Management has determined, pursuant to controlling case law, that the position is a patronage position.

4. Clarify the law so that illegal political terminations include a termination to create a position for a new employee with regard to the new employee's political affiliation, belief, or opinion.

5. Create a private right of action in State court for political firings in violation of State law and Article 40 the Maryland Declaration of Rights that would provide for damages and attorneys' fees and would not require exhaustion of administrative remedies.

6. Provide that State employees should be notified in writing of their classification and the rights pertaining to it when they are hired and if their classification changes.

7. Consider a legislative study of the number of at-will management service employees and the rationale of having entire departments or substantial parts of them designated "at-will."

8. Consider requiring the Department of Budget and Management (DBM) to report to the General Assembly on the designation of positions as special appointments.

9. Clarify the law to state that neither the Governor's Office nor the Governor's Appointments Office may utilize DBM to effectuate separations; and separate the function of the Director of the Office of Personnel Services and Benefits from the appointment activity of the Governor's Office or the Governor's Appointments Office.

10. Consider implementing certain retirement options, including restoration of the pension benefit to at-will employees terminated after 16 years of service for no cause and allowing employees who are terminated without cause to buy additional time in service to qualify for the State's retirement program.

While many of the recommendations require changing the law, other recommendations can be implemented through regulation or by General Assembly direction.

Minority Report

In anticipation of the findings and recommendations by the Special Committee on State Employee Rights and Protections, the committee's four Republican members issued a Minority Report. The Minority Report included a statement of the position of the Republican members that the committee's investigation of the current Administration was unnecessary, expensive, and fruitless. The Minority Report further alleged that the committee's majority and its special counsel demonstrated no interest in a fair and bipartisan review of State personnel management in past and current administrations. The Minority Report concluded that the current Administration neither illegally separated State employees nor dispatched employees to departments and agencies for the purpose of identifying State employees for dismissal because of their political affiliation.

Although the Minority Report was accepted by the committee and is attached to the full committee report, it was neither adopted nor approved by the committee. The committee also clarified that the Minority Report was not the result of a separate examination of the termination of at-will State employees.

Education

Enhancements and Inflation Will Combine to Fuel Largest Aid Increase Yet Under Bridge to Excellence Act

In fiscal 2008, the fifth and final year of Bridge to Excellence implementation, State funding for primary and secondary education is projected to increase by as much as $805 million, easily making it the largest among the record increases that have been realized each year since fiscal 2005. Approximately two-thirds of the projected increase is due to the Bridge to Excellence phase-in and other legislative enhancements, and the remaining one-third is attributable to relatively high inflation levels.

State K-12 Education Funding Could Increase by More Than $800 Million

In fiscal 2008, a combination of factors will result in an increase in State education aid that could be as high as $805 million. The projected jump in education funding is generated by the final year of scheduled formula enhancements under the Bridge to Excellence in Public Schools Act of 2002 (Bridge to Excellence), other funding enhancements enacted in recent years, and higher-than-expected inflation. If the full increase is realized, it would bring State aid for primary and secondary education to $5.3 billion in fiscal 2008, 18.0 percent higher than the fiscal 2007 funding level of $4.5 billion.

Although the majority of the projected funding increases are mandatory, discretionary aid enhancements totaling approximately $100 million, primarily the geographic cost of education index (GCEI), provide some flexibility in the budgeting process. Still, eliminating new funding for discretionary programs would not prevent fiscal 2008 from joining each of the last three years in providing progressively larger increases in aid. Beginning with a record $323 million boost in fiscal 2005 and followed by increases of $385 million in fiscal 2006 and $466 million in fiscal 2007, fiscal 2008 will be the fourth consecutive year of record increases in State education aid.

Increases Are Spread Across Many State Aid Programs

As shown in **Exhibit 1**, the largest funding increase, nearly $304 million, is scheduled for the foundation program, followed by a $172 million increase for the compensatory education formula. Although the foundation program accounts for more than half of State education aid, the special education, compensatory education, limited English proficiency, and guaranteed tax base formulas are all projected to grow by significantly larger percentages than the foundation program in the upcoming fiscal year. Collectively, the funding for these four programs is expected to increase by $278 million, or 25.0 percent, compared to a 12.2 percent increase in foundation aid. The high-growth programs reflect the emphasis in the Bridge to Excellence Act

on targeting funds to jurisdictions with low wealth and high concentrations of students at risk for experiencing difficulty meeting State performance standards.

Exhibit 1
Estimated State Aid for Education
Fiscal 2008
($ in Millions)

Program	FY 2007	FY 2008	Dollar Change	Percent Change	Percent of FY 2008
Foundation Program	$2,493.2	$2,796.8	$303.6	12.2%	52.9%
Cost of Education Index	0.0	95.7	95.7	--	1.8
Compensatory Education	726.7	898.9	172.2	23.7	17.0
Special Education Formula	231.8	285.6	53.8	23.2	5.4
Limited English Proficiency	88.8	117.9	29.1	32.8	2.2
Guaranteed Tax Base	60.5	82.9	22.4	37.0	1.6
Student Transportation	202.1	219.5	17.4	8.6	4.2
Extended Elementary Ed.	19.3	0.0	(19.3)	(100.0)	0.0
Bridge to Excellence Subtotal	**$3,822.4**	**$4,497.3**	**$674.9**	**17.7%**	**85.1%**
Teachers' Retirement	446.1	566.4	120.3	27.0%	10.7%
Nonpublic Special Education	116.5	124.0	7.5	6.4	2.3
Other Programs	94.5	96.9	2.4	2.5	1.8
Total	**$4,479.5**	**$5,284.6**	**$805.1**	**18.0%**	**100.0%**

Source: Department of Legislative Services

While most Bridge to Excellence funding has increased during the five-year phase-in, categorical funding for the extended elementary education program will be deleted in fiscal 2008. With the goal of providing more State funding through large, flexible block grants, the Bridge to Excellence Act eliminated approximately 25 smaller categorical programs. The Act retained the extended elementary education program for a number of years to ease the transition to the new funding structure, but the program will be folded into the compensatory education formula in fiscal 2008.

Due in part to the State Employees' and Teachers' Retirement Enhancement Benefit Act of 2006 (Chapter 110 of 2006), teachers' retirement payments are expected to increase from $446 million in fiscal 2007 to $566 million in fiscal 2008. The 27.0 percent increase in scheduled retirement costs in fiscal 2008 is significantly higher than the 9.6 percent growth incurred in fiscal 2007.

In total, direct aid to local boards of education, which includes all aid except teachers' retirement payments made on behalf of the local boards, comprises $685 million of the projected $805 million increase in State education funding, bringing total direct aid to $4.7 billion in fiscal 2008. This total represents a 17.0 percent increase over the $4.0 billion provided in fiscal 2007 and follows a 10.9 percent increase in fiscal 2007. Most direct aid comes from the Bridge to Excellence formulas, which are expected to account for 85.1 percent of total State education aid and 95.3 percent of direct aid in fiscal 2008. This pattern will continue in future fiscal years, even after the Bridge to Excellence formulas reach full funding. Although annual aid increases will be determined by inflation and enrollment changes rather than escalations in funding formula variables, the finance structure established by the Bridge to Excellence does not expire.

Record Increase Due to a Combination of Enhancements and Inflation

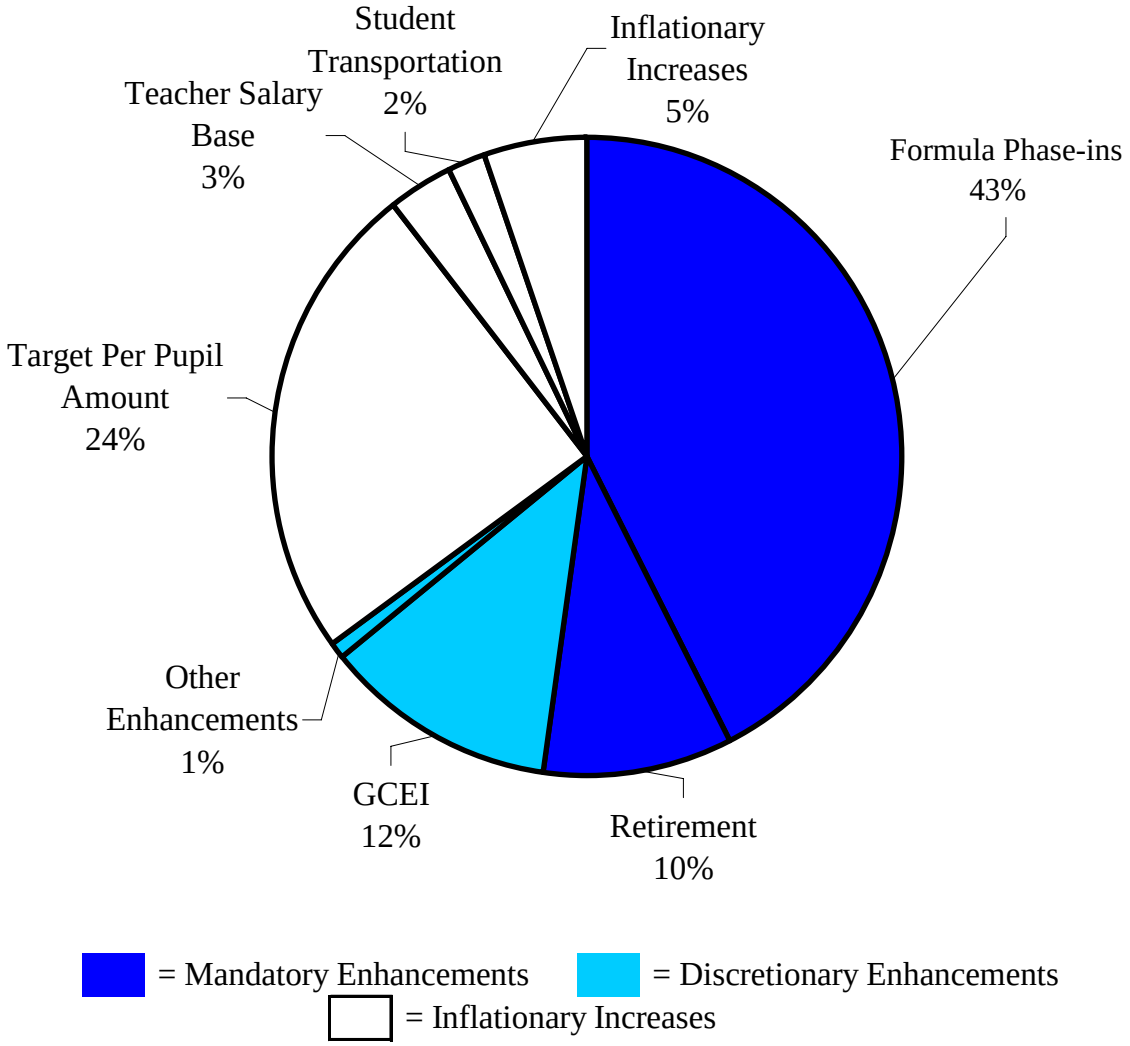
Although it is larger than expected, the growth in State aid is not entirely surprising. Fiscal 2008 is the final year of implementation for the Bridge to Excellence Act, and a significant portion of the increase, approximately $343 million (43 percent), is attributable directly to the final year of the phase-in of the new school finance structure. In addition to the mandated Bridge to Excellence programs, the GCEI will add another $96 million to the baseline estimate if it is funded at the statutory formula level in fiscal 2008. The Bridge to Excellence legislation envisioned the GCEI as one component of the larger funding structure, but unlike other formulas, it is discretionary and has not yet been funded. Finally, legislative enhancements passed at the 2006 session result in an increase of approximately $85 million, most of which ($78 million) is attributable to the teachers' retirement enhancement. **Exhibit 2** shows that, in total, enhancements will add $524 million to public school funding in fiscal 2008, accounting for approximately two-thirds of the full $805 million increase. All but $100 million of the enhancements are mandated and must be included in the fiscal 2008 State budget that will be submitted by the Governor.

The remaining $281 million increase projected for fiscal 2008 is due to inflation-related growth. Although inflation in the transportation sector yields a substantial increase in the student transportation formula ($14 million) and a higher teacher salary base results in greater retirement payments ($28 million), most of the inflation-related increase ($173 million) is due to a 5.7 percent increase in the target per pupil amount that is used to determine State aid amounts under several of the funding formulas.

As required by the Bridge to Excellence Act, the target per pupil amount is adjusted annually to reflect the change in the implicit price deflator for State and local government purchases, a government inflation measure published by the Bureau of Economic Analysis. **Exhibit 3** shows that the annual change in the implicit price deflator, as used to calculate the target funding level, has increased each year during Bridge to Excellence implementation, from less than 2 percent in fiscal 2004 to nearly 6 percent in fiscal 2008. At the same time, the actual per pupil funding level used in the formulas has been phasing up each year in order to reach the

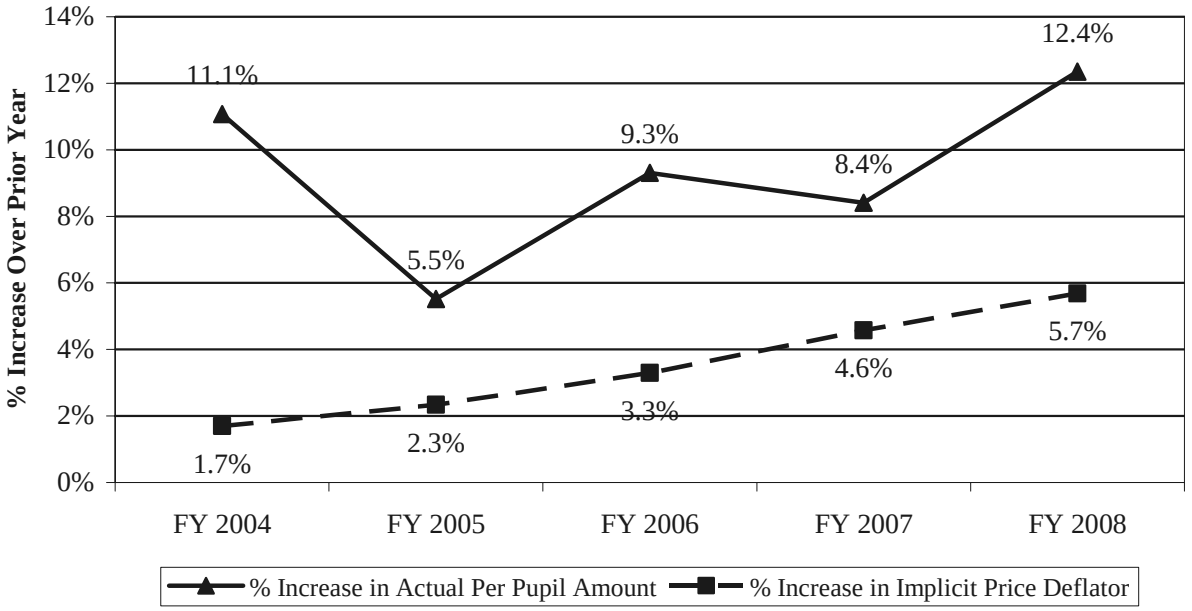
target funding level by the end of the implementation period. Thus, the annual per pupil amount is impacted by both inflation and the phase-in schedule. The combination of higher inflation and the phase-in to 100 percent of the target funding level will increase the per pupil amount by more than $700 in fiscal 2008, to nearly $6,700. This represents growth of 12.4 percent, the largest one-year increase experienced during the five-year implementation process.

Exhibit 2
Components of the Fiscal 2008 Education Aid Increase



Source: Department of Legislative Services

Exhibit 3
Annual Increases in Per Pupil Amount and Inflation
Fiscal 2004 to 2008



	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Annual Per Pupil Amount	$4,291	$4,766	$5,029	$5,497	$5,959	$6,695

Source: Department of Legislative Services

Education

The Challenge of No Child Left Behind

Although Maryland seems to be well ahead of many states in implementing the federal No Child Left Behind Act, parts of the State continue to struggle with meeting the law's ambitious goals. Statewide, student test results are improving, but 234 schools and 2 school systems are on the State's watch list due to persistently low assessment scores. All Maryland school systems are working toward the goal of providing a full complement of highly qualified teachers, but some are experiencing more success than others.

The federal No Child Left Behind Act (NCLB) remains one of the driving forces behind Maryland's educational policy. NCLB requires all states to set academic performance standards, measure students' progress towards meeting the standards, and have 100 percent of students at proficiency by the 2013-2014 school year. In addition, as one of the most significant components of student success, all teachers in core academic subjects must be "highly qualified" under NCLB's definition. Although Maryland continues to be singled out for its strong efforts in implementing NCLB, attainment of the law's goals has been elusive for some local school systems.

Achieving Adequate Yearly Progress Under No Child Left Behind

NCLB establishes a goal of having 100 percent of students reach proficiency in reading and mathematics by the 2013-2014 school year. Each state determines the proficiency standards it will use for its students and establishes intermediate performance targets for each school year prior to 2014. Students must be assessed annually in grades three through eight and again in high school, and performance data must be disaggregated into eight subgroups of students: African American; American Indian; Asian/Pacific Islander; Hispanic; White; special education; free and reduced price meals (FARM); and limited English proficient (LEP).

The Maryland School Assessments (MSAs) are used to measure the performance of students in grades three through eight, and the High School Assessments (HSAs) are used for high school students. Combining scores on the MSAs with attendance rates and scores on the HSAs with graduation rates determines whether a school, a school system, and the State as a whole make adequate yearly progress (AYP) towards 100 percent proficiency. In June 2006, Maryland was one of only two states to have its assessment system fully approved by the U.S. Department of Education (USDE).

2006 Assessment Results Continue Annual Improvement Trend

The 2006 MSA results for students in grades three through eight are shown in **Exhibit 1**. Since the testing began in 2003 (2004 for fourth, sixth, and seventh grades), both reading and math scores have shown yearly improvement. The most marked improvement has occurred in third grade reading proficiency levels, which have jumped 20 percentage points, with a similar increase in fifth

grade math scores. Since the implementation of the MSAs, proficiency rates in the higher grades have lagged behind those in the lower grades, with the discrepancy most pronounced in eighth-grade math scores, which are still 27 percentage points lower than fourth-grade scores. Students in several subgroups continue to perform below their peers, but gains have been made in closing the proficiency gap, most notably for special education, LEP, and FARM students in the lower grades.

Exhibit 1
Maryland School Assessment Results
Percentage of Students Demonstrating Proficiency
2003 to 2006

	Reading				Math			
Grade	**2003**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Three	58.1%	71.0%	75.8%	78.3%	65.1%	72.2%	76.8%	79.1%
Four		75.1	81.0	81.8		69.6	76.5	82.1
Five	65.7	68.4	74.3	76.6	55.0	63.1	69.2	73.4
Six		68.3	70.3	71.9		50.3	60.2	65.6
Seven		67.0	67.2	71.1		49.8	55.4	60.1
Eight	59.9	63.8	66.4	67.0	39.7	45.8	51.7	55.0

Source: Maryland State Department of Education

In addition to MSA results for grades three through eight, HSA scores in English and algebra count toward the achievement of AYP. The English 2 test, which replaced the grade 10 MSA reading test, has been administered for just two years, and 60.1 percent of high school students taking the test demonstrated proficiency in 2006, a marginal increase over 2005. The Algebra/Data Analysis test administered in 2006 has replaced the geometry HSA as the measure of high school math performance. A total of 66.6 percent of students who took the test in 2006 demonstrated the necessary proficiency, up from 53.8 percent the previous year. Beginning in 2009, HSAs take on new importance because Maryland high school students will be required to pass HSAs in English, algebra, biology, and government, or receive a minimum aggregate score on the tests, in order to graduate.

Failure to Meet AYP and Assignment to School Improvement Status

The Maryland State Department of Education (MSDE) determines annually whether schools and school systems make AYP based on MSA and HSA scores, as well as attendance and graduation rates. If schools fail to achieve AYP for two consecutive years, they are assigned to school improvement. Continued failure to meet AYP targets moves schools and school systems through a progression of steps that ultimately includes corrective action and restructuring. Schools move out of improvement status when they meet AYP targets for two consecutive years.

Final 2006 AYP results indicate that 312 schools, 23 percent of all schools in Maryland, did not achieve AYP in 2006, roughly the same number that did not make AYP in 2005. As **Exhibit 2** shows, MSDE has placed 234 schools in school improvement status because they failed to meet AYP for at least two consecutive years. These schools are located in 14 counties across the State and represent 17.4 percent of the State's schools. Close to three-quarters of the schools in improvement are located in Baltimore City and Prince George's County, with almost half the schools in both of the systems (46.6 percent in Baltimore City and 44.6 percent in Prince George's County) in school improvement status. Although it is a much smaller school system, 45.5 percent of Dorchester County schools are in improvement. Of the 73 schools in restructuring, the final and most severe phase of school improvement, 58 are located in Baltimore City. Across the State, a lower percentage of elementary schools are in school improvement (10 percent) than middle and high schools (29 and 28 percent, respectively).

Exhibit 2

Schools in Improvement Status 2006-2007 School Year

County	Year 1 or Year 2	Corrective Action	Restructure	Schools in Improvement	Total # Schools	% of Schools in Improvement
Allegany	1			1	22	4.5%
Anne Arundel	8	1		9	118	7.6
Baltimore City	17	15	58	90	193	46.6
Baltimore	7	5	1	13	158	8.2
Caroline	1			1	9	11.1
Dorchester	4	1		5	11	45.5
Frederick			1	1	59	1.7
Harford	2	2		4	51	7.8
Kent	2			2	8	25.0
Montgomery	17	1		18	195	9.2
Prince George's	39	30	13	82	184	44.6
St. Mary's	2	1		3	23	13.0
Somerset	2			2	9	22.2
Wicomico	3			3	24	12.5
State Total*	**105**	**56**	**73**	**234**	**1,347**	**17.4%**

*State total number of schools includes 283 schools from the 10 school systems with no schools in improvement.

Source: Maryland State Department of Education

In addition to individual schools in improvement, the Baltimore City and Prince George's County school systems are designated as in improvement status based on their assessment results. In November 2006, the State Board of Education voted to place the Prince George's County school system in corrective action, although no additional corrective actions were recommended pending the State board's review of the system's Master Plan Update in December. The Baltimore City Public School System remains in corrective action status for another year while addressing six corrective actions that have been assigned by the State board. With the exit of the seven school systems that were in Year 1 of System Improvement in the 2005-2006 school year, no other school systems are in any stage of improvement in 2006-2007.

Providing a Highly Qualified Teacher in Every Classroom

NCLB requires all teachers in core academic subjects to be "highly qualified" by the end of the 2005-2006 school year. Core academic subjects include English, reading or language arts, mathematics, science, foreign languages, civics and government, economics, arts, history, and geography. To meet the highly qualified standard, a teacher must have at least a bachelor's degree, hold a license to teach in the State, and must have obtained full State certification or passed the State teacher licensing examination. In addition, a teacher must have expertise in each subject the teacher is assigned to teach. Veteran teachers may be deemed "highly qualified" without passing a State licensing exam if they can demonstrate competency in core academic areas.

No state met the goal of providing a highly qualified teacher in every classroom by the end of the 2005-2006 school year, the deadline established by NCLB. In October 2005, in response to concerns expressed by many states about the consequences of missing the deadline, USDE announced a one-year extension for states that demonstrated a "good faith effort" to meet the highly qualified teacher requirement. States requesting an extension submitted revised plans for accomplishing the goal by the end of the 2006-2007 school year, with special attention paid to placing highly qualified teachers in schools with high concentrations of disadvantaged students. In August 2006, USDE granted Maryland a one-year extension, accepting its Revised State Plan as one of nine model plans.

As of June 2006, 20.6 percent of classes in Maryland were still taught by teachers who were not highly qualified. This represents a significant improvement from the 2004 level of 33.1 percent and a moderate decrease from the 2005 level of 24.7 percent. **Exhibit 3** shows that no school system had fully met the goal, but the percentage of classes not taught by teachers meeting the highly qualified standard was less than 10 percent in four counties: Allegany, Garrett, St. Mary's, and Talbot. Furthermore, improvements were made in the 2005-2006 school year in all counties except Somerset and Wicomico. Still, more than half of the classes in Baltimore City (53.2 percent), more than a third of classes in Prince George's County (37.9 percent), and roughly one-third of the classes in Dorchester (33.1 percent) and Somerset (31.0 percent) counties were not taught by highly qualified teachers.

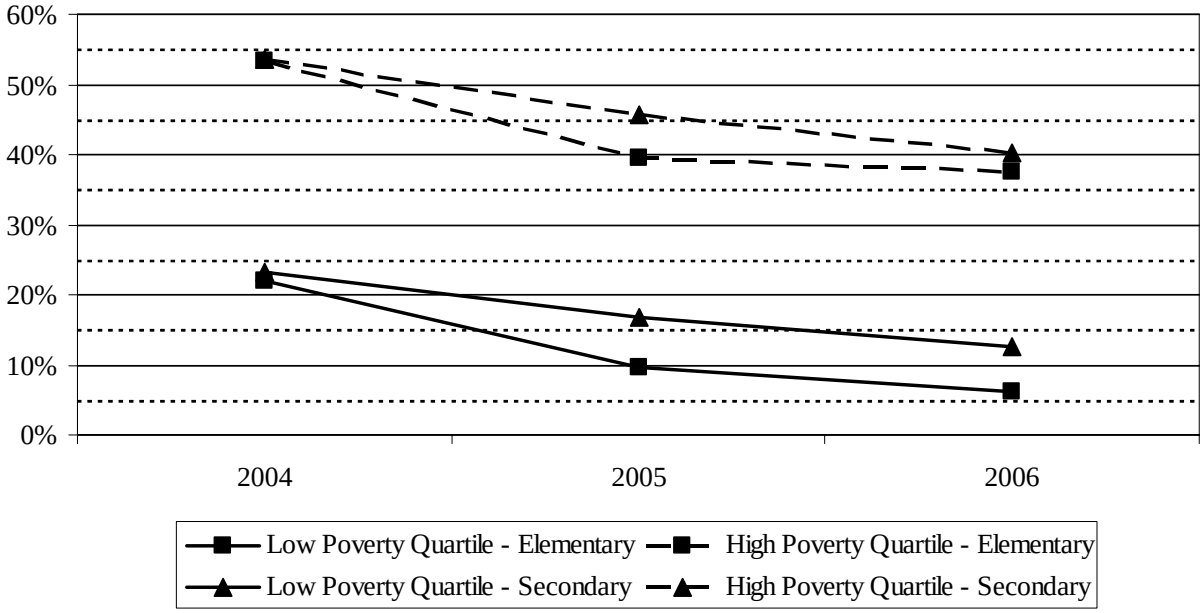
Exhibit 3
Percentage of Classes *Not* Taught by Highly Qualified Teachers

School System	2005	2006	School System	2005	2006
Allegany	6.4%	2.8%	Harford	11.1%	10.7%
Anne Arundel	16.0	15.5	Howard	15.8	11.0
Baltimore City	57.9	53.2	Kent	24.9	17.1
Baltimore	22.3	16.5	Montgomery	19.7	14.5
Calvert	14.5	13.0	Prince George's	38.0	37.9
Caroline	13.0	10.5	Queen Anne's	18.9	15.3
Carroll	14.4	10.8	St. Mary's	10.4	6.7
Cecil	13.1	10.5	Somerset	24.2	31.0
Charles	40.8	27.0	Talbot	12.2	8.1
Dorchester	43.5	33.1	Washington	15.6	10.9
Frederick	13.6	10.7	Wicomico	19.5	25.5
Garrett	9.9	6.7	Worcester	13.8	10.8
			State	**24.7**	**20.6**

Source: Maryland State Department of Education

As a further indication of ongoing problems in some areas of the State, **Exhibit 4** illustrates the continuing gap in the percentage of highly qualified teachers in high-poverty and low-poverty classrooms. Although the percentage of classes not taught by highly qualified teachers has decreased in both high- and low-poverty areas, a significantly higher proportion of classes not taught by highly qualified teachers has persisted in high-poverty schools from 2004 to 2006 at both the elementary and secondary school levels. In elementary schools, the 31.5 percentage point difference in classes not taught by highly qualified teachers has remained constant. A similar gap, 27.8 percentage points, exists in secondary schools, and only a small reduction in the difference has been achieved over the last two years.

Exhibit 4
Percentage of Classes *Not* Taught by Highly Qualified Teachers
2004 to 2006



Source: Maryland State Department of Education

Education

Baltimore City Public School System Takes Action to Improve Ailing Schools

Although the General Assembly blocked the State Board of Education's plan to take control of 11 Baltimore City schools, other corrective actions are being implemented in the schools in the 2006-2007 school year. The next steps for the schools, after the moratorium on State board action against the schools ends on May 30, 2007, are unclear. Meanwhile, the contract for the operation of three Baltimore City schools taken over by the State in 2000 will end in 2007, and special education services in the city continue under federal court supervision.

Moratorium on the State Takeover of 11 Baltimore City Schools

In March 2006, the Maryland State Board of Education (State board) voted to require significant changes to the governance and structures of seven middle schools in Baltimore City and to have a third party manage four high schools in the city under the direction of the State board. The takeovers were proposed by the State board in accordance with State regulations and the federal No Child Left Behind Act (NCLB) and were believed to be the first attempt at a state takeover under NCLB. The State board proposed the takeovers because State regulations and NCLB require increasingly severe interventions for schools and school systems that do not meet State academic standards. For several consecutive years, the seven middle schools and four high schools posted very low test scores.

Partly out of concern with the process that had been followed with the proposed takeover and the lack of communication between the Maryland State Department of Education (MSDE) and the Baltimore City Public School System (BCPSS), the General Assembly passed House Bill 1215 (Chapter 59) in the 2006 session that places a one-year moratorium on State-imposed school restructuring in Baltimore City. Specifically, the State board and the State Superintendent of Schools are prohibited from imposing a major restructuring of the governance structure of a Baltimore City public school or removing a public school from the direct control of the Baltimore City Board of School Commissioners. The prohibition terminates May 30, 2007.

State Board Directives to BCPSS and Implementation by BCPSS

While the State takeover was the subject of the statutory moratorium, the March 2006 State board action also included several directives to BCPSS that were not governed by the moratorium; therefore, BCPSS was required to comply with the directives. BCPSS requested certain modifications to the initial requirements, and the State board and BCPSS subsequently agreed upon a modified set of directives.

The directives fell into two categories: Master Plan and Corrective Action. The State board directed BCPSS to submit a new Master Plan for school years 2006-2007 and 2007-2008 by October 16, 2006. BCPSS met the deadline for submission, and the State board will vote on

the Master Plan at its December 2006 meeting. The directives also included five areas of Corrective Action. **Exhibit 1** details the required corrective actions and BCPSS efforts to implement the actions.

Exhibit 1
Corrective Action Mandated by the State Board and Implementation by BCPSS

Corrective Action	BCPSS Implementation
I. Instruction	
Adopt new middle and high school curricula in specified subjects	Adopted curricula from Anne Arundel, Cecil, and Carroll counties
Hire an independent evaluator to monitor the implementation of the Master Plan	BCPSS will present its procurement plan for hiring an independent evaluator to the State board at December 2006 meeting
II. Leadership	
Evaluate and, as necessary, replace area academic officers (AAOs) relevant to the failure to make adequate yearly progress (AYP)	Four AAOs were replaced, four AAOs were retained, one new AAO position was created to oversee the area with 12 of the lowest performing elementary schools
AAOs to work with MSDE to customize leadership program	BCPSS is working with MSDE
III. School Safety	
Develop training for school staff to improve school safety	Working with Johns Hopkins University to develop a comprehensive safety plan
Identify students who exhibit chronic, severe, and escalating misbehavior and implement case management	Case management process is being formalized through training and monitoring
IV. Low Performing Schools Management Structure	
Hire two full-time specialists in school improvement	MSDE deferred to BCPSS on this issue; BCPSS had already hired a Director of School Improvement and has established the Office of School Improvement
V. High School Graduation and Student Support	
Develop student support plans for students at-risk of failing High School Assessments	Selected individual learning plans for grades 7, 9, and 10 and Student Support Deans placed in 28 schools

Source: Maryland State Department of Education and Baltimore City Public Schools

Additionally, BCPSS has taken other steps to address the needs of the 11 targeted schools, including:

- new principals in four of the middle schools and three of the high schools;
- detailed restructuring plans for the four high schools that will be submitted to the interim Chief Executive Officer of BCPSS by November 10, 2006;
- quarterly assessments of student learning in reading/language arts and mathematics to track middle school student progress;
- quarterly assessments of student learning in High School Assessment areas;
- additional teachers to support students struggling in reading/language arts, mathematics, or English;
- additional guidance counselors targeted to seventh grade at-risk students in each school;
- Saturday school tutorial services for students at risk in middle schools;
- an expansion of the FUTURES mentoring program (drop-out intervention) in each high school; and
- "wrap around" city services provided at each school such as health suites; asthma intervention; school based mental health; regularly scheduled visits to schools by the Department of Social Services eligibility team to allow families to sign up for medical assistance and food stamps; and human services worker assigned to each school to allow families to sign up for energy assistance, emergency housing, and child care assistance.

State Regulations Unclear for Schools That Are Unsuccessful in Restructuring

Although the State takeover of the 11 schools was met with some criticism, the State board was acting within its authority. In Maryland, regulations adopted by the State board govern the processes that are used to identify schools as they progress through the school improvement categories required by NCLB. Once a school is identified for restructuring, the final stage in the progression, the local school system must develop a plan for an alternative governance structure at the school. The plan must be approved by the State board and must be implemented at the beginning of the next school year. However, the regulations do not address steps that may be taken when a school in restructuring implementation continues to perform below State standards.

With the exception of Chinquapin Middle School, all of the schools targeted for State takeover had been in restructuring implementation for two years or more without showing

substantial improvement, leaving open the question of how to proceed with the schools. The State board's takeover of the 11 schools utilized several corrective actions outlined in the regulations that may be taken under a restructuring school's alternative governance structure, including reopening the school as a public charter school and entering into a contract with an entity to operate the school. The moratorium on State board action against the schools ends on May 30, 2007, but the next steps for the schools, whether they involve State intervention or not, are not clearly defined.

Edison Schools Contract Approaching Expiration

In 2000, the State board placed three Baltimore City elementary schools, Furman L. Templeton, Montebello, and Gilmor, under State reconstitution because the schools were among the lowest performing elementary schools in Baltimore City. MSDE signed a contract with Edison Schools, Inc. (Edison), a national for-profit company that provides educational services, to operate the three schools beginning on July 1, 2000. The original contract was for five years, and MSDE exercised its one-time option to renew the contract for two additional years. The 2006-2007 school year is the seventh and final year of the contract between MSDE and Edison.

Two of the three Edison schools, Furman L. Templeton and Montebello, have made enough progress to exit the school improvement program. MSDE's authority to require an alternative governance structure for a school only extends to a school in improvement; therefore, when the Edison contract expires in June 2007, MSDE does not have the authority to enter into another contract with Edison to operate Furman L. Templeton and Montebello, and the responsibility for the operation of these schools will return to BCPSS.

The third Edison school, Gilmor, has not made as much progress as the other two schools. MSDE has the authority, therefore, to enter into a contract with an entity to operate Gilmor after the Edison contract expires in June 2007. However, two issues have arisen that could make MSDE less likely to contract with Edison. First, although Montebello and Furman L. Templeton made adequate yearly progress for two consecutive years and are no longer in the school improvement program, all three Edison schools showed a significant drop in test scores in the 2005-2006 school year. Second, the enactment of the public charter school law in 2003 presents the State board with the option to reopen Gilmor as a public charter school. The public charter school law requires a charter school to be operated by a nonprofit entity. If Gilmor becomes a charter school, Edison is likely to be ineligible to operate Gilmor because of its for-profit status.

Special Education Service Delivery Continues Under Court Supervision

Since 1988, special education services in Baltimore City have been subject to court oversight under a consent decree issued by the U.S. District Court for Maryland (*Vaughn, G., et al. v. Mayor and City Council of Baltimore, et al.*). Over the years, BCPSS has failed to comply with federal law and District Court orders, a situation that eventually led to the appointment of a Special Master to monitor special education services in BCPSS and, more recently, a request from the District Court judge for additional intervention.

In August 2005, after soliciting proposals from parties in the lawsuit, Judge Garbis ordered implementation of an Intensive Management and Capacity Improvement Team (IMCIT) plan recommended by MSDE. The plan assigns MSDE personnel to manage and direct BCPSS personnel in areas such as instruction and student accountability, transportation, personnel, student services and guidance, parent complaint, and information technology, as they relate to the delivery of special education services. MSDE has "borrowed" professionals with expertise in these areas from other Maryland school systems to work on the IMCIT with personnel. Although MSDE reports that there have been some successes, the IMCIT has had minimal success in areas such as guidance, parent complaint, and information technology due to the lack of a specific BCPSS counterpart, logistical obstacles, and bureaucratic hurdles with procurements and other services.

One of the main problems cited by Judge Garbis in August 2005 was the interruption of special education services, and he ordered more than 90,000 hours of related special education services (for example, speech-language pathology, occupational therapy, physical therapy, psychological, and social work services) to be recovered during the 2005-2006 school year. As of October 2006, more than 31,000 of these hours still had not been recovered. In addition, MSDE reports that special education services at BCPSS were again interrupted during the 2005-2006 school year.

Education

State on Track to Exceed Annual Funding Goal for Public School Construction Again in Fiscal 2008

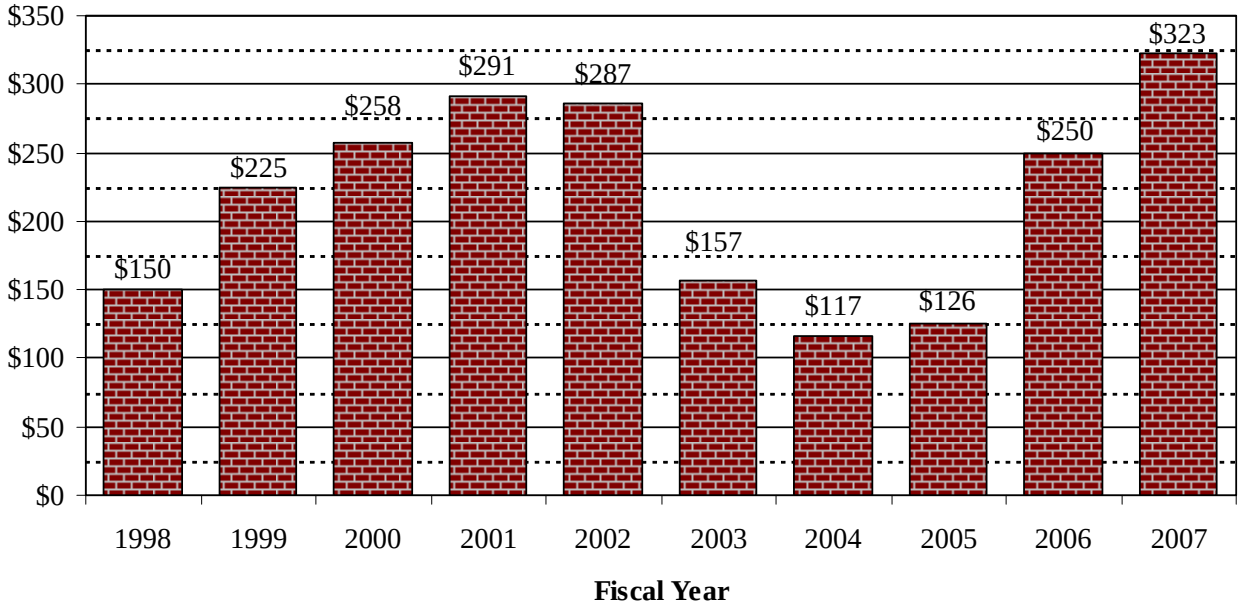
Public school construction has received significant attention following a 2004 task force report that identified $3.85 billion in school facility needs – requiring the State to provide $250 million annually for eight years to meet its share of the costs. The State met the goal in fiscal 2006 and exceeded the goal in fiscal 2007, providing a record high of $323 million. Preliminary estimates for school construction funding show the State achieving the fiscal 2007 level again in fiscal 2008. Another public school facility survey will begin in fiscal 2008, which will provide a new estimate of school facility needs.

Record High Provided in Fiscal 2007

The General Assembly provided $322.7 million for public school construction in fiscal 2007, a record high since the program began in 1970. Fiscal 2007 marks the second consecutive year the General Assembly has met the goal of the Public School Facilities Act of 2004 (Chapters 306 and 307) to provide at least $250 million annually for school construction. The $323 million total was provided primarily through State general obligation bonds; a premium received from the State bond sale totaling $16 million also supplemented the funding. The General Assembly has taken action in the capital budget to increase funding for school construction, most recently adding $79 million in fiscal 2006 (allowing the $250 million goal to be achieved) and $42 million in fiscal 2007. **Exhibit 1** shows the up-and-down cycles that school construction funding has experienced since fiscal 1998.

The Public School Facilities Act established a State goal to fully fund school construction projects by fiscal 2013 to meet all minimum required standards. The Act was a response to the November 2003 survey results of the Task Force to Study Public School Facilities, chaired by State Treasurer Nancy Kopp. The task force concluded that many Maryland public schools were deficient in some capacity and that the cost to bring schools up to standard would be $3.85 billion. Through the Act, the State would provide $2 billion of the $3.85 billion over the next eight years, with the remaining balance funded by local governments. In 2004, the State had committed to $800 million ($100 million annually) in the State's *Capital Improvement Program* (CIP), leaving a $1.2 billion shortfall. Increasing the authorization by $150 million annually ($250 million total) for eight years would allow the State to meet the goal.

Exhibit 1
State Funding for Public School Construction
($ in Millions)



Source: Department of Legislative Services; Public School Construction Program

Exceeding $250 Million Goal in Fiscal 2008 Likely

The Act also required the Capital Debt Affordability Committee (CDAC) to make an annual recommendation for school construction funding. In September, the CDAC recommended increasing the State's debt limit by $100 million more than the planned increase beginning in fiscal 2008, and the Governor indicated that the additional debt would be allocated to school construction. The State's fiscal 2007 CIP projected $150 million for school construction in fiscal 2008 to 2011. The additional $100 million would bring the annual amount to $250 million. State law requires the Governor to provide a preliminary estimate of capital funding available for school construction in the upcoming fiscal year by October 15. This year, Governor Robert L. Ehrlich, Jr. announced that $338 million would be provided for school construction in fiscal 2008. The $338 million includes approximately $15 million for the Aging Schools Program. Assuming $15 million will be allocated to Aging Schools, the $323 million available for school construction is equal to the fiscal 2007 amount.

The Governor-elect will prepare the State's fiscal 2008 CIP. The Governor can increase (or decrease) the amount of school construction funds provided in the capital budget from the preliminary estimate. However, under capital budget language adopted in fiscal 2006 and 2007 by the General Assembly and further changes to State law made in 2006, the Board of Public Works (BPW) cannot allocate more than 75 percent of the Governor's preliminary amount before May

2007, after the legislative session concludes. Since fiscal 2006, the General Assembly has set the total school construction allocation for each county in the capital budget. The Interagency Committee on School Construction (IAC), which is responsible for reviewing proposed school construction projects and making recommendations for allocations to BPW, then allocates the funds to eligible projects within each county based on local priorities. The General Assembly has made the IAC, rather than the BPW, solely responsible for allocating the funds in May since fiscal 2006.

The IAC met on November 9, 2006, to consider preliminary recommendations for fiscal 2008 school construction projects. For fiscal 2008, the counties have requested a total of $889 million for 422 projects, slightly more than requested in fiscal 2007. **Exhibit 2** shows the fiscal 2008 request and, for comparison, the amount received in fiscal 2007 by each county. Most of the requested projects, 80 percent, are major construction; of these projects about 50 percent are for new or replacement facilities, and the other half are for renovations. The IAC will hear county appeals and make final recommendations for allocating $242 million (75 percent of the $323 million preliminary amount) on December 5, 2006. BPW is scheduled to meet on January 24, 2007, to consider the IAC's recommendations, hear county appeals for projects not recommended by the IAC, and approve the initial allocations for fiscal 2008. The remaining $81 million (25 percent of the preliminary amount) and any additional funds available through the capital budget or contingency fund for fiscal 2008 will be allocated after May 1, 2007.

The IAC is comprised of five members, including two public members added by the General Assembly in 2005; the five members are the State Superintendent of Schools, the Secretary of Planning, the Secretary of General Services, Frederick Puddester (appointed by the Speaker of the House of Delegates) and Timothy Maloney (appointed by the Senate President).

School Facilities to Be Surveyed Every Four Years

The Public School Facilities Act required the Maryland State Department of Education (MSDE) to conduct a facility survey similar to the 2003 survey every four years. MSDE has proposed regulations that would require the local school systems to survey one-half of their public school buildings every two years beginning in 2007. The Act also required the State to provide the necessary funds to conduct the survey. MSDE's fiscal 2008 budget request includes $2.7 million to provide as grants to local school systems to conduct the survey. The Department of Legislative Services has estimated that the cost of the survey could be about half of the amount MSDE has requested.

The survey will provide a new estimate for the statewide figure of $3.85 billion in school facility needs, which was based on July 2004 dollars (for projects funded in fiscal 2005). As with other capital projects in the State, building costs have gone up significantly in the last few years. In response to rising costs, the Public School Construction Program has increased the allowable cost per square foot for building from $140.00 for fiscal 2005 to $215.00 for fiscal 2008, a 54 percent increase over the period. (The allowable cost increased 21 percent from fiscal 2006 to 2007 alone and 13 percent from fiscal 2007 to 2008.) As a result, projects are more expensive, and fewer (or smaller) projects can be completed with the same amount of funds.

Exhibit 2
State Public School Construction Funding
($ in Thousands)

County	FY 2007 Allocation	FY 2008 Request[1]
Allegany	$18,650	$0
Anne Arundel	22,675	57,299
Baltimore City	39,436	150,545
Baltimore	35,053	95,020
Calvert	2,723	20,137
Caroline	2,935	2,605
Carroll	8,282	23,246
Cecil	8,271	14,033
Charles	10,200	32,949
Dorchester	872	9,370
Frederick	17,942	37,530
Garrett	1,235	8,794
Harford	11,096	58,768
Howard	17,808	53,194
Kent	3,479	1,087
Montgomery	40,040	135,519
Prince George's	37,425	110,964
Queen Anne's	3,000	8,196
St. Mary's	5,495	13,493
Somerset	12,022	5,511
Talbot	2,405	2,409
Washington	4,478	20,284
Wicomico	4,178	14,259
Worcester	6,872	13,579
Bond Premium[2]	6,100	
Total	**$322,672**	**$888,791**

[1]Reflects county requests submitted to the IAC as of November 9, 2006, and could be adjusted by December 1, 2006, as amendments are submitted by the counties. In addition, not all projects requested are determined to be eligible for State funding.

[2]The General Assembly authorized $16 million in fiscal 2007 bond premium funds to replace $6.1 million of previously allocated funds that were improperly allocated to other jurisdictions by the IAC, and for the following new projects shown in the county allocation: $8.4 million was allocated to Allegany County to complete funding for the new high school project; and $1.5 million was allocated to Somerset County for Tawes Intermediate School.

Source: Public School Construction Program, Department of Legislative Services

Education

Charter Schools Continue to Open Despite Funding Questions

With 23 public charter schools now operating in Maryland and 20 to 25 additional applications under review by local boards of education, charter schools are becoming part of the educational landscape in Maryland. While start-up federal funding is expected to be available for at least another year, litigation regarding operating funding for charter schools continues and facilities for charter schools remain a struggle for some applicants.

Since the passage of the Maryland Public Charter School Act of 2003, 22 newly chartered schools have opened in the State. Of the new schools, 16 are located in Baltimore City, 2 are located in Anne Arundel County, 1 is located in Harford County, and 3 are located in Prince George's County. One additional charter school, Monocacy Valley Montessori Charter School in Frederick County, predates the 2003 Act. The Maryland State Department of Education (MSDE) reports that as of November 2006, between 20 and 25 charter school applications are pending review by local boards of education, and at least three charter schools (one each in Baltimore City, Prince George's County, and St. Mary's County) are expected to open in 2007. The majority of the charter schools that have opened in the State either serve, or intend to serve once they are fully operational, students in kindergarten through grade eight.

The Maryland Public Charter School Program

The Maryland public charter school law enables public school staff, parents of public school students, nonsectarian nonprofit entities, and nonsectarian institutions of higher education to apply to establish a public charter school. The schools must be nonsectarian and open to all students in the local school system on a space-available basis. The professional staff of a charter school must hold appropriate certification, and they have the same rights as other public school employees with respect to employee organizations. Charter schools must comply with the laws, regulations, and policies that govern other public schools, although waivers from some rules may be requested through an appeal to the State Board of Education (State board).

Regarding accountability, charter schools are subject to the federal No Child Left Behind Act (NCLB) and must participate in the State's accountability program. Of the 15 charter schools operating during the 2005-2006 school year, 2 did not take the State assessments because they only serve students younger than grade three, the earliest grade that is assessed; 8 successfully made adequate yearly progress (AYP) on the tests; and 5 did not make AYP.

Under State law, charter schools may not charge tuition; instead, they receive public funds commensurate with other public schools in the school systems in which they operate. The

law is silent with regard to funding for capital or facility needs. Charter schools are also eligible to receive start-up federal funds disbursed by MSDE.

Federal Government Provides Start-up Funds for Charter Schools

In 2004, Maryland received $15 million in federal grant money to be awarded over three years to public charter schools. So far, 83 grant awards totaling approximately $7.6 million have been made. The grants are designed to cover one-time start-up expenses such as furniture, instructional materials, and minor facility modifications. Federal charter school funds have been distributed by MSDE in three phases: preplanning (up to $10,000); planning and design (up to $100,000); and implementation (up to $300,000). MSDE hopes to be able to award the remaining $7.4 million in federal funds prior to August 2007, when the three-year federal period expires. If charter school applicants are not awarded all of the remaining grant money, MSDE may reevaluate the award structure or award additional money to existing charter schools.

MSDE intends to reapply for federal grant money at the beginning of 2007; however, MSDE reports that the reapplication process is highly competitive and that during last year's reapplication process, some states that had received grant money during the first cycle did not receive grant money upon reapplication.

Court of Special Appeals Calls for Specified Level of Operating Funding

During the spring of 2005, three charter school applicants challenged the level of operating funding offered by their local boards of education through their right of appeal to the State board. Some of the local boards have interpreted State law to mean that a charter school would be provided a per pupil allocation consisting of a combination of cash for discretionary use and in-kind services such as special education and security. The charter schools believe that the funding methodology used by the local boards violates the requirement for funding to be *commensurate* with that disbursed to other public schools.

In a May 2005 opinion, the State board ruled that charter schools must be funded by dividing the total annual local school system operating budget by the annual September 30 enrollment count for the previous year. This number would constitute the per pupil amount. Acknowledging that some support functions such as data collection and reporting can only be performed by the central office, the State board authorized a 2 percent reduction in the per pupil amount. Thus, the total amount of money disbursed to a charter school would be 98 percent of the per pupil amount multiplied by the student enrollment at the charter school.

The local boards appealed to the circuit court wherein the judge held that the funding issue was moot because there was no longer an existing controversy between the parties (*Baltimore City Board of School Commissioners, et al, v. City Neighbors Charter School, et al*.). Contracts between the charter schools and the local boards had been signed and the circuit court

held that this constituted a compromise regarding the funding issue; however, the charter schools appealed this decision to the Court of Special Appeals and in an opinion filed August 31, 2006, the Court of Special Appeals reversed the decision of the circuit court.

The Court of Special Appeals held that the funding issue is, in fact, a "live controversy" as evidenced by the fact that the charter schools signed only temporary funding agreements with the local boards for the 2005-2006 school year in order to reserve their right to litigate in the future. Therefore, regarding the merits of the dispute, the court further held that in giving proper deference to the State board's interpretation of the statute, and in considering legislative intent, "the plain meaning of 'disbursing an amount of money' is to 'pay out' in cash, rather than services." (*City Neighbors Charter School, et al. v. Baltimore City Board of School Commissioners, et al.*). Finally, the court affirmed the State board's 98 percent per pupil funding model. The Baltimore City Public School System has appealed the decision of the Court of Special Appeals and is waiting to hear whether the case will be heard by the Court of Appeals.

Despite the ongoing litigation, 8 new charter schools opened for the 2006-2007 school year, and 15 existing charter schools continue to operate under funding agreements negotiated with local boards of education. Unless the Court of Appeals alters the ruling of the Court of Special Appeals or some other change is made to clarify State law, future contracts with charter schools will be bound by the 98 percent funding rule.

Facilities Are an Obstacle for Some Charter Schools

In a report entitled *An Evaluation of the Maryland Charter School Program* prepared by the University of Maryland, College Park, "limited access to adequate school facilities and facilities financing options" were identified as some of the primary barriers that hinder the creation of new charter schools. Some local boards require a charter school to acquire a facility prior to submitting an application; however, many charter schools report difficulty in acquiring a facility prior to being granted a charter because a landlord will not sign a lease with a tenant if the tenant is unable to prove financial resources. Although Baltimore City provides six of its charter schools with facilities at a minimum cost ($1 per year), most other charter schools must use their allocated operational funds to also cover costs associated with facilities such as leases. Two charter schools report that the leasing of a facility is costing more than $250,000 per year.

MSDE notes that, although federal facilities money is available for charter schools, a state must have a law that provides for such funds, and the Maryland charter school laws do not address funding for charter school facilities. MSDE also suggests that State bond bills may be a temporary or partial solution to the facilities financing issue.

Education

School Systems on Track to Meet Bridge to Excellence Early Childhood Education Requirements by Next Year

According to the comprehensive master plans submitted to the Maryland State Department of Education, local school systems will be able to meet the requirement that full-day kindergarten programs be provided to all students and publicly funded prekindergarten be available to disadvantaged students by next school year. Additionally, assessment results suggest that a greater proportion of students are entering kindergarten fully prepared for school each year.

In addition to increasing State funding for public primary and secondary education, the Bridge to Excellence in Public Schools Act (Chapter 288 of 2002) required local school systems to provide full-day kindergarten for all students and make publicly funded prekindergarten programs available to all economically disadvantaged four-year-old children. The final report by the Commission on Education, Finance, Equity, and Excellence (commonly referred to as the "Thornton Commission"), which was the basis for the Bridge to Excellence legislation, noted that the benefits of the programs are supported with extensive research that demonstrates the importance of quality educational experiences in early childhood. Maryland's continuing commitment to early childhood education is evidenced by Chapter 585 of 2005, which established a Division of Early Childhood Development in the Maryland State Department of Education (MSDE) and transferred authority over child care programs from the Department of Human Resources to the new division.

Master Plans Indicate that Most Systems Have Reached Early Education Goals a Year Early

The Bridge to Excellence Act requires full-day kindergarten and targeted prekindergarten programs to be in place by the 2007-2008 school year, the same year that the Act's funding enhancements will be fully phased in. In the 2005-2006 school year, there were more than 24,000 students enrolled in prekindergarten programs in Maryland public schools, and 81 percent of the nearly 57,000 kindergarten students were in full-day programs. Although these numbers are not yet available for the 2006-2007 school year, the comprehensive master plan updates submitted by the local school systems report that 16 of the 24 school systems have successfully implemented full-day kindergarten for all students, up from 11 systems last year. In addition, 9 local school systems report that prekindergarten programs for eligible students are available at every school, and the other 15 claim the programs are available for eligible students at regional locations.

When the Bridge to Excellence legislation was enacted, one of the main concerns for local school systems was the capacity of school facilities to accommodate the required

prekindergarten and full-day kindergarten programs. Many school systems are meeting the capacity issue through the use of additional relocatable classrooms. The State is making $1 million available each year in fiscal 2006 through 2008 to help local school systems acquire relocatable classrooms to accommodate full-day kindergarten programs in the school temporarily. In addition, the Interagency Committee for Public School Construction (IAC) has made funding for projects related to the mandates a priority. According to MSDE, none of the school systems expect to have unaddressed capacity issues that will prevent them from meeting the 2007-2008 deadline.

Measuring the Impact of State Initiatives

To gauge the effects of ongoing early education efforts, Maryland measures the "school readiness" of students entering kindergarten using the Work Sampling System (WSS) kindergarten checklist. After observing their new students, public school kindergarten teachers evaluate and rate performance according to guidelines developed by MSDE and WSS assessment protocol. The assessments result in an indication of "full readiness," "approaching readiness," or "developing readiness" in six curricular domains: social and personal; language and literacy; mathematical thinking; social studies; the arts; and physical development and health. A composite school readiness score is then derived from the six domains. Students who meet the "fully ready" standard consistently demonstrate skills, behaviors, and abilities that are needed to meet kindergarten expectations successfully.

The 2001-2002 school year was the first in which all kindergarten students in all school systems were assessed. School readiness data from that year to the 2005-2006 school year is shown in **Exhibit 1**. In 2005-2006, teachers reported that 60 percent of kindergartners entered school "fully ready," increases of 11 percentage points since the baseline year and 2 percentage points from the previous year. The percentage of students approaching readiness dropped by 10 percentage points from the baseline year to last school year. Although it accounts for a relatively small proportion of students, the percentage of students who are developing readiness did not change significantly from 2001-2002 to 2005-2006, dropping from 7 to 6 percent.

Exhibit 1
Composite School Readiness Levels
2001-2002 to 2005-2006 School Years

Readiness Level	2001-02	2002-03	2003-04	2004-05	2005-06	Change
Full Readiness	49%	52%	55%	58%	60%	+11%
Approaching Readiness	44	41	39	35	34	-10
Developing Readiness	7	7	6	6	6	-1

Note: Number may not add to 100 percent due to rounding.

Source: Maryland State Department of Education

While the composite score of children at the full readiness level increased from 49 to 60 percent from school years 2001-2002 to 2005-2006, the percentage of Hispanic (46 percent in 2005-2006) and African American (52 percent) children rated at the full readiness level has been consistently lower than the rates for white (69 percent), Asian/pacific islander (67 percent), and American Indian/Alaskan native (64 percent) children. There are also gender and jurisdictional disparities.

One of the State policies that is presumed to have an effect on school readiness is the increase in the kindergarten eligibility age. This year, the State completed a four-year phased increase in the allowable age of kindergarten students. For the 2006-2007 school year, beginning kindergarten students had to be five years old by September 1. Four years ago, students had to be five by December 31. Thus, each successive cohort of kindergartners since the 2002-2003 school year has been slightly older than the cohort before it. Since older children are generally more prepared for school, the WSS results have likely been influenced somewhat by this change. It is difficult to know, therefore, how much of the progress on the WSS is attributable to real improvements in children's readiness, as opposed to annual increases in the average age of kindergarten students. With the increase in kindergarten age eligibility now complete, the impact of State efforts in early education may be easier to gauge in the future

Higher Education

How High Will (Can) Enrollment Grow at Public Institutions?

The most recent enrollment projections by the Maryland Higher Education Commission (MHEC) expect enrollment at public higher education institutions to grow moderately over the next 10 years. The University System of Maryland (USM) has a competing demand model that projects higher growth at USM institutions than MHEC. It is unclear from admissions data whether student demand is sufficient to meet USM's projections. USM appears to have met the fiscal 2007 enrollment targets overall, primarily due to "above the target" enrollment at University of Maryland University College; however, six institutions did not meet the targets.

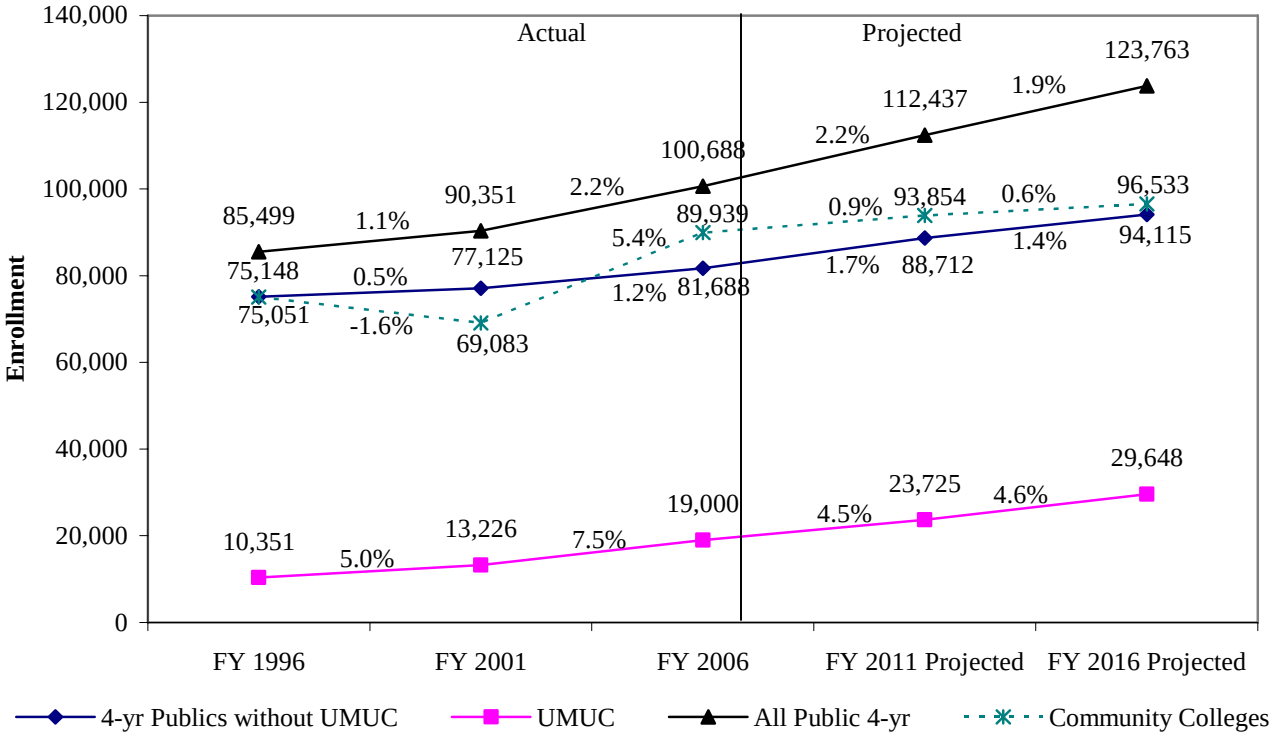
Enrollment Will Continue to Grow but at Slightly Slower Pace

Public undergraduate headcount enrollment – including the University System of Maryland (USM) institutions, Morgan State University (MSU), St. Mary's College of Maryland, and associate degree seekers at community colleges – is expected to increase 15.6 percent, or a 1.5 percent average annual increase, from fiscal 2006 to 2016 according to the Maryland Higher Education Commission's (MHEC) June 2006 projections. These most recent 10-year projections show slightly lower growth rates than MHEC's June 2005 projections.

Exhibit 1 shows the trends in undergraduate headcount enrollment over the past 11 years and the enrollment projections through fiscal 2016 at the above listed institutions. For all public four-year institutions, after small increases in enrollment from 1996 to 2001, five-year average annual growth rates doubled from 1.1 to 2.2 percent in fiscal 2006. Although this same growth rate is expected to continue through fiscal 2011, growth is expected to slow from fiscal 2011 to 2016. The average annual growth rate for all public four-year institutions, not including the University of Maryland University College (UMUC), is expected to increase slightly from 1.2 percent in fiscal 2006 to 1.7 percent in fiscal 2011. UMUC's average annual growth rate is expected to decline from a high of 7.5 percent experienced the past five years to 4.5 percent in fiscal 2006 to 2011. The average annual growth rates of community college associate degree seekers are expected to stabilize at less than 1 percent through fiscal 2016.

Overall, UMUC's share of total public undergraduate enrollment has increased. By fiscal 2016, UMUC is projected to enroll 13.5 percent of all public undergraduate students, up from 6.5 percent in 1996, while the share of enrollment at other public four-year institutions and community colleges is projected to decline from approximately 47 percent each to 43 or 44 percent each over the same period.

Exhibit 1
Public Undergraduate Headcount Enrollment



Note: Percents shown are average annual change. Data for community colleges includes only students pursuing associate's degrees; fiscal 2006 data for community colleges reflects fall 2005 actual headcount enrollment.

Source: Maryland Higher Education Commission; Maryland Association of Community Colleges; Department of Legislative Services

MHEC and USM Enrollment Projections Still Competing

MHEC provides the State's official enrollment projections, but USM has a separate model. USM refers to its full demand model as a representation of what could happen if all potential students are enrolled. The MHEC model represents what is likely to happen, given demographic data, budget constraints, and other factors. USM's model generally projects higher enrollments than MHEC's model.

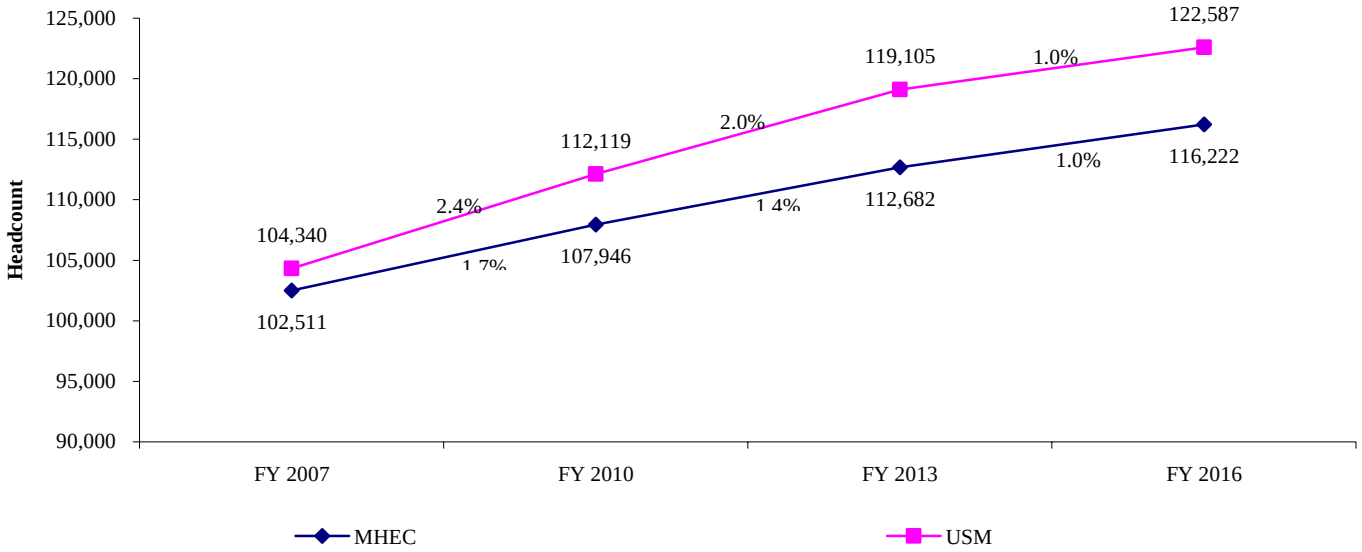
Exhibit 2 compares headcount enrollment projections from fiscal 2007 to 2016 at USM institutions, not including UMUC, using the USM and MHEC models. The data include

undergraduate and graduate students. MHEC projects a total of 116,222 students in fiscal 2016 while USM's model projects 122,587, a difference of 6,365 students. In terms of growth rates, USM projects that the average annual growth rate from fiscal 2007 to 2010 will be 2.4 percent, while MHEC projects a growth rate of 1.7 percent. For the period from fiscal 2010 to 2013, USM expects an average annual growth rate of 2 percent compared to MHEC's 1.4 percent. However, the MHEC and USM models project the same average annual growth rate of 1 percent from fiscal 2013 to 2016. Overall, USM estimates total enrollment growth of 17.5 percent and MHEC projects growth of 13.4 percent from fiscal 2007 to 2016. However, it is important to note that these growth rates are applied to different baselines; for fiscal 2007 USM projects 104,340 students compared to 102,511 students projected by MHEC.

Exhibit 2

MHEC and USM Total Headcount Enrollment Projections at USM Institutions*

Fiscal 2007-2016



*Data do not include University of Maryland University College.

Sources: Maryland Higher Education Commission; University System of Maryland

Enough Students to Meet Projected Demand?

In order to examine how much student "demand" there may be to enroll at public four-year institutions, the Department of Legislative Services (DLS) surveyed USM institutions and MSU in 2006 regarding their application and acceptance practices for admitting undergraduate students. Seven institutions generally accepted all students that were determined to be "qualified" for admission. These included Bowie State University, Towson University, University of Maryland Eastern Shore, Frostburg State University, Coppin State University, University of Maryland Baltimore County, and MSU. This suggests that in order to increase enrollment, these institutions will need to increase the number of qualified students applying for admission and deciding to attend the institutions.

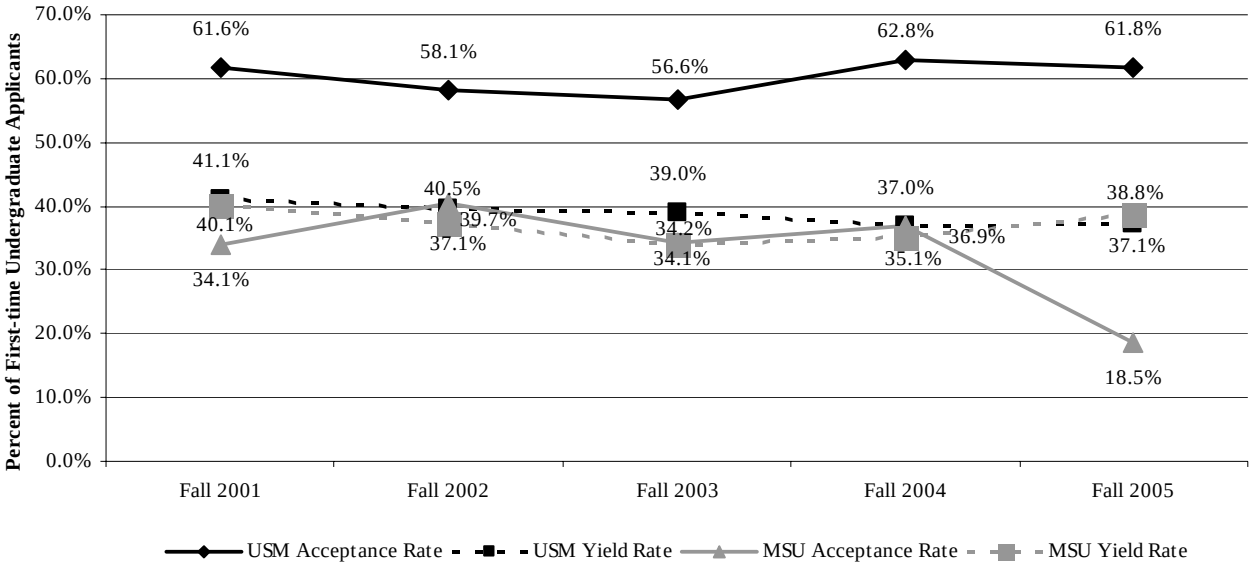
DLS also analyzed the acceptance and yield rates of these institutions in order to determine what type of "demand" students had for attending a particular institution.

As shown in **Exhibit 3**, the overall acceptance rate of the selected USM institutions (*i.e.*, the percent of applicants who were accepted by the institutions) has fluctuated somewhat, but has averaged about 60 percent. The overall yield rate of the selected USM institutions (*i.e.*, the percent of accepted students who enrolled at the institutions) has steadily decreased from 41.1 percent in fall 2001 to 37.1 percent in fall 2005. Therefore, the acceptance rate at these institutions is fairly stable while the yield rate is distinctly lower. Although the yield rate is declining, the number of students attending is increasing. Of the students who were accepted by the six institutions, 6,600 decided to attend in fall 2001 and 7,168 decided to attend in fall 2005.

After fluctuating from fall 2001 to 2004, MSU's acceptance rate declined sharply in fall 2005 through an effort to become more selective. MSU's yield rate has remained fairly stable, from 40.1 percent in fall 2001 to 38.8 percent in fall 2005, and has been roughly the same as the acceptance rate until fall 2005. However, the number of students attending also dropped sharply to 824 in fall 2005, from approximately 1,300 to 1,400 students each year in fall 2001 to 2004.

In fiscal 2007 USM institutions collectively received approximately $15 million to specifically fund enrollment growth. These funds were to support 3,386 additional full-time equivalent students (FTES) systemwide. **Exhibit 4** shows the total number of FTES that USM is expecting for fiscal 2007. The projection incorporates the actual enrollment for the fall semester and the predicted enrollment for the spring semester. Overall, USM is expected to exceed the total FTES projection by 107 FTES, mostly due to UMUC exceeding its target. However, six institutions did not meet their goals.

Exhibit 3
Acceptance and Yield Rates of USM* and MSU
Fall 2001-2005



*USM data includes Bowie State University, Towson University, Coppin State University, Frostburg State University, University of Maryland Eastern Shore, and University of Maryland Baltimore County.
Source: Department of Legislative Services; public higher education institutions

Exhibit 4
USM Budgeted FTES vs. Expected FTES
Fiscal 2007

	Budgeted Additional FTES	Total Budgeted FTES	Total Expected FTES	Difference Expected from Budgeted
UMB	50	5,465	5,465	0
UMCP	250	29,252	29,097	-155
BSU	96	4,172	4,154	-18
TU	805	15,196	15,317	121
UMES	123	3,465	3,616	151
FSU	16	4,222	4,108	-114
CSU	102	3,404	3,152	-252
UB	100	3,403	3,369	-34
SU	323	6,511	6,540	29
UMUC	1,325	16,134	16,610	476
UMBC	196	9,368	9,271	-97
USM Total	**3,386**	**100,592**	**100,699**	**107**

FTES=Full-time equivalent students
Source: University System of Maryland

Higher Education

Commission to Study Funding of Higher Education Established

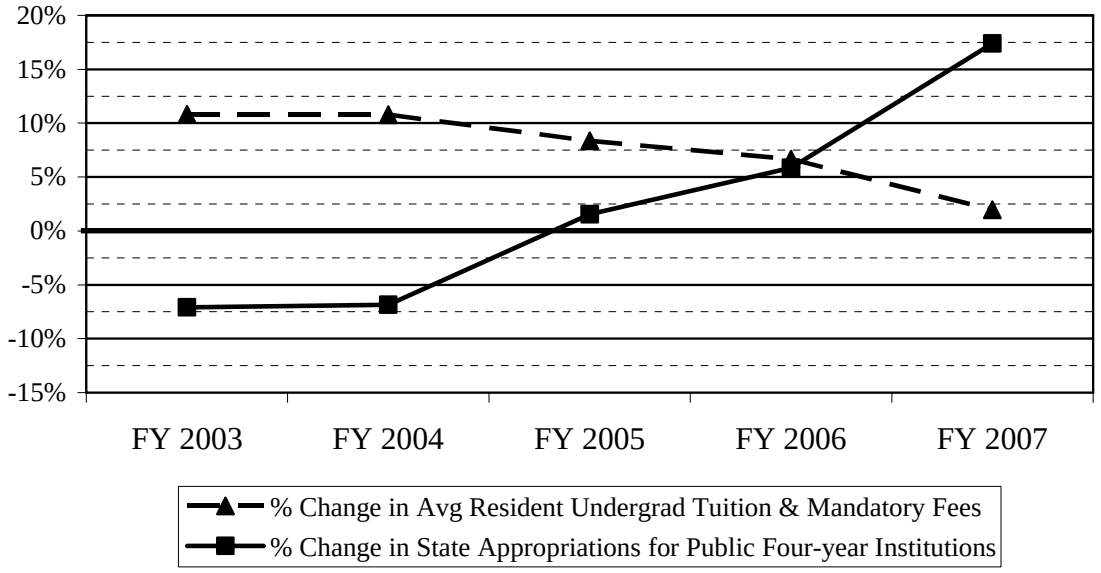
The ratio of State support to tuition revenue at public institutions of higher education had been declining until fiscal 2007 when institutions received large boosts in State funding and were required to hold tuition for resident undergraduates constant at most schools. A statewide commission will develop a model for funding higher education over the next year.

Trends in Tuition and Higher Education Funding

In recent years, the rising cost of tuition at Maryland's public four-year institutions has fueled concerns about access and affordability. The largest increases in undergraduate tuition and fee rates coincided with recession-driven declines in State general fund support. From fiscal 2002 to 2006, the percent of higher education revenues coming from tuition and fees increased from 31 percent in fiscal 2002 to 38 percent in fiscal 2006 while the percent coming from State general funds decreased from 41 to 32 percent. Average State aid per full-time equivalent student at select four-year public institutions decreased from $9,485 to $7,926 during this same period.

As shown in **Exhibit 1**, the average annual increase in tuition and fees for resident undergraduates at Maryland's four-year public institutions was 7.7 percent from fiscal 2002 to 2007. The largest tuition increases occurred in fiscal 2003 and 2004 when State general fund support for public universities decreased significantly. For full-time undergraduate students, tuition rates increased approximately 10 to 12 percent on average each year from 2002 to 2004. Growth in tuition and fee rates began to moderate with the increase in State appropriations beginning in fiscal 2005. This trend is most dramatic in fiscal 2007, when State appropriations increased by more than $100 million, and the General Assembly passed a tuition freeze for Maryland residents.

Exhibit 1
Annual Percent Changes in Resident Undergraduate Tuition and State Appropriations at Four-year Public Institutions of Higher Education



	FY 2002	FY 2007	Average Annual % Change
Average Tuition and Fees*	$4,779	$6,915	7.7%
State Appropriations ($ in Millions)**	$736.3	$804.0	1.8%

*Simple average of Maryland's 12 public four-year undergraduate institutions. The University of Maryland, Baltimore (UMB) is excluded from the analysis because it is primarily a graduate institution.
**Excludes State appropriations to UMB.

Source: Department of Legislative Services

Tuition Affordability Act of 2006

In response to the escalating cost of tuition, the General Assembly passed the Tuition Affordability Act of 2006 (Chapters 57 and 58). The law prohibits University System of Maryland institutions and Morgan State University from increasing resident undergraduate tuition for fiscal 2007 (2006-2007 academic year) beyond fiscal 2006 levels. The Act also limits resident tuition increases at St. Mary's College of Maryland to 4.8 percent. The fiscal 2007 budget includes $18.5 million in general funds originally budgeted for overstated health insurance costs that will offset the loss of tuition revenues for the four-year public institutions.

Commission to Develop the Maryland Model for Funding Higher Education

In addition to the one-year freeze on tuition increases, Chapters 57 and 58 establish the Commission to Develop the Maryland Model for Funding Higher Education. The commission is made up of legislators, cabinet secretaries, presidents of various institutions from all segments of higher education, other representatives of the higher education community, members of the business community, and members of the public. The commission is charged with reviewing options and making recommendations relating to the development of a statewide framework for higher education funding that is consistent and stable and ensures affordability of and accessibility to all of Maryland's institutions of higher education. Legislation was already enacted in 2006 to enhance State funding for community colleges by approximately 20 percent over the next six years; it is assumed that the additional funding will moderate tuition increases at community colleges and improve access. The commission is also required to review options and make recommendations relating to the appropriate level of funding for the State's historically black institutions to ensure comparability and competitiveness with other public institutions of higher education. The commission is expected to be appointed in November 2006 and must report its findings and recommendations to the Governor and the General Assembly by December 31, 2007.

Higher Education

Despite Efforts, State Continues to Struggle with Access and Affordability

As evidenced by the failing affordability grade Maryland received from the 2006 *Measuring Up* report card, the cost of college at Maryland's higher education institutions continues to be an issue. The grade comes despite the fall 2006 tuition freeze mandated by the General Assembly and increases to need-based student financial aid provided in recent years. A report by the Maryland Higher Education Commission indicates that students attending Maryland institutions are doing so in spite of unmet financial needs.

2006 *Measuring Up* Report Card Gives Maryland an "F" for Affordability

According to the 2006 *Measuring Up* report from the National Center for Public Policy and Higher Education, Maryland compares well with other states in preparing students for higher education (a grade of "A-"), providing opportunities to enroll in college ("A"), and ensuring that students complete a college degree ("B"). However, for the second time in a row, the State received an "F" for the affordability of a college degree. The *Measuring Up* affordability category measures whether students and families can afford to pay for postsecondary education given their income levels and the types of colleges and universities students attend. The category also examines the amount of need-based aid students receive to offset expenses and the loan burden associated with their higher education expenses.

Overall, the report notes that since the early 1990s higher education in the United States has become less affordable, when college costs are considered relative to family income. No state received an "A" in the 2006 report; 43 states received an "F." In explaining the low affordability grade for Maryland, *Measuring Up* reports that, after factoring in financial aid, low- and middle-income families still devoted 47 percent of their income to the payment of college expenses at public four-year institutions and 36 percent of their income at community colleges. The report does note that the State has increased its need-based financial support but also claims that it still makes a very low investment relative to other states. The report concludes that "Maryland has made no notable progress in providing affordable higher education."

State Is Taking Steps to Address Affordability Indicators

To generate a grade for Maryland, the *Measuring Up* report uses data from 2004. (The report is published every two years.) Although it is difficult to judge whether the grade would have been different using more recent information, the State has taken steps toward improving the affordability of higher education in recent years. Specifically, both the State and public institutions have increased need-based financial assistance, and the General Assembly mandated a 2006-2007 academic year tuition freeze for in-state undergraduate students at all four-year public institutions except one. In addition, the affordability of community colleges should

improve with State initiatives to increase funding for the colleges and increase State support for needy students at community colleges.

State and Institutions Increase Need-based Financial Aid

As demonstrated in **Exhibit 1**, need-based student financial aid has been a high priority for Maryland for several years. Funding for the State's need-based aid programs began to increase significantly in fiscal 2005, a trend that continues through fiscal 2007. The fiscal 2007 budget includes $83.3 million in State need-based aid, an increase of $40 million or 92.4 percent since fiscal 2003. In addition to the aid this will provide for students at four-year institutions, this funding level enabled the Maryland Higher Education Commission (MHEC) to fully implement the Community College Access Initiative in fiscal 2007, two years earlier than it had expected. The initiative, which was codified by Chapter 496 of 2006, covers a greater percentage of financial need for community college students.

Exhibit 1
State and Institutional Need-based Aid
Fiscal 2003 to 2007
($ in Thousands)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY03-07 % Chg
State Need-based Aid	$42,716	$41,777	$51,546	$68,355	$82,644	93.5%
Institutional Need-based Aid						
Univ. of MD, College Park	$5,592	$8,858	$7,991	$9,010	$11,300	102.1%
Univ. of MD, Baltimore	1,014	372	408	437	459	-54.8
Bowie State Univ.	922	1,214	1,340	1,374	1,721	86.6
Towson Univ.	1,982	3,283	4,707	5,100	6,460	225.9
Univ. of MD Eastern Shore	1,957	2,311	2,240	1,454	2,126	8.7
Frostburg State Univ.	1,147	1,171	1,259	1,645	1,393	21.5
Coppin State Univ.	42	54	242	296	1,475	3416.7
Univ. of Baltimore	87	192	249	230	271	212.0
Salisbury Univ.	183	571	583	1,259	1,562	751.4
Univ. of MD Univ. College	924	766	1,601	1,907	3,279	255.0
Univ. of MD Balt. County	944	774	1,021	1,517	1,786	89.1
USM Subtotal	**$14,794**	**$19,567**	**$21,640**	**$24,229**	**$31,832**	**115.2%**
St. Mary's College of MD	381	769	1,143	1,566	1,566	310.8%
Morgan State Univ.*	0	2,586	1,568	1,647	1,729	--
Institutional Subtotal	**$15,175**	**$22,922**	**$24,351**	**$27,441**	**$35,126**	**131.5%**
Total Need-based Aid	**$57,891**	**$64,699**	**$75,897**	**$95,796**	**$117,770**	**103.4%**

*Although Morgan State University (MSU) awards aid to students with need, in fiscal 2003 MSU did not provide aid that was specifically categorized as need-based aid.
Note: Numbers may not sum due to rounding.
Source: Department of Legislative Services; University System of Maryland (USM); Morgan State University; St. Mary's College of Maryland

As a supplement to State and federal programs, each institution provides financial aid to its students. In an effort to enhance need-based aid and offset the impact of tuition increases on less wealthy students, need-based institutional aid at Maryland's four-year public institutions (also shown in Exhibit 1) has more than doubled since fiscal 2003. St. Mary's College of Maryland and University System of Maryland (USM) institutions – in particular, Coppin State University and Salisbury University – have increased need-based aid significantly over this period. Combined, State and institutional need-based aid increased by approximately $60 million from fiscal 2003 to 2007.

The Unmet Financial Need of Students Receiving Aid

The 2002 *Joint Chairmen's Report* directed MHEC to develop a system to collect comprehensive financial aid data on aid recipients attending Maryland higher education institutions. Using data from the new information system that was developed to meet this requirement, MHEC produced a report, *Financial Need of Undergraduate Aid Recipients at Maryland's Colleges and Universities, 2004-2005*, that profiles all undergraduate aid recipients who attended Maryland's two- and four-year public institutions during the 2004-2005 academic year. In total, the report covers nearly 120,000 students who received approximately $750 million in financial aid. Sources of aid included the federal and State governments, higher education institutions, and private funds. According to the report, about 72 percent of all aid recipients demonstrated financial need. Financial need is determined by the student's expected family contribution (EFC), which is the amount a family is expected to contribute toward college costs. The EFC is made available after a student submits the Free Application for Federal Student Aid. Higher education institutions and federal and State government use the EFC to award financial aid to students. Unmet need is the gap between the cost of attending college and the student's ability to pay after factoring in expected family contribution and financial aid. Of those students with financial need, 47 percent were enrolled at community colleges and 53 percent were enrolled at public four-year institutions. A description of aid recipients at two- and four-year institutions is shown in **Exhibit 2**.

Exhibit 2
Students Receiving Financial Aid at Maryland's Public Institutions
Fiscal 2005

	Students at Public Four-year Institutions	Community College Students
Percent with Need	70%	76%
Average Cost Of Attendance	$19,392	$11,142
Average Aid Amount*	$9,926	$3,101
Percent with Unmet Need	73%	94%
Average Amount of Unmet Need	$7,746	$7,126

*Sources of aid include federal, State governments, higher education institutions, and private funds.

Source: *Financial Need of Undergraduate Aid Recipients at Maryland's Colleges and Universities, 2004-2005*

The exhibit shows that the average cost of attendance at a public four-year college for a student with need was $19,392, and the average award was $9,926. Among the students with needs, 73 percent had unmet needs even after aid and loans were considered, and the average unmet need was $7,746. At community colleges, the average cost of attendance for a student with need was $11,142, more than $8,000 lower than the cost of attendance at public four-year institutions. The average aid amount, however, was also much lower ($3,101), leaving 94 percent of financially needy community college students with unmet needs that averaged $7,126, only $600 below the average unmet needs of students at four-year public institutions. Student loans were also instrumental in reducing unmet need for students at both two-year and four-year institutions. Excluding loans, the unmet needs of these students, especially at four-year institutions, would have been even higher: $9,477 at four-year institutions and $7,620 at community colleges.

The Financial Aid Information System developed by MHEC is still relatively new. In the future, it will enable the State to track the impact of recent State initiatives and further improve college access and affordability in Maryland.

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Higher Education

Office for Civil Rights Partnership Agreement Expires, State Funding Continues

Although the State's five-year Partnership Agreement with the U.S. Office for Civil Rights (OCR) expired in December 2005, the fiscal 2007 budget continues the State's commitment to enhance Maryland's four public historically black institutions. The Maryland Higher Education Commission concluded that Maryland has satisfied the nine commitments made in the Agreement. As of fall 2006, OCR has not made a final determination of the State's progress under the Agreement. However, a lawsuit alleging that Maryland has failed to desegregate its higher education system was filed by a higher education coalition in October 2006.

State Enters into Agreement with OCR

In October 1999, the U. S. Department of Education's Office for Civil Rights (OCR) initiated a review of Maryland's compliance with state obligations under federal law, particularly Title VI of the Civil Rights Act of 1964 and the 1992 *Fordice* decision of the U. S. Supreme Court. Maryland was targeted due to its status as a state with a system of public higher education that was once racially segregated. Maryland is 1 of 10 states that formerly operated a dual higher education system in violation of Title VI and applicable federal law.

In 1992 the U. S. Supreme Court issued a decision in *United States v. Fordice* (505 U. S. 717) that set legal standards and requirements for desegregation of a previously segregated higher education system. The court found that race neutral admissions policies alone are not sufficient to determine that a state has effectively desegregated a formerly segregated higher education system. Furthermore, policies found to be traceable to the formerly segregated system must be reformed to the extent practicable and consistent with sound educational practices. In January 1994, OCR informed Maryland that the *Fordice* decision required a reevaluation of its desegregation efforts in the public higher education system.

In December 2000, the State of Maryland entered into a five-year Partnership Agreement with OCR to eliminate any remaining vestiges of segregation in Maryland's public institutions of higher education. The State's commitments under the agreement total more than 20 and fall into 9 broad areas including teacher recruitment; strengthening recruitment, retention, and graduation; improving campus environments; improving the diversity of faculty and staff and governing or advisory boards; and improving affordability and financial aid programs. The State also made specific commitments to enhance the State's four public historically black institutions (HBIs): Bowie State University; Coppin State University; the University of Maryland Eastern Shore; and Morgan State University. The agreement specifically called for the revitalization of Coppin State University based on a study of the college's operating and capital program needs.

OCR Partnership Agreement Expires

The Partnership Agreement expired on December 31, 2005. As part of the Partnership Agreement, the State and OCR are charged with making a determination as to whether the nine commitments contained in the Agreement have been fully implemented. In the fall of 2005, the Maryland Higher Education Commission (MHEC) convened two committees to review the progress made toward the nine commitments since December 2000. Committee I reviewed Commitments 1 through 8 and Committee II reviewed Commitment 9 regarding enhancing the State's HBIs. The two committees met in the fall of 2005 and early 2006 and submitted their reports to MHEC in the spring of 2006. On June 20, 2006, MHEC submitted a letter and the two committee reports to OCR to support MHEC's conclusion that Maryland has satisfied the nine commitments. If OCR determines that the State has fully implemented the commitments, then OCR will formally acknowledge in writing that Maryland has eliminated all vestiges of segregation in the public system of higher education. If the parties are not able to resolve matters by this process, then both the State and OCR reserve the legal right to utilize other established judicial processes. As of the fall of 2006, OCR has not initiated any enforcement action against the State nor made a final determination of the State's progress under the Partnership Agreement.

Funding Enhancements for HBIs

During the Partnership Agreement

MHEC concluded that the State made a good faith effort to achieve the broad goal of ensuring that the HBIs are "comparable and competitive" with the State's traditionally white institutions (TWIs). From fiscal 2002 to 2006, the HBIs received a total of $56.4 million in additional State operating funds for enhancements. In addition, the HBIs received a total of $330 million in capital funding during the same five-year period and, as a result, all capital projects specified in the Partnership Agreement were completed. The Committee II report notes that it is important to recognize that these enhancements were provided while Maryland was experiencing a recession and had a structural budget deficit. While other State agencies and institutions of higher education experienced reductions to general fund appropriations during this period, the budgets for HBIs were either protected from reductions or received modest increases. Specifically, between fiscal 2001 and 2006, the overall funding increase for TWIs averaged 1.8 percent, while funding for the HBIs increased by 7.0 percent.

After Expiration of the Partnership Agreement

Although the Partnership Agreement expired on December 31, 2005, action taken in the fiscal 2007 budget demonstrates the State's continued commitment to enhancing funding for the HBIs. The fiscal 2007 budget includes $4.9 million in continued enhancement grants for the HBIs, $6 million for Access and Success programs to improve graduation and retention rates, and an additional $100,000 for a consultant to work with each HBI to develop campus-based strategies to increase retention for first-year students. In addition, general fund support for the HBIs increases 27.5 percent, with individual institutions receiving 19 to 45 percent increases

over fiscal 2006. The General Assembly also added language to the budget bill expressing intent to continue support of the State's HBIs after the expiration of the OCR Partnership Agreement. The HBIs also received $37.6 million in capital funding in fiscal 2007. The five-year State Capital Improvement Program for fiscal 2007 includes a projected $419 million in capital funding at the HBIs, including $235 million at Coppin State alone to revitalize the campus, for fiscal 2008 through fiscal 2011.

Continued Commitments

MHEC's letter to the OCR states that Maryland has satisfied all of the nine commitments in the Partnership Agreement. However, MHEC plans to continue monitoring the State's ongoing commitment to equality of access to higher education in the State. MHEC will submit annual reports to the General Assembly and the Governor regarding the State's progress with the HBIs.

Issue of Duplicative Programs

In 2005, MHEC Secretary Calvin Burnett, Ph.D. approved an application by Towson University and the University of Baltimore to offer a joint MBA program. An appeal objecting to the Secretary's decision on the grounds that it violated the State's OCR Agreement was filed by Morgan State University. The appeal argued that the program would duplicate the MBA program offered for more than 30 years at Morgan State University and would thus lead to greater segregation at Baltimore-area colleges. In the fall of 2005, MHEC voted to uphold the decision by Secretary Burnett.

In response, Senate Bill 998 of 2006 was introduced and would have required MHEC to make a determination as to whether a new academic program is unreasonably duplicative at the request of any directly affected public institution of postsecondary education. An institution directly affected by an unreasonably duplicated academic program would have been able to appeal the MHEC determination to the circuit court. Senate Bill 998 passed the General Assembly but was vetoed by Governor Robert L. Ehrlich, Jr. (resulting in a $2 million contingent reduction to MHEC's fiscal 2007 administrative budget).

On October 13, 2006, the Coalition for Equity and Excellence in Maryland Higher Education filed a lawsuit in Baltimore Circuit Court arguing that the State has failed to desegregate its higher education system and requesting the elimination of several new academic programs at TWIs, including the joint MBA program at Towson University and the University of Baltimore. A motion has since been filed requesting that the case be moved to federal court.

Higher Education

Professional Development Schools Prepare Students to Teach

State policy requires a one-year internship in a professional development school (PDS) for undergraduate students preparing to become teachers. Prior to fiscal 2007, PDS funding was provided primarily through higher education institutions' budgets and federal grants. Federal funding is no longer available to support PDS. The State provided a special grant of $2 million for PDS in fiscal 2007. Direct State funding of PDS raises several issues, including the appropriate role for local school systems in supporting PDS.

State Policy

The *Redesign of Teacher Education*, State policy adopted by the Maryland State Department of Education (MSDE) and the Maryland Higher Education Commission (MHEC) in 1995, requires an institution of higher education (IHE) to provide a one-year internship in a professional development school (PDS) setting to students enrolled in undergraduate teacher preparation programs. In Maryland, teacher preparation accreditation by the National Council for Accreditation of Teacher Education (NCATE) and program approval by MSDE are contingent upon providing a PDS experience as required in the *Redesign*.

A PDS is a collaborative partnership for the academic and clinical preparation of intern teachers. The ultimate goal of a PDS is to provide competent teachers in order to ensure that all students receive a high quality education. Therefore, the focus of a PDS partnership is to improve student performance through research-based teaching and learning. A PDS may involve a single or multiple schools, school systems, and IHEs and may take different forms to reflect specific partnership activities and approaches to improving both teacher education and PreK-12 schools. Intern teachers spend a minimum of 100 days over two consecutive semesters at a PDS site. The difference between traditional student teaching and the PDS experience is that PDS interns are immersed in the school community. The intern teachers experience all of the typical teacher duties such as setting up their own classroom, attending faculty meetings, and holding parent-teacher conferences. In addition, all of the intern teachers attend their IHE classes at the PDS site. The goal is for the intern teacher to become more comfortable with all of the upcoming teaching responsibilities and more knowledgeable about the school, the students and other teachers, and the instructional program.

Since a PDS is a partnership between the IHE and the school, IHE faculty and in-service teachers and administrators are very involved as well. IHE faculty are involved in the school community by holding their classes for the intern teachers on-site, providing professional development opportunities for all teachers and administrators, and serving on school improvement teams. In-service teachers also benefit from the partnership through professional

development sessions and opportunities to serve as mentors to intern teachers or as PDS site coordinators.

According to a report by MHEC and the K-16 Leadership Council, during the 2004-2005 academic year, 20 IHEs in Maryland participated in 403 PDS sites that served 2,115 intern teachers and provided approximately 1,300 professional development sessions to more than 9,500 in-service teachers.

Funding

Historical Funding

Historically, funding for PDS was provided through IHEs' budgets and various grants. During the 2004-2005 academic year, a total of $5.5 million from all funding sources was spent on PDS. More specifically, 82 percent came out of the IHEs' budgets (the University System of Maryland also provides some funding to system IHEs); the local school systems provided 8 percent; another 8 percent came from federal grants; and in-kind contributions comprised 2 percent. As of 2005-2006, federal funding is no longer available to support PDS.

Additional Fiscal 2007 Funding

The fiscal 2007 budget included $2 million in MHEC's budget to support PDS activities. Since this was the first time that there was a specific line-item grant in the budget for PDS, the *2006 Joint Chairmen's Report* required MHEC and the K-16 Leadership Council to provide a plan for distributing the funds prior to expending the $2 million. The report proposes that the $2 million allocation assure a base level of staffing and resources for PDS throughout the State. IHEs will be able to enhance and expand PDS in the areas of strategic planning, portfolio review, coordination, mentoring, and professional development. A portion (15 percent) of the funding allocated to the IHEs will go toward strategic planning and data collection. Strategic planning includes both school and university representatives working together to determine the current developmental level of a PDS and the ways in which the PDS will move forward during the yearly cycle. Each of the 20 IHEs with professional development schools will receive a specified amount of funding for purposes of strategic planning based on the number of intern teachers the IHE serves. Although two other institutions, the Peabody Institute and the Maryland Institute College of Art (MICA), do not have PDS of their own, they will receive a small amount of funding for data collection. Peabody Institute and MICA will be encouraged to engage in partnerships with other IHEs that do have PDS.

The remaining balance of the fiscal 2007 PDS funding, $1.7 million, will be distributed to the 20 eligible IHEs based on the number of PDS students served and the average State appropriation per intern, which is $813.24 (remaining funding divided by total number of interns). The number of interns will be based on data for academic year 2004-2005 reported by the institutions. The report by MHEC and the K-16 Leadership Council stressed that the $2 million will enhance, and not supplant, existing funding for PDS.

Issues

Additional funding for PDS from local school systems: The sources of funding for a PDS vary depending on the IHE that is involved and the county in which the PDS is located. Some local school systems provide funding for PDS while others have certain funding requirements such as requiring an IHE to pay in-service teacher mentors a specified amount for the time they serve as mentors. The federal No Child Left Behind Act and its accountability measures are a large influence on educational activities in all schools. Therefore, the need has increased for IHEs, which initially train intern teachers, to collaborate with the schools and local school systems that will ultimately hire the teachers. It seems mutually beneficial for the local school systems and IHEs to share in the responsibility for training and developing both new and in-service teachers.

Underserved regions: Some regions of the State are not able to provide PDS placements for intern teachers due to their distance from IHEs. This can be an inconvenience for an intern teacher who hopes to make an easy transition to permanently teach at a school in an underserved region. It is also unfortunate for schools that miss out on the benefits of the PDS experience such as teacher recruitment, ongoing professional development, and increased teacher retention. The K-16 Leadership Council reports that discussions about cross-institutional partnerships are beginning among IHEs, K-12 schools, and community colleges in an effort to respond to regional needs.

Higher Education

Nursing Programs Face Capacity Shortage; Teaching Programs Looking for More Students

Nursing programs are facing a shortage of nursing faculty, which is causing institutions to turn prospective nursing students away. Teaching programs, on the other hand, have experienced a decline in graduates teaching in Maryland although they are accepting all qualified students who apply in critical shortage areas. Different strategies are needed to address each of these shortages.

The nursing and teaching professions are both experiencing workforce shortages. Higher education institutions are the supply side of workforce shortages. The capacity of higher education institutions to educate enough nurses and teachers is a key component of addressing these workforce shortages in Maryland.

Capacity of Nursing Programs

In September 2006 the Maryland Higher Education Commission, in collaboration with the Maryland Board of Nursing, published the *Maryland Nursing Program Capacity Study* as required by Senate Bill 511 passed during the 2005 session (Chapter 487). The study projected that there will be a need for 68,695 nurses by 2012 and 74,611 nurses by 2016. Depending on the method of projection, the gap between the demand for nurses and the supply of nurses in 2016 is between 2,512 and 15,536 nurses.

The Department of Legislative Services (DLS) conducted an informal survey of the University System of Maryland institutions with nursing programs during 2006. The survey evaluated the number of applicants to the nursing programs, the number of qualified applicants, and the number of applicants admitted from fall 2001 to fall 2006. Although the institutions' ability to provide this data varied, the general results showed that while the number of applications and the number of qualified applicants have increased since fall 2001, the number of accepted applicants has remained steady. Interest in the nursing profession has grown as shown by the dramatic increase in the number of applicants since fall 2001. However, because institutions do not have the capacity to enroll more students, qualified applicants are being turned away.

The *Maryland Nursing Program Capacity Study* has also shown this result by focusing on fall 2005 data. The study included all segments of higher education – community colleges, private institutions, and public institutions. Overall, there were 4,916 qualified applicants for either an associate degree program, a registered nurse to bachelor of science degree program, or a bachelor of science degree program. Of this number, 2,357 qualified applicants were not admitted.

The informal survey conducted by DLS asked what nursing education programs needed in order to accept more students. The most common response was the need for faculty in the classrooms and, particularly, in the clinical setting. The *Maryland Nursing Program Capacity Study* had a similar response to the same question. In particular, a 25 percent increase in the number of faculty would be needed to accommodate 1,299 additional students. This large increase is due to the low student to faculty ratios that are established by the Maryland Board of Nursing and the national accreditation commissions.

In an effort to increase the number of nurses and nursing faculty, Chapters 221 and 222 of 2006 established the Nurse Support Program II. The program provides grants to nursing programs through hospital rates. In total, 26 proposals were received, and 7 awards were made for multi-year funding. Of the seven awards, three went to community colleges, and four went to four-year institutions. The total first year funding that these institutions will receive is $1.4 million. When including the multiple years of funding, the awards totaled $6.2 million.

Capacity of Teacher Education Programs

The Maryland State Department of Education (MSDE) publishes the *Maryland Teacher Staffing Report* annually. This report analyzes the workforce shortage from the "supply" side and the "demand" side. MSDE, in its latest *Teacher Staffing Report*, has determined that the following content areas are experiencing critical shortages: career and technology (including health occupations); computer science; dance; Latin and Spanish foreign languages; math; science (chemistry, earth/space science, physical science and physics); and all of the special education areas.

Maryland's higher education institutions are the supply side of this workforce shortage. Every year, public four-year institutions report their *Managing for Results* data including the number of students successfully graduating from teacher education programs and gaining employment in Maryland schools. For USM as a whole, the number of teacher education students completing training and employed in Maryland schools has experienced a decline since fiscal 2001. In fiscal 2001, 1,363 students became teachers in Maryland schools. This number had dropped to 904 in fiscal 2004 and rebounded slightly to 1,082 in fiscal 2005. However, this is still well below the fiscal 2001 level.

To better understand the cause of this trend, DLS conducted an informal survey of the public four-year institutions with education programs to gather data on the number of applicants, the number of qualified applicants, the number of admitted applicants, and the number of applicants that decided to enroll in the teacher education program at that institution. It was determined that institutions do not cap the number of candidates they will accept into teacher education programs. However, if a content area within the program is not a shortage area, the program may be capped. If the content area is a shortage area, the program is not capped.

As discussed above, the nursing education programs receive so many qualified applications that the institutions must set a cap on enrollment and deny admittance to many students. In contrast, the teacher education programs surveyed by DLS accept any qualified applicant into a critical shortage content area. Given this information, the general conclusion can be made that in order to increase the number of students graduating and teaching in Maryland, consideration must be given as to how to attract more students to a career in teaching in Maryland schools.

Health and Health Insurance

Cigarette Restitution Fund Spending

Unresolved lawsuits continue to make Cigarette Restitution Fund revenues unpredictable. Fiscal 2008 revenue increases expected as a result of strategic contribution payments may be offset by nonparticipating manufacturer adjustments.

Tobacco Settlement Revenue

On November 23, 1998, four (now three) major tobacco companies agreed to settle all outstanding litigation with 46 states, 5 territories, and the District of Columbia. Under the Master Settlement Agreement (MSA), these original participating manufacturers agreed to compensate the states for smoking-related medical costs and conform to certain marketing restrictions. Since 1998, several additional tobacco companies have also entered into the agreement. These companies, known as subsequent participating manufacturers, have brought additional revenue to the states.

Recent Legal Actions Threaten Cigarette Restitution Fund Revenues

Legal actions by manufacturers participating in the MSA threaten to reduce the amount of tobacco settlement revenues available to the states. These manufacturers contend that manufacturers not participating in the agreement have increased their share of the market by exploiting legal loopholes to reduce their escrow payments to the states, giving those manufacturers a competitive advantage in the pricing of their products. Chapter 169 of 1999, subsequently amended in 2001 and 2004, established Maryland's qualifying statute to level the playing field with respect to price between participating and nonparticipating tobacco manufacturers. The statute requires nonparticipating manufacturers to either join the MSA or make refundable deposits into an escrow account based on the number of cigarettes they sell in the State. The agreement authorizes participating manufacturers that lose a certain share of the market to withhold three times the amount of their losses. This withholding is known as a nonparticipating manufacturer (NPM) adjustment. The agreement allows participating manufacturers to pursue this adjustment on an annual basis. In April 2005, the participating manufacturers gave notice to state Attorneys General that they were pursuing an NPM adjustment with respect to a loss of market share in 2003.

In March 2006, an arbitrator ruled that the MSA was a significant factor contributing to the participating manufacturers' 2003 loss of market share thus allowing a 2003 NPM adjustment. The ruling entitled the tobacco manufacturers to reduce their 2006 Master Settlement payment by approximately $1.1 billion, or 18 percent, of which Maryland's share is approximately $26.0 million. The agreement provides that the adjustment will apply to all states unless a state has enacted and is diligently enforcing its qualifying statute. Diligent enforcement of the statute will be determined on a state-by-state basis through either a court proceeding or

arbitration. If one state wins diligent enforcement, that state's share of the NPM adjustment will be deducted from those states that are found not to have diligently enforced. Consequently, it is possible that Maryland's share of the adjustment could exceed $26.0 million.

Pending resolution of the diligent enforcement proceedings, the participating manufacturers placed $781.8 million into a disputed payments account, reducing Maryland's 2006 payment by $17.7 million. The initial adjustment of $26.0 million was not fully deducted because Phillip Morris, the country's largest tobacco manufacturer, and several other participating manufacturers elected to make their full 2006 payments, reducing the initial adjustment by approximately $8.3 million. If the tobacco manufacturers win the diligent enforcement proceedings, the manufacturers who elected to make their full 2006 payment would have the option to offset future payments by the amount of their 2003 NPM adjustment.

Once the legal proceedings are concluded and if Maryland is found to have diligently enforced its qualifying statute, the $17.7 million in the disputed payments account will be released to the State. If it is determined that Maryland has not diligently enforced its qualifying statute, the State's Cigarette Restitution Fund (CRF) revenues could be reduced by between $26.0 million and the State's full 2006 Master Settlement payment, approximately $158.2 million. The actual amount would depend on how many other states are found not to have diligently enforced their qualifying statute. The fiscal 2007 State budget restricts $26.0 million in the Medicaid appropriation, pending conclusion of the proceedings.

In May 2006, Maryland filed two motions in Baltimore City Circuit Court for a declaratory judgment. The first motion sought a court ruling on whether the dispute would be decided by the courts or by arbitration, and the second motion argued that the State has diligently enforced its qualifying statute. At the time of this writing, a decision has not been rendered on either motion.

In April 2006, the participating manufacturers again gave notice to the state Attorneys General that they were pursuing an NPM adjustment with respect to a loss of market share in 2004. The amount of the 2004 adjustment will be about the same as the 2003 adjustment, approximately $1.1 billion, of which Maryland's share is approximately $26.0 million. The reduction will be applied to the fiscal 2007 payment due April 15, 2007. The same arbitration firm will be used to determine if the MSA was a significant factor contributing to the participating manufacturer's 2004 loss of market share. The course of litigation will be similar to the process used for the 2003 challenge.

Aside from the 2003 and 2004 NPM adjustment litigations, several nonparticipating manufacturers are also challenging the legality of the model statute provision in the MSA in New York Federal District Court. The model statute provision requires settling states to establish and enforce qualifying statutes that require nonparticipating manufacturers to make refundable deposits into escrow accounts. The provision is a nonseverable provision, and therefore, if found to be unlawful or unenforceable, will have to be substituted by a provision agreed to by the participating manufacturers or the MSA will be terminated. The likely conclusion of this litigation is several years away.

Cigarette Restitution Fund Revenues and Expenditures – Fiscal 2005 to 2007

As shown in **Exhibit 1**, Maryland's fiscal 2006 Master Settlement payment was reduced by $17.7 million as a result of the 2003 NPM adjustment. However, expenditures were slightly higher due to a $15.4 million unexpended fund balance. Given the uncertainty surrounding the 2004 NPM adjustment, the fiscal 2007 budget assumes a similar reduction in revenue. Additionally, the fiscal 2007 budget restricts $26.0 million in the Medicaid appropriation pending resolution of the 2003 NPM dispute. Beginning in fiscal 2008 and continuing through fiscal 2017, the State will receive strategic contribution payments. These payments reflect the states' legal contributions to the tobacco settlement. Maryland's share of these payments is estimated at $28.0 million annually. Although CRF revenues are projected to increase as a result of the strategic contribution payments, actual revenues may be less due to the NPM adjustments.

Exhibit 1
Cigarette Restitution Fund Revenue and Expenditures
Fiscal 2005-2007
($ in Millions)

	FY 2005 Actual	FY 2006 Actual	Fiscal 2007 Working Appropriation
Beginning Fund Balance	$10.5	$15.4	$4.4
Settlement Payments	152.0	158.2	152.3
NPM Adjustment		-17.7	-17.7
Available Revenue	**$162.5**	**$155.9**	**$139.1**
Payment to Law Offices	-30.0	-29.9	
Prior Year Recoveries	1.5	1.1	
Total Available Revenue	**$134.0**	**$127.1**	**$139.1**
Expenditures	$118.6	$122.7	$166.1
Restricted Medicaid Funds			-26.0
Total Expenditures	**$118.6**	**$122.7**	**$140.1**
Ending Balance	**$15.4**	**$4.4**	**$-1.0**

NPM: Nonparticipating manufacturer
Note: Numbers may not sum due to rounding

Source: Department of Budget and Management; Department of Legislative Services

Health and Health Insurance

Medicaid Enrollment and Expenditure Trends

The fiscal 2007 Medicaid budget appears sufficient to cover currently projected expenditures. However, Medicaid continues to be a major consumer of general fund revenues. For fiscal 2008, in addition to increases based on enrollment and medical inflation, the enhancement of physician rates is expected to drive overall costs up 8.5 percent over fiscal 2007.

Overview

Maryland's Medicaid and Children's Health Programs provide eligible low-income individuals with comprehensive health care coverage. Funding is derived from both federal and State sources with a federal fund participation rate of 50 percent for Medicaid and 65 percent for the Maryland Children's Health Program (MCHP).

The Medical Assistance (Medicaid/MCHP) budget accounts for about 15 percent of State general fund expenditures and is one of the fastest growing segments of the State budget. Over the next five years, Medicaid costs are expected to rise at a rate of about 8 percent annually while general fund revenues are forecast to grow at a 5 percent clip. Failure to constrain Medical Assistance costs or identify additional revenue streams will ultimately result in Medical Assistance squeezing out funding for other programs.

Fiscal 2007 Outlook

The fiscal 2007 Medical Assistance budget of $4.6 billion ($2.2 billion of general funds) appears adequate to cover projected expenses. Favorable inflation and utilization trends, the availability of $40 million ($20 million general funds) of surplus fiscal 2006 dollars, and the development of the fiscal 2007 budget off an overstated fiscal 2006 base will offset higher than budgeted expenditures associated with:

- a 5.2 percent calendar 2006 managed care rate increase ($24 million of general funds);
- the federal fund match for MCHP declining from 65 to 50 percent for part of fiscal 2007 ($15 million of general funds). Maryland will exhaust all available MCHP block grant dollars before the close of fiscal 2007. Block grant dollars are available to cover 65 percent of MCHP costs. Once the block grant is exhausted, the federal match on the remaining MCHP expenses will fall to 50 percent; and

- the need to substitute $26 million of general funds for Cigarette Restitution Funds budgeted for Medicaid but held in abeyance pending the resolution of a legal challenge by manufacturers participating in the tobacco settlement. (*See separate issue paper on Cigarette Restitution Fund Spending.)*

Expenditures for fiscal 2007 services are expected to exceed fiscal 2006 costs by about 7 percent due to medical inflation (5 percent) and enrollment growth (2 percent) among children and people dually eligible for Medicaid and Medicare.

Fiscal 2008 Forecast

For fiscal 2008, Medical Assistance expenditures of $5.0 billion are anticipated of which almost half will be general funds. Overall costs will increase by about 8.5 percent while general fund spending is expected to grow by about $164 million or 7.5 percent over projected fiscal 2007 costs. Factors contributing to the anticipated expenditure growth include enrollment increases of almost 2 percent, changes in medical inflation/utilization (5.9 percent), and a planned enhancement to physician rates. Enrollment growth is spurred by a continued rise in the number of children qualifying for MCHP and the number of seniors qualifying for Medicaid and Medicare. The forecast also assumes the State will:

- ***Enhance Physician Rates ($40 million increase):*** Chapter 5 of the 2004 special session and Chapter 1 of 2005 earmark an increasing portion of the revenue from the health maintenance organization premium tax to raising Medicaid physician rates. In fiscal 2007, the Medical Assistance Program will spend about $90 million ($45 million in State special funds from the premium tax) to raise physician rates and reimburse Medicaid managed care organizations for their tax payments; this amount will increase to $130 million in fiscal 2008.

- ***Continue Hospital Day Limits:*** Medicaid regulations currently limit the number of days of hospital coverage for adults to 120 percent of the average length of stay by diagnosis-related groups. When the day limits were first implemented in fiscal 2004, they were scheduled to sunset at the close of fiscal 2005. While the target savings from day limits has been reduced since fiscal 2005, the limits have not been eliminated. The fiscal 2008 Department of Legislative Services' forecast assumes the day limits again generate savings of $50 million ($25 million of general funds).

- ***Implement the Federal Deficit Reduction Act of 2005:*** Savings from the federal Act are expected to rise by $20 million ($10 million of general funds) consistent with estimates by the Congressional Budget Office of savings from tightening restrictions on asset transfers.

- ***Again Exhaust MCHP Dollars:*** The State will again exhaust all available federal block grant dollars for MCHP before the close of the fiscal year. Dropping the federal match from 65 to 50 percent for part of the year will increase general fund expenses by $19 million.

Exhibit 1
Enrollment and Service Year Expenditures*

	FY 2006 Actual	FY 2007 Estimate	FY 2008 Estimate	FY 07-08% Change
Enrollment by Category				
Medicaid	525,076	531,300	537,819	1.2%
MCHP	103,260	112,070	116,350	3.8
Total	**628,336**	**643,370**	**654,169**	**1.7%**
Cost Per Enrollee	**$6,701**	**$7,068**	**$7,544**	**6.8%**
Total Funds ($ in Millions)	**$4,210**	**$4,547**	**$4,935**	**8.5%**

*Expenditures by fiscal year are based on the cost of providing services during that fiscal year rather than the year that the bills were actually paid. Cases and funding associated with the Maryland Pharmacy Program, the Maryland Primary Adult Care Program, and the Kidney Disease Program are excluded from the chart.

Source: Department of Legislative Services

Health and Health Insurance

Health Information Technology

Substantial progress has been made in 2006 nationally and in Maryland to improve the application of health care information technology.

According to an Institute of Medicine study, each year up to 100,000 Americans die from mistakes such as misreading illegible prescriptions or incorrectly treating patient conditions based on incomplete medical records. In the past few years, health information technology (HIT) has emerged as a means to reduce medical errors, cut health care costs, and improve the quality of medical care. Progress toward the wider use of HIT continues in 2006.

Federal Activities

In August 2006, President George W. Bush issued an executive order directing federal agencies to utilize HIT systems that meet recognized interoperability standards by January 1, 2007. Interoperability is described in the executive order as the ability to communicate and exchange data accurately, effectively, securely, and consistently with standards recognized by the U.S. Department of Health and Human Services (HHS). The following developments in October 2006, will assist in moving toward interoperability:

- The Certification Commission for Healthcare Information Technology (CCHIT) was the first group to be designated as a Recognized Certification Body by HHS, which will enable CCHIT to evaluate HIT products to ensure that they meet baseline requirements for functionality, interoperability, and security.

- The American Health Information Community (AHIC), which was formed to make recommendations to HHS on interoperability, privacy, and security, agreed on a set of HIT standards for maintenance of personal health records, transmission of laboratory results, and disease outbreak reports.

Congress has also been active. In July 2006, the House of Representatives passed the Health Information Technology Act (H.R. 4157) which would (1) codify the Office of the National Coordinator for Health Information Technology; (2) establish a committee to make recommendations on national standards for medical data storage; (3) develop a permanent structure to govern national interoperability standards; (4) clarify that current medical privacy laws apply to data stored or transmitted electronically; and (5) require the HHS secretary to recommend a privacy standard to reconcile differences in state and federal laws. The Act also includes provisions that would increase the number of billing codes used by health care providers

to file insurance claims and provide exemptions from anti-kickback laws allowing hospitals to donate HIT software to physicians.

In November 2005, the U.S. Senate approved the Wired for Health Care Quality Act (S. 1418), a similar HIT bill that does not include the provisions on billing codes or anti-kickback laws. As of the adjournment for midterm elections in 2006, the bills have not been reconciled.

State Activities

Although it is likely that actions at the federal level will be the key determinant toward the widespread adoption of HIT, numerous efforts in Maryland are also noteworthy:

- **Maryland Health Care Commission.** Recognizing the significance of the increased use of technology in promoting the efficient delivery of health care services, the recent reorganization of the Maryland Health Care Commission (MHCC) has resulted in the creation of the Center for Health Information Technology. MHCC stays in frequent contact with a number of national organizations involved in HIT and is involved in a variety of initiatives designed to expand HIT adoption in Maryland. The development of HIT initiatives at the State level eventually will enable Maryland to take an active part in setting the broad national strategy to implement the sharing of electronic health information.

- **Task Force to Study Electronic Health Records.** Chapter 291 of 2005 established the 26-member Task Force to Study Electronic Health Records, which is staffed by MHCC. The task force has been meeting regularly since January 2006 and is studying the current use and potential expansion of electronic health records across the State including (1) electronic transfer; (2) electronic prescribing; (3) computerized physician-order entry; (4) implementation costs; (5) impact on school health records; and (6) impact on patient safety.

  Members of the task force include legislators, representatives from the Office of the Attorney General, the Johns Hopkins and the University of Maryland Schools of Medicine, and the federal Veterans Administration as well as 20 members appointed by the Governor to represent a broad range of provider and consumer interests. The task force has been divided into three workgroups: (1) electronic patient information; (2) computerized prescribing; and (3) infrastructure management. A final report of the task force is due in December 2007.

- **MHCC Privacy and Security Study.** MHCC has engaged a broad range of stakeholders in an effort to assess the current practices related to privacy and security of electronically exchanging health information and to help develop secure health-information data-exchange systems in Maryland. The stakeholders will be called upon to assist

MHCC in its health-sector privacy and security study which will assess how organizational business policies and practices as well as State and federal laws regarding privacy and security affect the exchange of health information. MHCC will examine the readiness of payors, physicians, medical laboratory and diagnostic imaging centers, hospitals, long-term care providers, and consumers for health information exchange. The study is expected to begin in late October 2006, with a final report released April 2007. Information gathered from the study will provide the framework for other statewide HIT initiatives and will be shared at a national conference of states convened by HHS.

- **MHCC and Health Services Cost Review Commission HIT Regulations.** MHCC and the Health Services Cost Review Commission (HSCRC) are working jointly to advance HIT in Maryland. MHCC and HSCRC plan to identify up to three vendors to design the governance, business model, architecture, policies, and practices of a statewide regional health-information organization. In June 2006, MHCC published proposed regulations authorizing MHCC to accept applications for funding select HIT initiatives. The regulations describe the review of applications and development of recommendations for funding. HSCRC will make final decisions on each application recommended for funding and will implement the funding through adjusting the rates of the hospitals involved in the selected HIT initiatives. HSCRC adopted regulations in October 2006 to consider hospital rate adjustments for HIT projects recommended for approval by MHCC.

- **HIT at State-operated Facilities.** There are 16 State-operated health facilities in Maryland (7 psychiatric hospitals, 3 residential treatment centers, 4 residential centers for the developmentally disabled, and 2 chronic hospitals). These facilities utilize a Hospital Management Information System (HMIS) which is a basic census and billing system. Census and billing functions are basic administrative functions, and most health care facilities utilize some form of automated system. However, these functions fall far short of the full range of applications possible with HIT. Those applications include pharmacy management, treatment planning, clinical assessments, dietary functions, case documentation, physician order entry, scheduling, portable electronic medical records, and external consultations. Individual facilities have taken steps to expand what is available electronically at the facilities (for example, the State psychiatric hospitals utilize an electronic pharmacy/medications ordering system). However, there exists a clear opportunity to expand the use of HIT.

  In the 2006 session, $2.3 million was appropriated in the Department of Budget and Management for the Department of Health and Mental Hygiene (DHMH) to replace HMIS with a fully integrated administrative (census and billing) and clinical management information system to include targeted clinical activities such as a pharmacy module, electronic medical records, and a clinical point of entry system. The intent is to replace paper-based systems with an electronic record that can be accessed by all appropriate treatment team members. The system will also collect performance requirement data utilized by the Joint Commission on Accreditation of Healthcare Organizations for

accreditation purposes. The system will have standard basic functions across all facilities with optional functions tailored to specific needs of individual institutions based on populations served.

According to the Department of Health and Mental Hygiene, it is currently working on the Request for Proposals (RFP) for the HMIS replacement system and hopes to publish the RFP at the end of January. DHMH hopes to be able to award a contract to begin work on the project by the end of the fiscal year.

Health and Health Insurance

Expanding Access to Health Care Coverage

Fourteen percent of Marylanders live without health insurance, while more are underinsured. States are increasingly taking up the challenge of providing access to health care.

Background

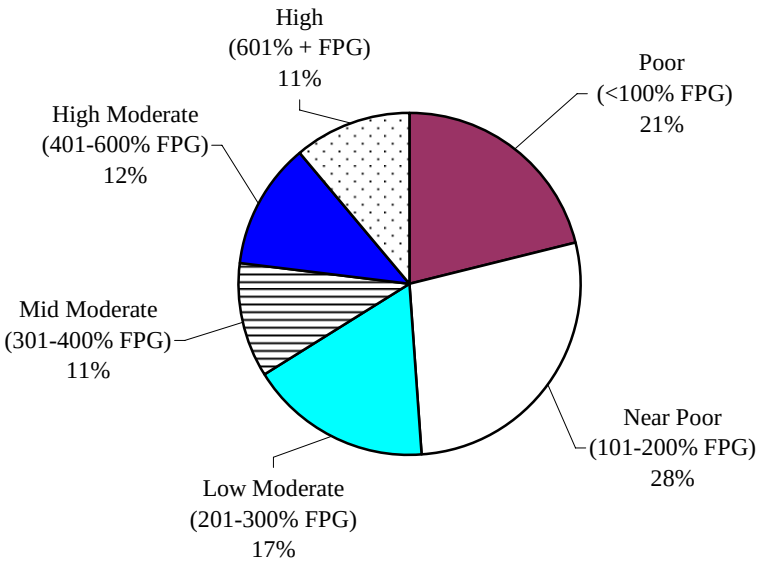
Nationally, about 50 million individuals are uninsured, and still more are underinsured. In Maryland, about 784,000 people or 14 percent of the State's population live without health insurance. In an effort to address the problem of uninsurance, several states have looked at substantive health care reform. This year, Massachusetts passed a much-anticipated universal health care law that combines both private and public sector reforms. Many state policymakers, including those in Maryland, are looking closely at the new law to see if its model would work for them.

A Snapshot of Maryland's Uninsured

While those who earn 200 percent or less of the federal poverty level guidelines (FPG) comprise almost half of Maryland's uninsured, those who earn more than 400 percent FPG make up abut 23 percent of the uninsured. (See **Exhibit 1**.) In 2006, that means about 180,000 people in Maryland earn at least $39,200 (or $80,000 for a family of four) and do not have health insurance.

Most of Maryland's uninsured are working adults. About 60 percent, or 467,000, are currently employed. For these workers, firm size factors significantly in whether an individual has health insurance. Sixty-one percent of uninsured workers work for businesses that employ 99 or fewer workers. Thirty-three percent work for businesses that employ fewer than 10 employees. (See **Exhibit 2**.)

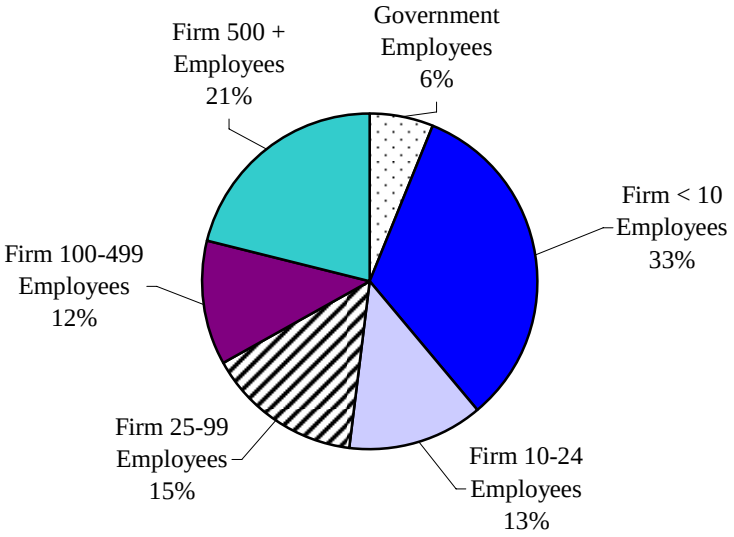
Exhibit 1
Maryland's Uninsured by Poverty Level
(Nonelderly Population)



FPG: Federal Poverty Level Guidelines

Source: Department of Legislative Services

Exhibit 2
Uninsured Workers (Ages 19-64) by Sector and Firm Size



Source: Department of Legislative Services

Maryland Health Care Programs

Maryland has a variety of public health care programs in place to provide a safety net to lower-income individuals. However, the State has faced criticism over its lack of Medicaid coverage for poorer adults. According to one report, Maryland ranks fortieth out of 50 states in its Medicaid eligibility for working parents. This ranking comes in sharp contrast to the fact Maryland holds the second highest median household income in the nation.

- **Medicaid:** The backbone of Maryland's public health programs is Medicaid. An adult may qualify for Medicaid if the adult is (1) aged, blind, or disabled; (2) in a family where one parent is absent, disabled, unemployed, or underemployed; or (3) a pregnant woman. Adults with very low incomes also qualify for Medicaid (about 40 percent of the federal poverty level guidelines or FPG). The Maryland Children's Health Program (MCHP) also covers children with family incomes up to 300 percent FPG and pregnant women with incomes up to 250 percent FPG. About 643,000 individuals are enrolled in the Medicaid and MCHP programs in fiscal 2007.

- **Maryland Primary Adult Care Program (PAC):** Established through a federal Medicaid waiver, this program enrolls individuals who earn up to 116 percent FPG who are not eligible for regular Medicaid. PAC covers primary care health services and prescription drugs. Primary care services are provided through a managed care network. Specialty care and hospital services are not covered. Current enrollment is about 23,000.

- **Maryland Health Insurance Plan (MHIP):** This program is a high-risk health insurance pool that provides comprehensive health coverage to medically uninsurable individuals. Enrollees in regular MHIP pay a premium slightly higher than what they would pay for a private health insurance plan. MHIP+ offers lower premiums and cost sharing to individuals with incomes up to 225 percent FPG. The plan has approximately 9,200 enrollees as of November 2006.

- **Other Programs:** Maryland also offers several other public health programs targeted at certain populations, such as its mental health, cancer prevention, and AIDS/HIV programs. The Senior Prescription Drug Assistance Program helps pay Medicare Part D premiums and cost sharing. In addition, the Medbank program, a nonprofit organization, works with pharmaceutical manufacturers to provide low-cost or free medications to qualifying individuals with chronic health problems.

Small Group Insurance Market

Much attention has been focused in recent years on the small group market, comprised of businesses with 2 to 50 employees. As indicated in Exhibit 2, a large percentage of Maryland's uninsured are employed in small businesses. Since the late 1990s, both the number of participating employers and the number of individuals with insurance coverage in the small

group market have declined. The main reason for the decline is cost. The cost of the standard benefit plan required to be sold in the small group market has risen faster than wages. By law, the average premium cost for the standard benefit plan may not exceed 10 percent of the State's average wage. To stay under the 10 percent cap, the Maryland Health Care Commission has increased deductibles, copayments, and coinsurance and reduced pharmacy benefits. Many stakeholders believe these actions represent a temporary fix, however, and recommend statutory changes to turn the situation around.

Recent Legislative Action

Concern about the rising number of uninsured has prompted several legislative initiatives, including:

- Chapter 280 of 2005, which created a Community Health Resources Commission to provide grants to local clinics and other "community health resources" serving the low-income uninsured. Chapter 280 also established a Joint Legislative Task Force on Universal Access to Quality and Affordable Health Care. Appointed late in 2005, the task force was extended by Chapter 21 of 2006 and required to report its findings and recommendations to the Governor and the General Assembly by December 31, 2006. As of November 1, the task force has held four public hearings around the State and expects to review all the options presented at a meeting in December.

- Chapter 409 of 2005, which established a Joint Legislative Task Force on Small Group Market Health Insurance charged with reviewing requirements for the standard benefit plan, the range of permissible products, and other factors in the market. Chapter 26 of 2006 extended the task force report due date until July 1, 2007.

- Chapter 1 of 2006, "Fair Share Health Care Fund Act," which would have required for-profit employers with 10,000 or more employees in the State to spend at least 8 percent of total wages on health insurance, or else pay into a State fund used to support the Medicaid program. The law was overturned in federal district court (see separate issue paper "ERISA Preemption and the Fair Share Health Care Fund Act").

- HB 441 of 2006, which would have increased the tobacco tax by $1 and used the revenue to expand Medicaid coverage to parents with household income up to 100 percent FPG.

- HB 1121 of 2006, which would have imposed an income tax surcharge on higher income individuals who chose not to purchase health insurance and used the revenue to subsidize insurance for low income individuals.

- SB 530/HB 1460 of 2006, which would have established a health insurance exchange through which individuals and small businesses could purchase health insurance. The

legislation would have provided tax credits to individuals to help offset the cost of insurance.

- HB 1510 of 2006, "Public-Private Partnership for Health Coverage for All Marylanders" would have undertaken a major restructuring of the health care system and health insurance in the State, in an effort to provide coverage to all Maryland citizens.

Reforms in Massachusetts and Other States

Like Maryland, states across the country are seeking ways to maintain and expand health care coverage, through creative uses of Medicaid as well as private health insurance initiatives.

- **Massachusetts:** Massachusetts' plan requires all individuals to maintain health insurance or face certain tax penalties. Employers are required to provide health insurance for their employees as well, or face a $295 fair share charge. The state's Medicaid program will be expanded to include children in families that are at or below 300 percent of FPG. The state will also offer subsidized health insurance to lower-income individuals. With these changes, Massachusetts expects to reduce its uninsured rate to just 1 percent by 2010. The plan is projected to cost about $1.3 billion in fiscal 2007, although much of the expansion is funded by existing federal funds, much of which are not available to Maryland.

- **Vermont:** Vermont created the Catamount Health program in 2006 to provide affordable coverage for as many as 96 percent of its currently uninsured individuals, beginning October 1, 2007. Catamount will combine all uninsured individuals into one group to leverage purchasing power in the individual health insurance market, thereby lowering average premium prices. In addition, subsidies will be provided to income-eligible people. Another significant component of Vermont's law is its Blueprint for Health, a chronic disease management program that will emphasize early screening, patient self-management, and financial rewards for health care providers who are proactive about chronic care management. Vermont intends to fund the program using tobacco taxes and matching federal funds. In addition, employers must pay $365 per year for each uninsured employee. The program provides for enrollment caps to limit the state's financial liability.

- **Other States:** Maine's Dirigo Health program makes coverage available to uninsured individuals, businesses and municipalities with 50 or fewer employees, and the self-employed. Coverage under Dirigo is off to a slower than expected start. California recently passed a universal health care law creating a single-payor system administered by the state. It was vetoed by the Governor in September 2006. Hawaii passed a bill to provide universal health care to all children in the state but the bill was vetoed by the Governor. The Healthy New York program is a state-subsidized reinsurance program that provides low-cost insurance to low- and moderate-income individuals who would otherwise be unable to afford coverage. New York also has legislation under

consideration that would require all employers with 25 or more employees to pay at least 80 percent of insurance premiums into a fund. The state would then use the funds to purchase insurance coverage for all. Other states have used Medicaid waivers, tax credits, and subsidies to small businesses and individuals as ways to expand coverage.

Prospects for the 2007 Session

Recommendations from the two legislative task forces on universal access and small group market health insurance will frame consideration of legislation to expand health care coverage at the 2007 session. Given previous legislation in Maryland, as well as activities in other states, legislative initiatives may focus on expansion of Medicaid to parents as well as childless adults, incentives for moderate income working individuals to purchase insurance, creation of a health insurance exchange to facilitate the purchase of insurance, and penalties on higher income individuals who can afford coverage but choose not to purchase it.

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Health and Health Insurance

ERISA Preemption and the Fair Share Health Care Fund Act

Maryland's Fair Share Health Care Fund Act was recently overturned because it was ruled to be preempted by the federal Employee Retirement Income Security Act.

Introduction

In response to declining numbers of employers offering health insurance and concern that the ones who do offer insurance do not offer insurance to appropriate numbers of employees or at appropriate levels, state and local jurisdictions have been considering "pay or play" laws. These types of laws require employers to offer health insurance at a certain level to their employees ("play") or pay a fee to the state ("pay"). One of the first states to enact a "pay or play" law was Maryland, in January 2006, with the enactment of the Fair Share Health Care Fund Act (the Act).

Whether states have the authority to enact this type of law remains a question, as opponents of these laws argue that they are preempted by the federal Employee Retirement Income Security Act (ERISA), which broadly preempts state laws that relate to plans regulated under ERISA. In July 2006, the U.S. District Court for the District of Maryland overturned the Act, finding that it was preempted by ERISA.

Maryland's Employer Mandate and Recent Litigation

Overview of ERISA Preemption

ERISA is a federal law that regulates employer sponsored benefit plans, including health plans. ERISA very broadly preempts "any and all State laws insofar as they may now or hereafter relate to any" ERISA plan. States may continue to regulate health insurance under ERISA, but only by regulating the insurers, not by directly regulating the ERISA plans themselves.

However, the Supreme Court has ruled that the term "relate to" cannot be given its full meaning, or "for all practical purposes pre-emption would never run its course."[2] The Supreme Court has ruled that it will find that ERISA preempts state laws that have either a "reference to" or "connection with" an ERISA plan. In order to find whether a state law has a connection with an ERISA plan, courts must look to (1) the objectives of the ERISA statute; and (2) the nature of the effect of the state law on ERISA plans.[3]

[2] *Egelhoff v. Egelhoff*, 532 U.S. 141, 146 (2001).
[3] *Id*. at 147.

Fair Share Health Care Fund Act

In the 2005 session, the General Assembly passed the Fair Share Health Care Fund Act. The Act requires for-profit employers with 10,000 or more employees that do not spend up to 8 percent of the total wages paid to employees in the State on health insurance costs to pay into the Fair Share Health Care Fund an amount equal to the difference between what the employer spends on health insurance costs and the 8 percent threshold. For nonprofit employers with 10,000 or more employees, the spending threshold is 6 percent. The purpose of the Fair Share Health Care Fund is to support the State's Medicaid program. "Health insurance costs" are defined in the Act to include any health care costs that may be deductible by an employer under federal tax law, including payments for prescription drugs and medical savings accounts. The Governor vetoed the Act, but the General Assembly overrode the Governor's veto at the beginning of the 2006 legislative session.

At the time the law was passed, three employers had over 10,000 employees in Maryland – Giant Foods, Johns Hopkins, and Wal-Mart. A fourth employer, Northrup Grumman, was thought to have about 10,000 employees. Only Wal-Mart did not meet the threshold required by the Act.

U.S. Federal District Court Finds the Act Preempted by ERISA

In February 2006, the Retail Industry Leaders Association (RILA) filed suit in federal court to overturn the Act on the ground that the Act was preempted by ERISA. RILA is a national trade association for large retailers, of which Wal-Mart is a member.

In July 2006, the U.S. Federal District Court in Maryland issued its decision in the case. The court found that the Act was preempted by ERISA because the Act had a connection with an ERISA plan. The court found that the Act violates ERISA's objective to permit nationally uniform administration of employee benefit plans because the Act creates health care spending requirements that are not applicable in other jurisdictions and might conflict with requirements in other jurisdictions. The court noted that as a consequence of the Act a national employer would have to "segregate a separate pool of expenditures for its Maryland employees and structure its contributions – and employees' deductibles and copays – with an eye to how this will affect the Act's 8 percent spending requirement."[4]

The court disagreed with the Office of the Attorney General's argument that the Act does not mandate that a large employer must spend a certain amount on its ERISA plan. The Attorney General argued that an employer subject to the Act could comply with the Act by spending money on health savings accounts (HSAs) or first aid facilities for its employees, or simply pay the remainder to the Medicaid program. The court instead found that HSAs fall outside the definition of ERISA plans only if they are voluntary on the part of employees, and that therefore, an employer could not ensure its compliance with the Act by contributing to an HSA. The court also disagreed with the State's argument that an employer could comply with the Act by

[4] *Retail Industry Leaders Ass'n v. Fielder*, Civil No. JFM-06-316, page 20 (D. Md. 2006).

constructing first aid facilities on the premises of an employer. Finally, the court did not agree that the alternative of an employer to simply pay the money to Medicaid was a viable one. The court called this a "Hobson's choice" for an employer, finding that "if employers are faced with the choice of paying a sum of money to the State or offering an equal sum of money to their employees in the form of health care, no rational employer would choose to pay the State." [5]

The State has appealed the case to the U.S. Court of Appeals for the Fourth Circuit. Oral argument for the case has been scheduled for November 30, 2006.

Employer Mandates in Massachusetts and Vermont and the Potential for ERISA Preemption

Since Maryland enacted the Act, other states have enacted employer mandates for health insurance, or "pay or play" laws. As part of comprehensive health care reform laws, Massachusetts and Vermont both enacted laws that require employers that do not provide a certain level of insurance coverage for their employees to pay a fee to the state. The Massachusetts law requires employers with 11 or more employees to pay a fair and reasonable contribution to the employees' health insurance premiums. Employers who do not meet this test will be assessed $295 per employee per year. The Vermont law assesses all employers an annual fee of $365 for each uninsured employee employed by the employer. For 2007 and 2008, Vermont allows eight full-time employees to be excluded from calculation of the assessment.

It is arguable that these mandates are different from Maryland's requirement and would not be preempted by ERISA because (1) the laws are part of comprehensive reform packages and apply broadly to all employers; and (2) the alternative of an employer to pay an assessment of several hundred dollars as opposed to insuring its employees is not a "Hobson's choice" because it is likely that the assessment is far less than what the employer would actually spend on an employee's annual health insurance costs.

However, some argue that any employer mandate relating to health insurance will be preempted by ERISA because any state requirement for otherwise voluntary employer-sponsored health benefits would prevent an employer from administering a uniform interstate employee health benefit package. As of November 2006, there has not yet been a lawsuit challenging the validity of either the Massachusetts or the Vermont employer mandate.

[5] *Id.* at 24 -25.

Health and Health Insurance

Physician Reimbursement

In comparison to a commonly used benchmark, Medicare reimbursement rates, physician reimbursement in Maryland is considered low. Some believe this is due to an imbalance in negotiating power between physicians and health plans.

Background

A perceived imbalance in negotiating power between health plans and physicians led to the introduction of several bills in the 2006 session that sought to give physicians more clout in fee negotiations. The bills are symptomatic of growing frustration among physicians with both public and private compensation. Inattention to this issue, according to the physicians, could lead to physician shortages and inability to access care when needed. Health plans counter that restraining physician compensation holds health care costs down and helps plans compete for large employer business. At the same time, an increasing resolve exists to link reimbursement to performance and other quality measures.

Health Insurance Reimbursement Rates in Maryland Fall Below Medicare and Rates Paid in Other States

Medicare physician payments account for about 25 percent of all spending on physician services. Medicare reimbursement rates are commonly used as a benchmark by both private payers and Medicaid. Minimal increases in Medicare rates in recent years, therefore, have broad ramifications for overall physician compensation.

Each year the Maryland Health Care Commission (MHCC) reports on the level of practitioner spending among the privately insured population. Most recently, MHCC reported on spending in 2004. Fees for physician services paid by health maintenance organizations (HMOs) averaged about 3.0 percent below the Medicare level, while fees paid by non-HMO plans were about 2.6 percent above the Medicare level. Although services provided in a hospital setting commanded rates exceeding Medicare, services provided in an office-based setting, accounting for 70 percent of all practitioner payments, were paid at below-Medicare rates.

In addition to differences by service setting, fees also differed markedly by size of payer and by the practitioner's participation status with the payer. The two dominant health insurance carriers in the State, CareFirst BlueCross BlueShield and United/MAMSI, paid at rates comparable to or below Medicare, while the smaller carriers generally paid at rates significantly higher. Rates paid to practitioners under contract to the health insurance carrier averaged slightly under the Medicare level, whereas nonparticipating practitioners received payment at

rates about 63 percent above Medicare from non-HMO plans and about 39 percent above Medicare from HMO plans.

According to MHCC, Maryland insurance reimbursement rates are well below the average nationwide; across the country, insurance reimbursement rates exceed Medicare by about 20 percent. MHCC surmises that a relatively large supply of physicians and moderately high HMO penetration help sustain lower fees in Maryland than in the U.S. as a whole.

Legislative Action Has Addressed Inadequate Medicaid Reimbursement and a "Level Playing Field" Between Physicians and Private Health Plans

For many years, Medicaid fees for physician services were far below Medicare and private insurance rates. Occasional fee increases were targeted to obstetrical and primary care services. That situation changed with the passage of the medical malpractice law at the special session of 2004 and the corrective law of 2005. The Rate Stabilization Fund supported by a 2 percent tax on HMOs and managed care organizations (MCOs) dedicates an increasing proportion of revenues each year to higher Medicaid reimbursement rates. In fiscal 2006, $15.0 million was used to increase rates for procedures commonly performed by obstetricians, neurosurgeons, orthopedic surgeons, and emergency medicine physicians. In fiscal 2007, $25.2 million was targeted to anesthesia, general surgery, radiation oncology, gastroenterology, otorhinolaryngology, dermatology, and allergen immunology – specialties with particularly low fees. Fees in these areas have been raised to 80 to 100 percent of Medicare levels. Additional funds will be allocated in fiscal 2008, 2009, and 2010 with the goal of attaining parity with Medicare fees.

Legislation was enacted in 2006 to support physicians' negotiating position with private health plans without impairing the ability of the plans to appropriately manage their physician networks. The new laws will also help patients gain timely access to physicians. Specifically:

- Chapter 597 requires health insurance carriers to maintain adequate provider networks, in accordance with regulations to be adopted by the Maryland Insurance Administration (MIA). If a carrier cannot provide reasonable access to a specialist with expertise needed to treat a patient's condition, the law requires the carrier to allow the patient to see a specialist who is not part of the carrier's provider network, without higher cost sharing. The new law provides an incentive for carriers to bring physicians into their provider networks.

- Chapter 554 prohibits carriers from including in their provider contracts terms that prevent the provider from negotiating lower reimbursement rates with other carriers. Such "most favored nation" clauses were viewed as anticompetitive by the General Assembly.

- Chapter 54 prohibits carriers from requiring participating health care providers to have their credentials revalidated if the providers are only changing a tax identification number or changing employers. The recredentialing process can take several months, and physicians may not be able to bill for their services until the process is completed. Chapter 54 also requires MIA to report on ways to improve the credentialing system for health care providers.

- Chapter 476 prohibits carriers from requiring a health care provider, as a condition of participation on a provider panel, to also serve on a provider panel for workers' compensation services. The General Assembly has consistently taken the position that physicians should be able to pick and choose which health benefits plans in which to participate.

Legislation was introduced but not enacted to:

- alter the method for calculating the reimbursement by HMOs of covered services provided by nonparticipating practitioners; and

- require carriers to allow patients to assign their insurance benefits to their practitioner.

The chairs of the Senate Finance Committee and the House Health and Government Operations Committee have requested the Department of Legislative Services (DLS) to study the assignment of benefits issue and report back to them.

Pay-for-performance Is Promoted to Improve Quality and Reduce Cost

Current policy discussions about physician reimbursement strongly link practitioner payment to some measure of performance. Payers use incentives to encourage practitioners to incorporate evidence-based standards of care and technology in their practices and improve patient satisfaction. Medicare has supported demonstration projects that provide bonus payments for attainment of quality indicators. In January 2006, Medicare launched the Physician Voluntary Reporting Program that measures physician performance on 16 evidence-based indicators, such as giving aspirin at arrival for acute myocardial infarction and assessing elderly patients for falls. Federal proposals to reverse planned reductions in Medicare fees over the next several years have made higher fees contingent on reporting on quality measures.

In Maryland, CareFirst has provided financial support for the Bridges to Excellence program, with a goal of reducing waste and inefficiency in the provision of health care, reengineering processes to reduce mistakes, and increasing accountability and quality by providing comparative provider performance data to consumers. UnitedHealthcare is implementing its Premium Designation Program, designating with one or two stars in its provider directory those physicians who reach quality and efficiency standards. Under the

Maryland HealthChoice program, Medicaid MCOs receive monetary rewards and penalties for performance on specified quality measures such as timely immunizations of children.

Prospects for the 2007 Session

As health care costs continue to rise faster than wages or overall inflation, health plans and employers will continue to resist pressure by physician and other health care practitioner groups to give practitioners more leverage in contract negotiations. The committees may receive briefings on the DLS study of assignment of benefits and the MIA interim work on network adequacy and provider credentialing. Additional funds will be available in the Medicaid budget to continue to raise physician reimbursement rates.

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Health and Health Insurance

Impact of Federal Medicaid Reforms on Maryland

In February 2006, federal deficit reduction legislation made significant changes to the Medicaid program. In addition to mandatory reforms that include a proof of citizenship requirement and changes to asset transfer rules, new options are now available to the Maryland Medicaid Program, including expanded premium and cost-sharing provisions.

The Federal Deficit Reduction Act (DRA) of 2005, signed on February 8, 2006, is anticipated to reduce federal entitlements by nearly $100 billion over the next decade. Included in the DRA are significant reforms to the Medicaid program. Although the full impact of these changes to the Maryland Medicaid program is not yet clear, several new options are available to the State.

Major Medicaid Reforms in the Federal Deficit Reduction Act

The DRA includes both mandatory and optional reforms. The two most significant mandatory reforms are a proof of citizenship requirement and changes to asset transfer rules that will impact individuals in long-term care. Key optional reforms allow states to increase premiums and cost sharing for enrollees, replace existing Medicaid benefits for certain groups with more limited "benchmark" coverage, and extend Medicaid "buy-in" coverage to certain children with disabilities.

Proof of Citizenship Requirement

Effective July 1, 2006, U.S. citizens covered by or applying for Medicaid must prove their citizenship by submitting a birth certificate or passport (or a limited set of other documents) as a condition of coverage. This mandate will affect most new applicants and current recipients, though individuals who receive Social Security Income (SSI) or Medicare; refugees, asylees, and other qualified aliens are exempt. To assist implementation of this requirement, the Department of Health and Mental Hygiene (DHMH) is matching new and renewal applicants with State vital records data to verify citizenship status. To date, approximately 60 percent of applicants have been verified through this date, while remaining applicants will be required to complete an affidavit for citizenship or identity.

Changes to Asset Transfer Rules

States must lengthen the "look back" period from three to five years to determine whether beneficiaries made inappropriate transfers of assets that otherwise would have been used to pay for nursing home care. The period of ineligibility for those who inappropriately transfer assets will now be the later of either the date of transfer or the date the beneficiary otherwise would

have become Medicaid eligible. States must also now count certain annuities, promissory notes, and mortgages toward eligibility thresholds and deny nursing home services to individuals with more than $500,000 in home equity. DHMH has prepared regulations to implement new asset transfer rules and plans to submit the regulations in January.

Premiums and Cost Sharing

The DRA authorizes states to impose premiums and additional cost sharing on Medicaid enrollees. Currently, only nominal cost sharing of no more than $3 per service is allowed, and cost sharing is prohibited for pregnant women and children and for specific services such as emergency room visits. Under the DRA, states may impose premiums and copayments up to 20 percent of the cost of services on Medicaid beneficiaries with family incomes over 150 percent of the federal poverty level (FPL). Copayments up to 10 percent of the cost of services are authorized for beneficiaries with family incomes between 100 and 150 percent of the FPL. States may also increase copayments for nonemergency services in an emergency room.

Premiums and cost sharing for services for mandatory children and pregnant women as well as cost sharing for preventive services for children, pregnancy-related services, and emergency services are prohibited. States are also authorized to increase cost sharing for nonpreferred prescription drugs to up to 20 percent of costs for individuals with incomes above 150 percent of the FPL and nominal cost sharing for individuals with incomes under 150 percent of the FPL.

The DRA prohibits total cost sharing and premium amounts from exceeding 5 percent of a family's income over a one-month or quarterly time period. The DRA also makes premiums and cost sharing "enforceable" for the first time in that providers can deny services if a beneficiary does not pay the cost-sharing amount at the point of service, and states can terminate coverage for failure to pay premiums for 60 days.

"Benchmark" Benefits

Another option available to states is the ability to replace the existing Medicaid benefits package for children and certain other groups with more limited "benchmark" coverage. This coverage could be the current State employee plan, coverage offered by the largest health maintenance organization (HMO) in the State, or the federal Blue Cross Blue Shield plan. Pregnant women, mandatory parents, individuals with disabilities and special needs, dual eligibles, and long-term care beneficiaries are exempt from benchmark coverage.

In addition to benchmark benefits, under the Family Opportunity Act, states may allow children with disabilities with family income up to 300 percent of the FPL to buy into Medicaid. Coverage is phased in starting in 2007 for children up to age 6 and rising to age 19 by 2009. States may charge income-related premiums, and parents must participate in employer-sponsored insurance if the employer covers at least 50 percent of the premium.

Options for Maryland

DHMH is currently implementing the mandatory changes required under the DRA and reviewing available options. Narrative in the fiscal 2007 budget requires DHMH to submit a report by December 1, 2006, on encouraging healthy behaviors and proper utilization of services. DHMH indicates that Maryland's options under the DRA will be more fully detailed in this report.

DHMH indicates that, of the 687,000[6] Maryland Medicaid enrollees as of June 2006, less than 10 percent would be subject to premium provisions, and less than half would be subject to cost sharing or benchmark benefits. More specifically, 61,000 individuals (9 percent) would be eligible for premiums, including 12,000 current Maryland Children's Heath Program (MCHP) premium enrollees; 300,500 enrollees (44 percent) would be eligible for copayments; and 307,000 enrollees (45 percent) would be eligible for benchmark benefits. Without additional data, it is unclear what cost savings the State could achieve under these options or what impact these changes would have on enrollees.

Implementation of Optional DRA Provisions in Other States

Although Maryland has not yet acted on the optional reforms available under the DRA, some states have been granted state plan amendments by the federal Centers for Medicare and Medicaid Services to implement new options under the DRA.

Kentucky: the KyHealth Choices Program

In May 2006, Kentucky launched the KyHealth Choices program. The program includes four population-based benefit packages, four prescription medication per-month limit (unless medically necessary and for certain chronic conditions), and copayments of, on average, $1 to $10 for some services and prescriptions. Copayments are capped at $225 per year each for prescriptions and services. KyHealth Choices also includes "Get Healthy" accounts for individuals with specific chronic diseases under which enrollees can earn rewards for actions such as keeping appointments. Rewards can then be used for additional benefits such as smoking cessation or to fund copayments.

West Virginia: Benchmark Benefits for Parents and Children

Effective July 1, 2006, West Virginia implemented two new benchmark benefit plans for parents and children. The plan includes a "basic" benefits plan that is more limited than the state's current benefits but includes all mandatory and some optional services. An "enhanced" benefits plan is available if parents comply with certain responsibilities such as maintaining

[6]Includes enrollees in Medical Assistance, MCHP, Pharmacy Assistance (now Primary Adult Care Program), and Family Planning.

scheduled appointments and adhering to health improvement programs. The benchmark benefit package will be phased in over time, beginning with four counties.

Health and Health Insurance

Health Disparities

Maryland data point to a number of health status disparities impacting Maryland's growing minority populations. There have been a number of recent efforts to bring greater attention to such disparities, and more are anticipated.

Background

Documented health disparities exist in the U.S. and Maryland among racial and ethnic minorities. According to the 2002 Institute of Medicine's (IOM) report, *Unequal Treatment: Confronting Racial and Ethnic Disparities in Health Care*, racial and ethnic minorities tend to receive a lower quality of health care services and are less likely to receive routine medical procedures as compared to nonminorities, even when access-related factors, such as health insurance status and income, are controlled. Because combined racial and ethnic minority populations are expected to make up an increasingly larger proportion of the U.S. population in coming years, the number of people affected by health disparities will only increase if this issue is not addressed.

What is a health disparity? The IOM report defines health disparities as "racial or ethnic differences in the quality of health care that are not due to access-related factors or clinical needs, preferences, and appropriateness of intervention." Among researchers who study health disparities, the current thinking is that there are two types of disparities:

- Health status disparities which occur when a racial or ethnic minority group shows a higher incidence of illness, injury, disability, or mortality.

- Health care disparities which occur when a racial or ethnic minority group has different insurance coverage and access to health care, as well as other factors that could affect health care quality that are not due to a health status disparity.

Federal Initiatives

In 1986, the Office of Minority Health was established by the Department of Health and Human Services (HHS) to improve and protect the health of racial and ethnic minority populations. The HHS Office of Minority Health is responsible for several initiatives, including *Closing the Health Gap*, which is a national campaign designed to help improve the health of racial and ethnic minority populations who are affected by serious diseases and health conditions at significantly higher rates than white Americans.

Other examples of federal programs designed to assist in the elimination of health disparities include *Healthy People 2010* and *Racial and Ethnic Approaches to Community Health (REACH) 2010*. *Healthy People 2010* outlines the nation's health objectives and includes as one of its main goals the elimination of racial and ethnic disparities in health. *REACH 2010* was launched in 1999 by the Centers for Disease Control and Prevention and is designed to eliminate disparities in health status in the following six priority areas: cardiovascular disease, immunizations, breast and cervical cancer screening and management, diabetes, HIV/AIDS, and infant mortality.

Health Disparities in Maryland

Maryland has an increasing minority population. Data provided by the Maryland Vital Statistics Administration reveal that the 2005 estimated Maryland population is 40.3 percent minority. The following are examples of health status disparities affecting Maryland's minority populations.

- **Excess Black Mortality and Infant Mortality:** Data provided by the Vital Statistics Administration show that statewide, for years 2003 to 2005, blacks died at a 27 percent greater rate than whites. According to the Maryland Vital Statistics Administration's *2005 Preliminary Report*, infant mortality rates statewide were three times higher in 2005 for non-hispanic blacks than non-hispanic whites. The infant mortality rate varies from 4.7 deaths per 1,000 live births for non-hispanic whites to a high of 12.7 deaths per 1,000 live births for non-hispanic blacks.

- **HIV/AIDS:** Data provided by the AIDS Administration shows that the rate of black residents living with HIV and AIDS has progressively increased from 606.9 per 100,000 population in 2000 to 777.8 per 100,000 population in 2004, 13 times greater than the 2004 rate for whites, which was 59.9 per 100,000 population.

- **Heart Disease and Diabetes:** According to the Maryland Vital Statistics Administration's *2004 Annual Report*, in 2004, blacks died 1.3 times more often than whites from heart diseases and 2.1 times more often than whites from diabetes.

Health Disparities Initiatives in Maryland

For the past decade, the General Assembly has considered legislation to address health disparities in racial and ethnic minorities. Examples of this legislative activity include the establishment of the Office of Minority Health and Health Disparities in 2004 to coordinate State efforts on eliminating health disparities. One of the office's major initiatives is a statewide plan to eliminate health disparities. The statewide plan, which is expected to be published early in the 2007 session, will address issues relating to health disparities, such as, health professional

education, health disparities data, resources for reducing disparities, and access to quality health care. In 2006, legislation was passed requiring the Office of Minority Health and Health Disparities, in collaboration with the Maryland Health Care Commission, to develop a "Health Care Disparities Policy Report Card." The report card will include data on racial and ethnic disparities in Maryland and is required to be published annually.

Prospects for the 2007 Session

Maryland is one of only four states that prohibit insurers from collecting data on race and ethnicity. The IOM report concluded that the collection of racial and ethnic data is paramount to the goal of eliminating health disparities in racial and ethnic minority populations. Keys to successfully identifying disparities and determining the leading health causes of death and chronic illness are dependent on the availability of consistent and reliable data on racial and ethnic minority populations. Identifying health disparities can also provide valuable information for the development and implementation of effective health promotion and disease prevention programs.

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Social Programs

Foster Care Caseload Trends

Enhanced federal fund attainment, growth in the number of adoptions, and a shift from high cost institutional placements to community-based care will produce a fiscal 2007 surplus in the foster care program. The savings could be redirected to fill the 217 child welfare caseworker and supervisor positions needed to meet the staff-to-caseload ratios recommended by the Child Welfare League of America.

The State's foster care and subsidized adoption programs provide temporary and permanent homes for children in need of out-of-home placements due to abuse, neglect, or abandonment. Foster care placements – such as family homes, group homes, and institutions – offer temporary out-of-home care until achievement of a permanency plan. Permanency options include reunification with the family and adoption. Families that accept legal custody of a child with special needs may receive monthly payments under the subsidized adoption program.

Foster Care and Subsidized Adoption Caseloads

Exhibit 1 shows that the Department of Legislative Services (DLS) anticipates an increase of 1.3 percent per year in the combined foster care/subsidized adoption caseload from fiscal 2006 to 2008. The combined increase is the result of a projected increase of 6.5 percent per year in the subsidized adoption caseload moderated by a 4.5 percent per year decline in the foster care caseload. The foster care caseload is decreasing due to a decline in entries and an increase in exits to adoption. Fiscal 2006 marked the first time that subsidized adoptions made up over half the total caseload.

Funding

Total program costs are expected to increase at a slower rate from 2006 through 2008 than was experienced from 2005 to 2006. Total program costs are expected to increase $10.1 million between fiscal 2007 and 2008 compared with increases of $24.6 million and $15.4 million between fiscal 2005 and 2006 and 2006 and 2007 respectively. The moderation in cost increases is due primarily to decreased reliance on institutional placements which are the most expensive out-of-home placement, in favor of treatment foster care. While also an expensive placement, treatment foster care saves on average almost $2,000 per month per placement compared to institutional placements.

Exhibit 1
Foster Care and Subsidized Adoption Caseload and Expenditures
Fiscal 2006-2008

	FY 2006	FY 2007 DLS Estimate	FY 2008 DLS Estimate	Average Annual % Change FY 2006-08
Caseload				
Foster Care	6,561	6,263	5,979	-4.5%
Adoptions	6,878	7,327	7,806	6.5%
Total	**13,439**	**13,590**	**13,785**	**1.3%**
Expenditures				
Monthly Cost Per Case	$1,855	$1,929	$1,962	2.9%
Total Cost ($ in Millions)	**$299.1**	**$314.5**	**$324.6**	**4.2%**

Source: Department of Human Resources; Department of Legislative Services

Reversing a long-term trend, foster care appears to be adequately funded. In fiscal 2006 the Department of Human Resources (DHR) transferred general funds out of the foster care maintenance account to help cover shortfalls in other areas of the budget. Current estimates also indicate there may be a surplus in foster care maintenance in the magnitude of $26 million.

The healthy status of the foster care account is abetted by higher than expected federal Title IV-E (IV-E) attainment. In fiscal 2006, IV-E attainment reached 27 percent of total spending, which was more than $10 million higher than originally budgeted.

The anticipated fiscal 2007 surplus could be used to eliminate the practice of rolling bills from one fiscal year into the next. In recent years, bills totaling between $14 million and $16 million have been rolled into the subsequent fiscal year due to insufficient funding in the foster care maintenance payments budget. Language added by the General Assembly to the fiscal 2007 foster care maintenance payments budget restricts the appropriation so that it may only be used for maintenance payments or transferred to the local child welfare budget to fund additional child welfare caseworker positions.

DHR reported to the budget committees in October 2006 that an additional 217 filled child welfare caseworker and supervisor positions are needed to meet the staff-to-caseload ratios recommended by the Child Welfare League of America. DHR was required by budget bill language to reexamine its staffing levels and factor in employee leave, training requirements, and other activities that limit the time workers spend working on actual cases.

Social Programs

Temporary Cash Assistance Caseload and Expenditure Trends

Maryland's welfare rolls have declined sharply over the last three years, and continued declines are anticipated. The State's policy of universal engagement of adult recipients had resulted in a significant drop in the number of employable adults receiving cash assistance.

Background

Temporary Cash Assistance (TCA) provides monthly cash grants to needy children and their parents or relative caretakers. The program is funded with general funds, federal Temporary Assistance for Needy Families (TANF) block grant dollars, and certain child support collections.

Caseload Trends

In the early years of welfare reform, efforts to transition individuals from welfare to work and a growing economy led to a rapid reduction in the number of TCA recipients. After dropping at rates exceeding 20 percent per year during the 1990s, the pace of caseload decline slowed considerably in the early years of this decade. With the recovering economy and the implementation of a universal engagement policy in fall 2003, the caseload decline accelerated again falling by 3.7 percent in fiscal 2004, 11 percent in fiscal 2005, and 14.7 percent in fiscal 2006. Universal engagement requires participation in activities such as up-front job search, assessment of employability, developing an independence plan, training, and subsidized employment.

Fiscal 2007 Forecast

As shown in **Exhibit 1**, the Department of Legislative Services (DLS) estimates an annual average caseload of 51,830 for fiscal 2007, a decline of 10 percent from the previous year. The projected decline is based on the caseload decline experienced during fiscal 2006 when the caseload dropped below 60,000 for the first time and by the end of the fiscal year had fallen to 52,391.

Exhibit 1
TCA Enrollment and Funding Trends
Fiscal 2006-2008

	FY 2006 Actual	FY 2007 Approp.	FY 2007 Estimate	FY 2008 Estimate	FY 07-08 % Change
Average Monthly Enrollment	57,589	57,064	51,830	49,239	-5.0%
Average Monthly Grant	$150.23	$154.55	$154.55	$160.09	3.6%
Funds in Millions					
General Funds	$16.7	$11.8	$11.8	$11.8	0.0%
Total Funds	$117.9	$105.8	$96.1	$94.6	-1.6%

Source: Department of Human Resources; Department of Legislative Services

Fiscal 2008

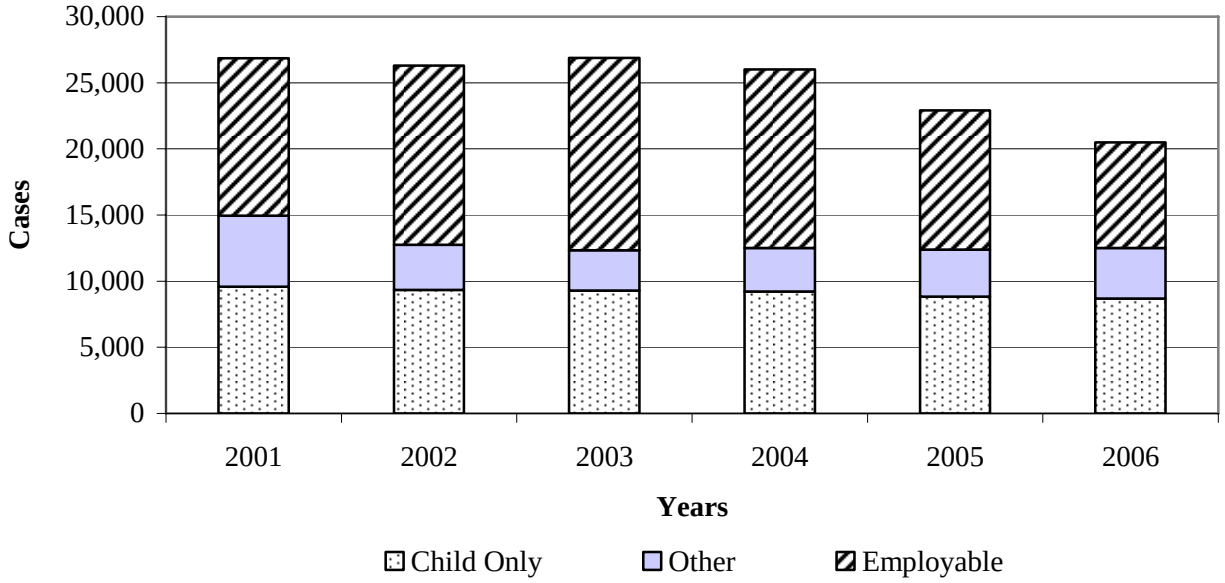
DLS expects the caseload decline to moderate in fiscal 2008 because the core caseload – those cases not headed by an employable adult – makes up a greater percentage of the caseload as the caseload declines. DLS estimates a caseload of 49,239, an average grant of $160.09, and total expenditures of $94.6 million. The estimate of the average grant and the total expenditures reflect the annualized cost of a 1.1 percent increase in the grant amount in fiscal 2007 and another 3.2 percent (equal to the recent increase in the minimum living level) increase in October 2007. General funds remain the same between fiscal 2006 and 2007 because Maryland is nearing the minimum Maintenance of Effort requirement under the TANF program. The federal reauthorization of TANF will cause changes in how various populations receiving cash assistance are counted *vis-à-vis* the work participation calculation, but reauthorization is not expected to have a dramatic effect on the caseload decline.

Characteristics of the Current Caseload

To track recipients needing employment services, the Department of Human Resources (DHR) divides the caseload into two main groups: (1) the "core" caseload; and (2) cases headed by an employable adult. The core cases include child only cases, women with children under age one, disabled cases, relative caretakers, and other cases exempted from work requirements. With the exception of women with children under age one, DHR does not expect the core cases to transition off cash assistance by seeking employment. Child only cases, for example, typically leave the rolls after reaching adulthood. As employable adults have successfully entered the

labor market, the core cases have represented an increasing percentage of the total TCA caseload. As shown in **Exhibit 2**, while the total caseloads have declined since 2003, the non-employable core caseload has remained virtually the same. As a result, the non-employable core caseload – as a percent of total caseload – has increased from just under 46 percent in 2003 to 61 percent in 2006. The employable caseload declined from just over 54 percent in 2003 to 39 percent in 2006.

Exhibit 2
Characteristics of the Current Caseload
July Caseloads



Note: "Other" category includes Child Under One, Relative Caretaker, Disabled, and Other Exemptions.

Source: Department of Human Resources

In the early years of welfare reform, DHR concentrated on serving those easiest to place in employment. Through its successful efforts, most of these cases have transitioned from welfare to work. Now, the remaining cases headed by an employable adult typically face multiple barriers to employment such as substance abuse and/or mental health issues, poor work histories, low educational attainment, and limited access to transportation and child care. To realize further caseload reductions, DHR must continue to provide intensive services to help these employable adults enter and remain in the labor force.

Social Programs

State Oversight of Group Homes

Interest in improving the oversight of group homes led to the enactment of three bills and the adoption of fiscal 2007 budget bill language. To date, progress has been made in implementing many of the legislative requests and recommendations.

During the 2005 interim, group home oversight was a topic of hearings before various legislative committees. Legislators expressed concerns that group home oversight was not sufficient, group homes were concentrated in certain areas of the State, and certain providers were not adequately supervising and caring for the children they serve. Interest in improving the oversight of group homes led to the enactment of three bills and the adoption of fiscal 2007 budget bill language.

Legislative Action During the 2006 Session

Enhanced Licensing Requirements

Chapter 275 of 2006 institutes additional licensure requirements for group homes licensed by the Department of Human Resources (DHR), the Department of Health and Mental Hygiene (DHMH), and the Department of Juvenile Services (DJS). An application to operate a group home must now include a business plan, a written quality assurance plan, and prior licensing reports issued within the previous 10 years. Furthermore, each group home's board of directors must include at least one Maryland resident, may not include employees or their immediate family members, and must adopt bylaws stating that board members are legally responsible for the group home's management and operation.

State Resource Plan for Residential Child Care Programs

Chapter 355 of 2006 requires the Governor's Office for Children (GOC) to develop a State Resource Plan for Residential Child Care Programs to enhance access to services provided by these programs. A preliminary plan was issued in May 2006.

Residential Child Care Capital Grant Program

Chapter 441 of 2006 established a Residential Child Care Capital Grant Program under GOC to make grants to local jurisdictions and nonprofit organizations to expand group home service capacity in Maryland. Beginning in fiscal 2008, the Governor may include an appropriation in the State capital budget for the program.

Fiscal 2007 Budget Bill Language Requirements

Fiscal 2007 budget bill language requires that independent audits from each group home be submitted to the Interagency Rates Committee (IRC), which sets group home rates, and a review of the audits be incorporated into the rate setting process by March 31, 2007. The language also requires several reports from GOC and the three licensing agencies on (1) the level of earnings retained by providers; (2) the level of direct care spending; (3) how performance-based incentives can be incorporated into the rate-setting process; (4) the number of incidents reported by providers; (5) the status of the implementation of previously enacted legislation regarding group homes; (6) the appropriate number of licensing and monitoring staff; and (7) how information sharing among child-serving agencies can be improved.

Executive Branch Action in Response to Fiscal 2007 Budget Language

Performance-based Incentives for Rate Setting

In October 2006, GOC submitted a report on performance-based rate setting for group homes. The current rate-setting methodology for group homes does not include performance-based factors but uses a measure of the extent and intensity of services provided to children as a proxy for performance. According to the report, IRC has developed a performance-based rate process which will be implemented once a system for outcomes evaluation is implemented and operational.

Incidents Reported by Providers

GOC submitted a preliminary report on group home incidents and monitoring deficiencies in July 2006. GOC is currently developing a uniform incident and deficiency reporting system and plans to explore two options for obtaining police reports for incidents at group homes. One option would require memorandums of understanding between each licensing agency and local law enforcement. A second option would identify a contact in each of the licensing agencies who would obtain individual police reports and forward them to GOC.

The July 2006 report indicates that GOC will begin quarterly reporting by provider to the General Assembly on (1) monitoring deficiencies that caused harm or had the potential to cause harm to a child or the community; (2) incidents that caused harm or had the potential to cause harm to a child or the community; (3) incidents that required law enforcement intervention to the extent that the report has been provided to the licensing agency; and (4) available police reports involving group homes to the extent that the report has been provided to the licensing agency.

State Board for the Certification of Residential Child Care Program Administrators

Chapter 438 of 2004 requires that all residential child care program administrators be certified by the State Board for the Certification of Residential Child Care Program Administrators by October 1, 2007. DHMH submitted a status report on the board in November 2006 indicating that the board was appointed in October 2005 and has drafted regulations regarding certification, continuing education, ethical practice, and hearing procedures. The board has also commissioned Towson University to develop a State certification examination to be finalized in May 2007. The board's next steps include development of a fee schedule, licensing application, and process for disciplinary action.

Appropriate Numbers of Licensing and Monitoring Staff

In October 2006, GOC submitted a report on the ratio of licensing and monitoring staff to group homes for children. This report notes that due to the wide range of facilities monitored by the three licensing agencies, it is not possible to recommend a standard ratio. However, the report does quantify current workforce shortages in each of the agencies. The report concludes that the Office of Heath Care Quality (OHCQ) requires approximately 2.72 additional surveyors for group homes licensed by DHMH. DHR, which has 16 filled licensing and monitoring positions and was granted an additional five positions for fiscal 2007, requires five additional positions. DJS notes that one additional licensing and monitoring position is required to meet future projected demand.

Additional Improvements in the Regulation of Group Homes

Several additional improvements have been made to the regulation and oversight of group homes since the 2006 session.

- In February 2006, the State initiated a toll-free hotline (866-718-5496) for community concerns. Callers with complaints about group homes are transferred to the licensing coordinator for that program, and a database of all calls is maintained. Each licensing agency is responsible for reporting the resolution of each complaint to GOC.

- In May 2006, GOC issued a request for proposals to local jurisdictions to compete for $1 million in fiscal 2007 funds to increase group home service capacity. The funds were awarded to bolster capacity in Baltimore City and on the Eastern Shore.

- Uniform licensing and monitoring tools were developed and implemented, standardizing licensing and monitoring practices in all three agencies.

Social Programs

Implementation of New Federal Welfare Requirements

Congress reauthorized the Temporary Assistance for Needy Families block grant in January 2006. Changes in the legislation will make it more difficult for Maryland to comply with federal work participation requirements and may result in financial sanctions against the State.

Welfare Reform

Under the Temporary Assistance for Needy Families (TANF) federal block grant program, states provide time-limited Temporary Cash Assistance (TCA) payments to indigent families. Benefits are limited to a cumulative 60 months for a family on welfare. In Maryland, the Family Investment Program (FIP) oversees welfare and the TANF block grant program. Under the State program, Maryland's 23 counties and Baltimore City were given the flexibility to create their own tailor-made welfare programs with the goal of emphasizing job training and placement, with TCA as a last resort. Like other states Maryland has seen caseloads decrease to record levels and people leave welfare for better than minimum wage jobs.

TANF Reauthorization

After several short-term extensions, in January 2006 Congress reauthorized TANF through 2010. Although there were some big changes to TANF, it is unlikely that major changes in State law will be required to meet the federal requirements. Maryland continues to receive an annual block grant of $229 million and the State match – Maintenance of Effort (MOE) – will remain at 75 percent of the federal grant. An extra $1 billion over five years will be allocated among the states for child care, and one year of transitional Medicaid will continue. At least 50 percent of TANF recipients must still be working for at least 30 hours per week, and the type of work activities established by Congress in 1996 were unchanged.

The significant changes to the 1996 law include:

- modifying the "caseload reduction credit" which states may apply against their work participation rate. The credit was calibrated to 1995 when welfare caseloads were at an all-time high; TANF reauthorization moves the look back time to 2005 when welfare caseloads were much lower;

- counting families that were placed in separate state programs (programs that use no federal TANF funds) toward the work participation rate; and

- requiring the Secretary of the federal Department of Health and Human Services to develop standards to guide states in defining the work activities.

Penalties for failing to meet the new standards include a 5 percent reduction in TANF funds, and a corresponding 5 percent increase in the MOE to 80 percent.

TANF Reauthorization and Maryland

The changes to the work participation rate and caseload reduction credits most affect Maryland. One of the provisions of the original TANF program that had been touted as the key to the success of Maryland's welfare program was the caseload reduction credit. Maryland's welfare caseload plummeted after 1995. The "caseload reduction credit" allowed Maryland to continue its efforts to move people off welfare without incurring any penalty – in effect, reducing the required work participation rate to 7 percent. By changing the look back from 1995 to 2005, the required work participation rate will rise to about 40 percent. In addition, by mandating that separate state program cases be counted toward the work participation rate, more than 2,000 people, many of whom do not work enough to meet the work participation requirement, will be added to the calculation.

Maryland's FIP has much work to do in order to meet these new federal TANF requirements. Nevertheless, FIP officials claim that they will meet the new requirements. If Maryland does not comply with the new work participation rates, the total cost to the State in terms of penalties could be as much as $34 million. To avoid the penalties Maryland may have to create community-service jobs to meet the new work participation rates – the cost of which has not been determined.

One method that FIP officials hope will help in meeting the new TANF requirements is the already implemented initiative called "universal engagement." Universal engagement requires every FIP recipient who can work to immediately comply with FIP requirements or face sanctions. FIP caseworkers will actively engage recipients to assure that the State is meeting work participation rates. The universal engagement program already appears to be contributing to a decline in the FIP caseload. (See separate Issue Paper on Temporary Cash Assistance Caseload and Expenditure Trends.)

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Social Programs

Juvenile Justice Issues

The Department of Juvenile Services continues to face a broad variety of challenges, including significant budget deficits.

As the Department of Juvenile Services (DJS) tries to reorganize its service delivery system into new geographical areas and promote increased control over services by regional managers, it continues to face a variety of operational challenges. A number of the more important challenges are discussed below.

Population Trends

Key population trends for DJS are shown in **Exhibit 1**. A number of points can be made from the exhibit:

- Through the first four months of fiscal 2007, the number of pre-adjudicated youth in secure detention facilities has increased by 11 percent over fiscal 2006. With an average daily population (ADP) of 322, the pre-adjudicated secure detention population is at its highest in the period shown.

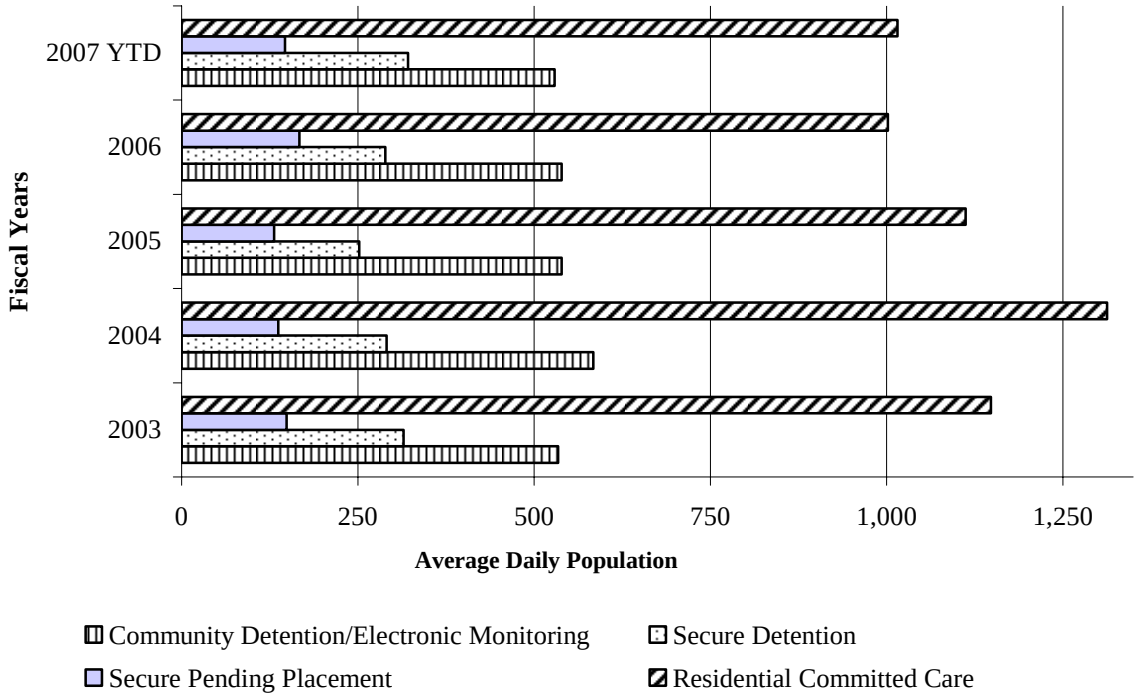
- This increase in pre-adjudicated youth in secure detention unfortunately more than offsets a welcome drop in youth housed at secure detention facilities who are pending placement (adjudicated delinquent but pending a placement in a committed program). Overall, on a daily basis, the number of youth held in detention facilities in the first four months of fiscal 2007 is up 3 percent over fiscal 2006 and is at the highest level in the period shown.

- DJS' efforts to reduce pending placement include the development of a nonresidential alternative to residential commitment for Baltimore City youth who would otherwise likely be pending placement. Specifically, this program has lowered the number of youth in pending placement at the Baltimore City Juvenile Justice Center (BCJJC). When DJS opens the new 48-bed program at the currently closed Victor Cullen Academy, the pending placement population may be further reduced although at the time of writing no contract has been awarded for the operation of this program.

- The use of residential committed care is up slightly (1 percent) in the first four months of fiscal 2007, although at an ADP of 1,016 it is far lower than in fiscal 2003 through 2005. However, the use of out-of-state placements continues to rise, an ADP of 95 in the first four months of fiscal 2007, or 16 percent over fiscal 2006. This is a legacy of the

decision to close committed programming at the Hickey School, some of which was not readily available in-state. Again, the promised programming at Victor Cullen may reduce out-of-state placements.

Exhibit 1
Department of Juvenile Services
Population Trends
Fiscal 2003-2007 (YTD)



Budget Problems Continue to Abound

During the fiscal 2006 close-out, DJS reported that almost $9 million in fiscal 2006 bills were rolled over into fiscal 2007 because the department had no funds to cover these expenditures. This roll-over of deficits has become a regular occurrence for DJS. Most of the deficit related to higher than budgeted expenditures for per diem committed placements (private provider residential placements for youth adjudicated delinquent).

Other deficits, totaling some $3.4 million, are anticipated for fiscal 2007 in per diem expenditures to cover the cost of a security contract at the Hickey School approved by the Board

of Public Works in August that was not budgeted and to cover the cost of two higher than budgeted residential contracts.

Facilities Issues

Prompted by the legislature, DJS unveiled a long-overdue facilities master plan in January 2006. The plan laid out an ambitious 10-year capital program based around the revised service delivery areas proposed by the department. DJS chose to make the development of a new detention center in Baltimore County as its number one priority in the 2006 session. While there was sufficient justification for the development of this center, essentially to replace the current antiquated facility at the Hickey School, DJS was not able to identify a site for the project. As a result, the legislature diverted the funding for the development of a new detention center to replace another aging facility at Cheltenham.

At the time of writing, DJS still has not identified a site for the new detention center in Baltimore County. It also has yet to submit the appropriate program statements to the Department of Budget and Management in order to be able to move forward on the replacement of Cheltenham. Finally, another capital project which failed to move forward in the 2006 session, the renovation of BCJJC required in order to significantly expand educational space, has also yet to be finalized. This project was delayed by the legislature because of a lack of project detail including cost estimates. That detail and the supporting cost estimates have yet to be reported to the legislature.

Department of Justice Report on Conditions at BCJJC

Concern about conditions at DJS detention facilities sparked two separate Civil Rights of Institutionalized Persons Act (CRIPA) investigations by the U.S. Department of Justice (DOJ) in recent years. The first, at Cheltenham and the Hickey School, resulted in a June 2005 agreement between the State and DOJ calling for a series of improvements in a number of programmatic and physical areas. The second CRIPA investigation, announced during the 2005 interim, concerned BCJJC.

In August 2006, DOJ issued its formal findings based on its investigation. The key findings of the investigation were that youth confined at BCJJC suffered significant harm and risk of harm from the center's failure to:

- adequately protect youth from youth violence;
- adequately safeguard youth against suicide; and
- adequately provide behavioral health services.

At the time of writing, the State and DOJ had not announced any formal agreement concerning required improvements. However, DJS disputed the findings as not representing current conditions and practices at BCJJC. It should be noted that similar arguments were raised after the CRIPA investigation of Cheltenham and the Hickey School, but nonetheless, the final agreement between the State and DOJ at those facilities required significant additional investments in a variety of resources.

Conclusion

There have been concerted efforts in recent years to improve programming offered by DJS. While investments in education and health services have increased significantly, DJS clearly continues to face many operational challenges as noted above. These challenges are in addition to ongoing staffing issues, specifically high vacancy levels and chronic retention problems.

Social Programs

Distribution of Federal Older Americans Act Funding

In response to the proposed changes in the distribution formula for the federal Older Americans Act dollars, the Budget Reconciliation and Financing Act of 2004 established a hold harmless provision. The hold harmless provision was ultimately extended through fiscal 2007. In the absence of legislative action, the hold harmless provision will not apply in fiscal 2008.

Background

The federal Older Americans Act (OAA) provides funding for services to seniors and their caregivers. In fiscal 2006, Maryland received $17.1 million in OAA funds, which are distributed according to a formula to Maryland's 19 area agencies on aging (AAAs) serving the State's 24 local jurisdictions. The General Assembly directed the distribution of OAA funds in fiscal 2005 through 2007; however, in the absence of legislative action, that directive will not apply to fiscal 2008.

Older Americans Act Funding in Maryland

OAA funds comprise between 7.9 and 47 percent of each AAA's annual budget (a mean average of 22.6 percent) and are used at the AAAs' discretion for transportation, outreach, information and assistance, and in-home services. Federal law requires the Maryland Department of Aging (MDOA), in cooperation with AAAs, to develop and submit for approval an intrastate funding formula for the distribution of OAA funds. This formula must reflect the proportion of persons 60 and over in the "greatest economic or social need, with particular attention to low-income, minority individuals."

Maryland's current formula uses three weighted factors, a county's proportion of the State's (1) total population aged 60 and over (45 percent); (2) low-income population aged 60 and over (45 percent); and (3) low-income minority population aged 60 and over (10 percent). This formula has been in place for more than two decades and is updated every 10 years based on census figures.

Growth in Senior Population Has Outpaced Increases in Federal Funding

Between 1990 and 2000, the number of Maryland seniors aged 60 and over grew by nearly 90,000 (12.4 percent). All but three Maryland jurisdictions (most notably Baltimore City which lost 18 percent of its senior population) experienced growth in their senior population.

Unfortunately, OAA funding has not kept pace with this growth. For example, between fiscal 2002 and 2006, OAA funds increased by only 2 percent. As a result, when the 2000 census data was applied, rural jurisdictions and Baltimore City lost a significant portion of their funding, and funding for the larger suburban jurisdictions did not increase proportionate to the increased senior population in those jurisdictions.

Legislative History

During the 2004 session, MDOA proposed changing the formula in order to utilize the 2000 census data and provide special consideration to rural jurisdictions that would lose funding when 2000 census data was applied. Through committee narrative and the Budget Reconciliation and Financing Act of 2004, the General Assembly directed that the funds be allocated based on the 2000 census data, eliminated the special consideration in the formula for rural areas, and earmarked $442,210 of State dollars to hold the rural jurisdictions harmless in fiscal 2005 and 2006.

During the 2005 session, MDOA introduced House Bill 1321, proposing a new formula based on five weighted factors: three used in the current formula and two additional factors (geographically isolated population aged 60 and over and disabled population aged 65 and over). The bill did not pass. As a result, the existing formula was used to distribute fiscal 2006 and 2007 funds, and through budget bill language, the provision of hold harmless funds was extended through fiscal 2007 and amended to include Baltimore City.

In the absence of legislative action, distribution of fiscal 2008 OAA funds will be at the discretion of MDOA, which anticipates distributing the funds according to the existing formula. Also, without legislative action, hold harmless funding for the AAAs serving rural jurisdictions and Baltimore City will be discontinued in fiscal 2008. **Exhibit 1** shows the AAAs affected by discontinuation of the hold harmless funds.

Options for Legislative Action

Since there is no legislative directive dictating the distribution of OAA funds in fiscal 2008, MDOA is free to keep the existing formula (without hold harmless funds) or establish a new formula. However, the General Assembly does have the ability to influence the process, including (1) extending the provision of hold harmless funds through fiscal 2008; (2) proposing a formula for the distribution of OAA funds; or (3) acting to provide stability to AAA funding through a phase-in requirement.

Exhibit 1
AAAs Affected by Discontinuation of Hold Harmless Funding
Fiscal 2007-2008

AAA	FY 2007[1] OAA Funding	FY 2008 OAA Funding	FY 2007-2008 Change in Funding	FY 2007-2008 Percent Change
Allegany	$457,427	$368,517	-$88,910	-24.1%
Baltimore City	4,301,972	4,249,201	-52,770	-1.2%
Cecil	226,410	225,412	-998	-0.4%
MAC, Inc.[2]	1,100,814	901,080	-199,734	-22.2%
Queen Anne's	171,170	156,320	-14,850	-9.5%
USA, Inc.[3]	545,186	494,288	-50,898	-10.3%
Washington	552,292	518,241	-34,051	-6.6%

[1] Includes State's hold harmless funding.
[2] MAC, Inc. is a nonprofit/nongovernmental AAA that services Dorchester, Wicomico, Somerset, and Worcester counties.
[3] Upper Shore Aging (USA), Inc. is a nonprofit/nongovernmental AAA that services Kent, Caroline, and Talbot counties.

Source: Department of Aging

Extend the Provision of Hold Harmless Funds through Fiscal 2008

As shown in Exhibit 1, seven AAAs serving 12 jurisdictions will lose a total of $442,210 in hold harmless funding in fiscal 2008. Reductions in funding range from 0.4 percent (Cecil County) to 24.1 percent (Allegany County). The General Assembly could require that funds be provided to these AAAs to preserve their funding at fiscal 2007 levels. This action would, however, require identifying a funding source.

Propose a Specific Funding Formula for OAA Funds

One option for the General Assembly is to recommend a specific funding formula. Any recommendation would only be a proposal because federal regulations mandate that the formula for distribution of OAA funds be developed by MDOA, in cooperation with the AAAs and approved by the federal Administration on Aging. Any proposed formula must also reflect the proportion of persons 60 and over in the "greatest economic or social need, with particular attention to low-income, minority individuals" per federal requirements. The current funding formula could be altered to include different variables or the weights of each variable could be

adjusted. According to the federal Administration on Aging, as of March 2005, the eight main variables used by other states include poverty/low income (42 states, weighted from 15 to 50 percent); age (41 states, weighted from 20 to 70 percent); rural (35 states, weighted from 2 to 20 percent); minority (32 states, weighted from 3 to 25 percent); low-income minority (15 states, weighted from 5 to 25 percent); disabled/impaired (9 states, weighted from 5 to 15 percent); living alone (5 states); and limited English (5 states, weighted from 2 to 6.25 percent).

Establish a Phase-in Requirement for OAA Funds

Another legislative option for the General Assembly is a phase-in requirement that would mandate how much the funding for any one AAA could fluctuate from year to year. For instance, OAA funding for each AAA may not increase or decrease more than 5 percent annually. This requirement would insert some stability into the funding of the AAAs when the formula changes or when census data is updated.

Transportation

Major Changes in the Draft Consolidated Transportation Program

The Maryland Department of Transportation's draft 2007 *Consolidated Transportation Program* (CTP) lists all capital projects funded in the current fiscal year as well as those planned for the next five years. The 2007 draft CTP totals $8.9 billion, a $270.3 million decrease from the 2006 CTP.

Overview

The Maryland Department of Transportation publishes an annual *Consolidated Transportation Program* (CTP) that lists all transportation capital projects funded in the current fiscal year and those planned for the next five years. **Exhibit 1** compares last year's proposed six-year program with the six-year program contained in the draft 2007 CTP.

Exhibit 1
Comparison of Proposed Capital Program
($ in Millions)

	2006-2011 CTP	2007-2012 Draft CTP	Change	Percent Change
State Funds				
Special Funds	$4,833.1	$4,812.1	-$21.0	-0.43%
Other Funds*	802.7	822.7	20.0	2.49%
Subtotal State Funds	5,635.8	5,634.8	-1.0	-0.02%
Federal Aid	3,581.3	3,312.0	-269.3	-7.52%
Total Funds	**$9,217.1**	**$8,946.8**	**-$270.3**	**-2.93%**

*Other funds include proceeds from the sale of bonds issued by the Maryland Transportation Authority and the Maryland Economic Development Corporation, customer and passenger facility charges collected by the Maryland Aviation Administration, and certain types of federal aid that do not pass through the Transportation Trust Fund.

Source: Maryland Department of Transportation, 2007 Draft *Consolidated Transportation Program*

The funding level in the 2007 six-year program decreases by $270.3 million (2.9 percent) from the six-year funding level in the 2006 CTP. Special funds decrease by $21.0 million (0.4 percent), primarily due to cash flow changes in the capital program. Cash flow changes are often attributable to projects deferred to later years, projects ending, and project delays. In particular, the Maryland Aviation Administration (MAA) experienced decreases due to

completion of its large capital expansion program, including construction of Concourse A and reconstruction of Concourse B at the Baltimore/Washington International Thurgood Marshall Airport. Also, the State Highway Administration (SHA) experienced a decrease over the six-year period due to federal funds being used to pay the debt service on Grant Anticipation Revenue Vehicle (GARVEE) bonds issued for the InterCounty Connector.

Effect of GARVEE Bonds on Federal Aid

Federal aid is expected to decrease by $269.3 million (7.5 percent). To construct the InterCounty Connector, $750 million in GARVEE bonds will be issued. GARVEE bonds are backed by future federal highway aid that the State will receive. The debt service for the bonds is paid from the federal aid received by the State. Over the six-year period (fiscal 2007-2012), it is estimated that the debt service on GARVEE bonds will be $340 million. As a result, the federal aid available for other SHA projects will be reduced by approximately the same amount.

Summary of Major Changes

As shown in **Exhibit 2**, projects totaling $53.8 million were added to the construction program, and $25.9 million in projects was added to the development and evaluation (D&E) program. Exhibit 2 also shows a number of projects that have experienced construction schedule delays; many of these are MAA projects dealing with design and financing changes and uncertainties. Finally, Exhibit 2 shows one project that has been advanced and one project that has been removed from the construction program.

Exhibit 2
Major Changes in the 2007
Consolidated Transportation Program
($ in Millions)

Projects Added to the Construction Program

	Project Description	Cost
MTA	MARC Procure Riverside Facility from CSX	$25.0
SHA	US 40, Duval Highway; Interchange at Edgewood Drive (Washington)	6.1
SHA	MD 28, Tuscarora Road; Replace Bridge over Tuscarora Creek (Frederick)	5.0
MTA	MARC New Edgewood Station and Improvements	4.6
SHA	I-83, Harrisburg Expressway; Replace Bridge on Freeland Road over I-83 (Baltimore)	3.1
MPA	Canton Warehouse Facility	3.0
SHA	MD 136, Calvary Road; Replace Bridge over James Run (Harford)	2.9
SHA	MD 313, Greensboro Road; Replace Bridge over Long Marsh Ditch (Caroline and Queen's Anne)	2.9
MAA	Comprehensive Roadway Signing Phase II at BWI	1.2
	Total	**$53.8**

Exhibit 2 (continued)

Projects Added to the D&E Program

	Project Description	Cost
SHA	I-695 Baltimore Beltway; Replace Bridge at MD 139 (Charles Street) (Baltimore)	$6.9
SHA	MD 404, Shore Highway; Upgrade MD 404 from Cemetery Road to MD 480 (Caroline)	6.2
MTA	Central Maryland Maintenance Facility	5.1
MAA	Terminal Modernization Program at BWI	4.0
MTA	WMATA Green Line Extension	2.0
SHA	MD 180/MD 351, Jefferson Pike/Ballenger Creek Pike; Study the Reconstruction of the I-70 Interchange and Capacity Improvements to MD 180/MD 351 (Frederick)	1.0
SHA	US 15, Catoctin Mountain Highway; Study a New Interchange at Monocacy Boulevard (Frederick)	0.7
SHA	MD 198, Laurel Fort Meade Road; Reconstruct from MD 295 to MD 32 (Anne Arundel)	0.0[7]
SHA	I-795, Northwest Expressway; Construct Interchange at Dolfield Road (Baltimore)	0.0[8]
	Total	**$25.9**

Construction Schedule Delays

	Project Description	Comment	Fiscal Year
MAA	Concourse D/E Baggage Screening System and Baggage Claim Improvements at BWI	Design delay result of rescoping project based on airline consultation	2006 to 2007
MAA	Airfield Pavement Program at BWI	Construction start dependent on federal approval of Passenger Facility Charge Application	2006 to 2007
MAA	Midfield Complex – Aircraft Hangar at Martin State Airport	Construction delay result of legislative budget reduction	2006 to 2008
MAA	Midfield Complex – New Air Traffic Control Tower and Taxiway Extension at Martin State Airport	Development of affordable tower design delaying construction	2006 to 2008
MAA	Runway Safety Area Improvements Design at BWI	Design start dependent on environmental assessment schedule	2007 to 2008
MAA	Airport Administrative Office Building at BWI	Design start dependent upon environmental assessment schedule	2007 to 2008
MTA	Halethorpe MARC Station Improvements	Construction delayed until budget year due to AMTRAK review and approval of Phase II	2007 to 2008
SHA	MD 732, Guilford Road; Replace Bridge 13029 over CSX Railroad (Howard and Anne Arundel)	Delay in acquisition of needed right-of-way	2006 to 2007

[7] Anne Arundel County is contributing up to $4.5 million for the Planning Phase.
[8] Project planning to be funded by private developers.

Exhibit 2 (continued)

Construction Schedule Advancements

	Project Description	Comment	Fiscal Year
SHA	MD 2/4, Solomons Island Road; MD 2/4 Intersection at MD 231 (Calvert)	Increased safety concerns	2008 to 2007

Projects Removed from the Construction Program

	Project Description	Comment
MPA	Wallenius Wilhelmsen Improvements – Phase II	Construction cost of Phase I exceeded budgeted amount. Funds for Phase II are being reprioritized.

BWI – Baltimore/Washington International Thurgood Marshall Airport
MAA – Maryland Aviation Administration
MARC – Maryland Rail Commuter
MPA – Maryland Port Administration
MTA – Maryland Transit Administration
SHA – State Highway Administration
WMATA – Washington Metropolitan Area Transit Authority

Source: Maryland Department of Transportation, 2007 Draft *Consolidated Transportation Program*

Transportation

REAL-ID Act

With the passage of the "REAL-ID Act" of 2005, all states will need to meet federal guidelines regarding driver's licenses and personal identification cards; regulations are expected by the end of 2006. According to a recent analysis conducted by the National Conference of State Legislatures, the National Governor's Association, and the American Association of Motor Vehicle Administrators, the cost to states to implement the Act will total $11 billion.

Background

On May 11, 2005, President George Bush signed the Emergency Supplemental Appropriation for Defense, the Global War on Terror, and Tsunami Relief, 2005 (H.R. 1268; P.L. 109-13), which included the REAL-ID Act ("the Act"). The Act requires federal agencies (*e.g.*, airline security and federal buildings) on or after May 11, 2008, to accept only state issued personal identification (ID) cards and/or driver's licenses that have met certification standards. The legislation contains a number of provisions outlining broad requirements for the issuance of driver's licenses or personal ID cards. Specifically, the Act establishes national standards for driver's licenses and documents, issuance of driver's licenses and personal ID cards, federal uses, immigration requirements, identity and document verification, data retention and storage, security and fraud prevention, and linkages with state databases. The Act requires the U.S. Department of Homeland Security (DHS), in consultation with the U.S. Department of Transportation, to adopt regulations clarifying the Act's provisions. These regulations are expected to be issued by the end of 2006.

What Does REAL-ID Do?

The Maryland Department of Transportation's Motor Vehicle Administration (MVA) is the State entity responsible for issuing State personal ID cards and driver's licenses and as a result will be responsible for implementing the Act. While DHS has the final authority to clarify the Act through regulation, the following are some of the Act's broad provisions.

- **Uniformity of Data:** The Act requires uniformity amongst all states in the design and information contained on a personal ID card and driver's license. The current Maryland license already meets many of the requirements outlined in the Act including an individual's address and signature, a digital photograph, machine-readable technology, and counterfeiting measures. As a result, the changes to the current Maryland license and personal ID card may not be significant.

- **Document Verification:** MVA will also be required to verify all documents submitted for a personal ID card or driver's license with the issuing agency. To do this, each individual will need to present documentation of the individual's date of birth, proof of a Social Security account number, and documentation of the individual's principle residence. Individuals are unlikely to have same day service, as the verification process will be time intensive and MVA wait times will likely increase.

- **Legal Status:** As part of the verification process, MVA will be required to confirm that an individual is legally permitted to reside in the country. Maryland is one of seven states that do not require individuals to be considered "lawfully present" to obtain a personal ID card or driver's license. To conform to the provisions in the Act, the General Assembly will need to adopt legislation requiring individuals to demonstrate that they are legally residing in the country.

- **Security Measures:** States are also required to adopt data and physical security measures to protect the information collected. This information will also need to be made available to all other states for electronic access.

Recent Developments

The financial cost to Maryland to implement the Act is uncertain and will remain so until the final regulations have been issued. In the fall of 2006, the National Conference of State Legislatures, the National Governor's Association, and the American Association of Motor Vehicle Administrators conducted a survey to determine the cost to states of implementing REAL-ID. Based upon responses from 47 states, the survey estimated that the REAL-ID Act will cost states $11 billion to implement over the first five years:

- **$8.5 billion** for the reenrollment of all driver's license and personal ID holders within five years of the May 2008 compliance deadline;

- **$1.4 billion** for the new verification process which requires MVA and other state departments of motor vehicles to independently verify each document submitted with the issuing agency;

- **$1.1 billion** to implement the design features spelled out in the REAL-ID Act. Most states have incorporated various aspects of the design features; however, a single security configuration will minimize states' flexibility in card design and production; and

- **$400 million** for support costs such as security clearances on employees.

Chapter 9 of 2004 requires MVA to set the level of its miscellaneous fees, which includes all fees except the Vehicle Emissions Inspection Program fees, titling taxes, and vehicle

registration fees, to cover 95 to 100 percent of its operating and capital expenditures. Any additional capital investment or increased operating expenditures resulting from the Act's implementation will result in fee increases or reductions in other areas.

MVA proposed regulations in the summer of 2006 that would refine the type of documents that would be accepted for foreign nationals to obtain a driver's license or personal ID card. The emergency regulations would require religious and school documentation to come from entities in the United States and not from foreign countries. The proposed regulations have been submitted to the Joint Committee on Administrative, Executive, and Legislative Review; however, as of October 30, 2006, the committee has asked the agency to refrain from adopting the regulations to allow the committee further time to examine the proposal.

Conclusion

Once the federal regulations for the Act have been issued, MVA will need to determine what steps are necessary to implement the Act. At a minimum, in order to comply with the Act, the General Assembly will need to adopt legislation requiring individuals to demonstrate that they are legally residing in the country in order to obtain a personal ID card or driver's license. In addition, funding will likely be an issue. The 2007 draft Consolidated Transportation Program includes $3.5 million in fiscal 2007 and 2008 to upgrade systems and policies in order to comply with the Act. In order to meet cost recovery requirements, any costs exceeding the budgeted amount will be borne by State residents through fee increases or reductions in other areas.

Transportation

Public-Private Partnerships

The use of public-private partnerships (P3s) has enabled some states to address budget shortfalls and build otherwise cost-prohibitive transportation facilities. As the Maryland Transportation Authority (MdTA) continues to investigate the use of P3s in Maryland, legislation may be necessary to determine the proper scope of P3 agreements.

Introduction

The entrance of the private sector in the development and financing of transportation infrastructure is a recent development and one that represents a fundamental change in how transportation projects are financed and constructed. In the past year, a number of P3s have been created for transportation infrastructure purposes. For example, Indiana leased a toll road to a private consortium in a 75-year lease for $3.8 billion. States are turning to P3 agreements due to the demand for transportation projects resulting from congestion and deteriorating infrastructure. This demand, coupled with the need for additional revenues, has resulted in states seeking alternative financing mechanisms such as P3 agreements. In Maryland, MdTA has the ability, through regulations, to enter into P3 agreements on behalf of the State.

What Is a Public-Private Partnership?

A P3 is an agreement between a state and a private entity whereby the private entity undertakes the construction of a project (highways or transit) or responsibility for the operation of an asset (*e.g.*, toll roads) on the state's behalf. In doing so, the private entity assumes some, but not all, of the responsibilities and risks associated with a project or asset. P3s typically fall under two types of agreements with variations possible:

1. **Concession Agreements:** A concession agreement involves the leasing of an existing, publicly financed toll or transit facility to a private entity to operate and maintain the asset for a set period of time in exchange for an upfront lump sum payment.

2. **Design, Build, Operate, Maintain:** A private entity is granted the right to finance, design, build, own, operate, and maintain a transportation infrastructure project. The private sector partner owns the project, assumes all of the risk, and may collect all of the revenue.

Issues

There are a number of policy issues for the legislature to consider regarding P3s. These include:

- **Weak Legal Framework:** In Maryland, there is no formal statutory framework governing P3 projects or agreements. The current legal framework for a P3 consists of regulations, existing procurement law, and an Attorney General opinion. Contracts or agreements establishing a P3, and P3 projects themselves, are solely governed by MdTA regulations. As such, the General Assembly is not afforded an equal voice in determining the appropriate scope of P3 projects. Because of the complex and enduring policy issues relating to P3 agreements, a statutory framework would provide the necessary structure to govern P3 projects in a manner that is fully vetted and promotes consensus.

  Currently, 21 states have laws authorizing some form of P3 for transportation projects.[9] Of those states, Arizona, Missouri, Indiana, North Carolina, and Alaska limit P3 authorization to only one or more pilot projects. In states that have actually utilized a P3 for transportation projects, such as California, Indiana, Texas, and Virginia, the respective legislatures have enacted statutory frameworks governing such agreements.

- **Lack of Legislative Oversight:** In Maryland, Chapter 472 of 2005 provides that the General Assembly has 45 days to review and comment on any MdTA contract or agreement to acquire or construct a revenue-producing transportation facility. Specifically, MdTA must provide to certain legislative fiscal committees, for review and comment, a description of the project, a summary of the contract, and a financing plan. This requirement does not apply to any contract or agreement pertaining to existing transportation facilities, nor does it apply to a request for proposals (RFP) issued by MdTA.

  House Bill 1555 of 2006 (failed) would have required MdTA to submit to certain legislative fiscal committees, for 45-day review and comment, a description of the proposed lease and a summary of the proposed agreement for any RFP issued by MdTA for a P3 project. The bill also would have required an additional 45 days for legislative review and comment before MdTA entered into a P3 agreement. While this legislation would have been a step toward legislative oversight, it did not address unsolicited P3 proposals, nor did it provide a statutory framework for P3 agreements.

  Currently, neither statute nor regulation provide for General Assembly approval of P3 projects, although MdTA must submit a P3 contract or agreement to the Board of Public Works for approval. Although MdTA regulations provide for local agencies and affected

[9] Alaska, Alabama, Arizona, California, Colorado, Delaware, Florida, Georgia, Indiana, Louisiana, Maryland, Minnesota, Missouri, Nevada, North Carolina, Oregon, South Carolina, Texas, Utah, Virginia, and Washington

jurisdictions to submit comments on P3 projects, these comments are not binding. Therefore, any concern that is not adequately addressed during the review and comment phase essentially leaves the General Assembly or a local jurisdiction with no immediate recourse – except ad hoc legislation.

- **Role of the Private Sector:** An important question regarding P3 arrangements is what is the appropriate role of the private sector in the construction and delivery of public goods. In a P3 arrangement, the public sector cedes some, if not all, control of an asset to the private sector. The public sector is motivated by providing goods and services to the public whereas the private sector is motivated by market and economic forces. How these differing motivations can work together is an important consideration.

- **Financial Implications:** A P3 often results in a lump sum payment to the public entity or a project being constructed in return for the right to collect revenues. The benefit to the public sector is that projects that might not have been financially feasible to construct in the short-term can now be constructed through a P3 arrangement. A limitation of P3 agreements is that they are often several years in length (two deals have been for 75 and 99 years each); because of the long duration of many P3 agreements, it is not clear that the public sector will fully capture the actual value of an asset.

  Another issue is what impact the leasing of an existing revenue-producing State asset may have on the debt issued by MdTA. The debt service for bonds outstanding is paid from the revenues generated by all revenue-generating facilities. The leasing of one revenue facility would reduce the revenues generated by MdTA, thus affecting bond holders.

  Finally, in a case where MdTA would receive monies, either through a concession or design, build, operate, and maintain agreement, the General Assembly would not have control as to how the money would be used. Current regulations would allow for MdTA to receive the funds unless otherwise specified in the contract. Given that MdTA is a nonbudgeted entity, the General Assembly could not control how the funds are spent except through legislation or unless the contract indicated that the funds would be transferred to the Transportation Trust Fund or the general fund.

Conclusion

The use of P3s has enabled some states to solve budget shortfalls and build otherwise cost-prohibitive transportation facilities. As a relatively new approach to transportation financing, however, P3s raise a number of concerns. Chief among these concerns are the long-term fiscal effects of leasing a major transportation facility to a private entity, the proper scope of P3 agreements, and the proper role of the private sector in financing and operating public transportation. States that have engaged in P3 agreements have established statutory frameworks governing P3s. Maryland currently lacks substantial legislative oversight for, and a

comprehensive statutory framework governing, P3 agreements and projects. As MdTA continues to investigate the viability of P3 agreements in addressing Maryland's transportation needs, legislation may be necessary to determine the proper scope of P3 agreements.

Transportation

Transit Funding Study Steering Committee

Chapter 443 of 2006 requires the Maryland Department of Transportation to conduct an analysis of transit funding. The Act established a Transit Funding Study Steering Committee to provide guidance and direction to the department while conducting that analysis. The final report of the steering committee, due December 15, 2006, could spur legislation during the 2007 session.

Background

Legislation addressing funding for mass transit was introduced during the 2006 session as Senate Bill 850/House Bill 1345. As enacted, Chapter 443 of 2006 requires the Maryland Department of Transportation (MDOT) to:

- provide an analysis of the operating and capital needs for transit services in the State over a 20-year horizon, including a comprehensive, financially unconstrained review of potential needs;
- review how transit services are funded across the country and in select cities outside the United States with large transit systems; and
- identify State funding strategies to take advantage of potential new federal funding for the Washington Metropolitan Area Transit Authority.

Chapter 443 also established the Transit Funding Study Steering Committee to provide guidance and direction to MDOT during its analysis of transit funding. Three members from the House and three members from the Senate were appointed to the committee.

Current Status and Implications for the 2007 Session

As of October 25, 2006, the Transit Funding Study Steering Committee had held one meeting to provide a broad overview of transit services offered in Maryland and transit funding trends. It is anticipated that there will be three more meetings of the committee. Those meetings will focus on what other jurisdictions are doing in terms of transit funding, what the transit needs of the State are, and options for addressing those needs. Pursuant to Chapter 443, a report must be submitted to the General Assembly by December 15, 2006. The report is expected to spur legislative activity during the 2007 session.

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Economic and Community Development

Sunny Day Fund

Since its inception in 1988, 106 projects, including 3 multiyear commitments, have received funding from the Sunny Day Fund, for a total commitment of $175.1 million. The number of projects has decreased over the last few years. With less money appropriated to the fund, the amount of uncommitted funds available has dwindled to approximately $700,000.

Overview

The Economic Development Opportunities Program (Sunny Day) Fund was created in 1988 to enhance Maryland's competitive position with neighboring states. The fund provides conditional loans and grants to attract, retain, and expand private-sector enterprises or institutions, public institutions, and federal research and development institutes.

As shown in **Exhibit 1**, the fund has provided $175.1 million in conditional loans and grants since its inception. A total of 106 projects in 16 counties have been approved. In terms of geographic distribution, about 75 percent of the projects and 80 percent of the funds have been targeted to the Washington and Baltimore regions. The Department of Business and Economic Development (DBED) administers the fund, and the Legislative Policy Committee (LPC) reviews and comments on proposed Sunny Day projects before DBED can approve expenditures.

Approved projects are usually large scale. Fiscal 2007 approvals include $7.5 million for the expansion of MedImmune, Inc.'s pharmaceutical facility in Frederick County, $1.6 million to assist the University of Maryland Biotechnology Institute to purchase and install biopharmaceutical equipment, and $1.7 million to support the University of Maryland, College Park's new nanotechnology laboratory. The level of Sunny Day activity has diminished significantly over the last five years, reflecting reduced appropriations due to State budgetary constraints, as well as a shift of activity to the Maryland Economic Development Authority Assistance Fund.

Exhibit 1
Approved Sunny Day Fund Projects
Fiscal 1988-2006

County	Number of Projects	Total Funding
Anne Arundel	6	$15,474,000
Baltimore City	20	24,502,000
Baltimore	16	26,629,000
Caroline	1	800,000
Carroll	4	5,072,000
Cecil	1	2,275,000
Dorchester	3	2,283,000
Frederick	5	16,250,000
Garrett	3	3,850,000
Harford	5	11,130,000
Howard	7	7,115,000
Kent	1	750,000
Montgomery	15	29,395,000
Prince George's	7	16,423,000
Washington	6	8,400,000
Wicomico	2	3,000,000
Statewide/Regional	4	1,751,000
Total	**106**	**$175,099,000**

Note: Although LPC has approved funding for 135 projects, the actual number of projects that received funds is reduced to 106 due to the withdrawal of 29 projects. If the withdrawn projects are included, the total approved is $209.9 million.

Source: Department of Business and Economic Development

Project Requirements and Monitoring

Projects for which Sunny Day funds are requested must contain performance requirements such as a specified number of jobs created and retained and level of capital investment. The accuracy of this data is critical since loan agreements often provide for forgiveness of all or a portion of the loan if the performance requirements are met. As shown in

Exhibit 2, full or partial forgiveness has been provided to approximately one-third of all projects (39), amounting to $39 million of forgiveness against $43.5 million of original loan and conditional grant totals since the program began.

Exhibit 2
Forgiven Loans and Claw-backs
Fiscal 1988-2006
($ in Millions)

	Number of Projects	Amount	Original Loan Amount
Forgiven Loans	39	$39.0 – forgiven	$43.50
Claw-backs	21	$12.1 – repaid	$20.50

Source: Department of Business and Economic Development

Data Quality

Legislative audits of DBED's activity in fiscal 2001 and 2003 disclosed major problems with the quality of information related to job creation and retention, including significant double-counting. DBED has taken steps to improve its data collection methods, primarily through installation of a new agency-wide computer system. The new system should rectify problems of double-counting as well as duplication of efforts and difficulty in locating the most current information on a project. DBED has been requested to report on its progress to the Office of Legislative Audits in November 2006 in time for the auditors to issue a report for the 2007 session.

Performance Failure

If a project fails to meet established performance requirements, DBED may invoke claw-back provisions that were set forth under the funding agreement. To date, a total of 21 projects have been subject to claw-back, with a total amount repaid of $12.1 million against original funding of $20.5 million. The original funding includes transactions that may have had partial forgiveness, as well as repayment due to nonperformance. Not reflected in Exhibit 2 are four companies in the portfolio that are currently in bankruptcy or have a parent that is in bankruptcy for an aggregate of $9.25 million. DBED continues to monitor the business activities of these distressed operations and will support any potential restructuring that results in continued employment that stays within the original scope of the projects.

Sunny Day Fund Balance

As shown in **Exhibit 3**, all but about $700,000 of the Sunny Day Fund balance has been committed as of October 26, 2006. Repayments of principal and interest are expected to be $2.8 million in fiscal 2007. The funds available represent a substantial decrease from the $13.5 million available at the same time in fiscal 2006 due to more project fund commitments.

Exhibit 3
Maryland Economic Development Opportunities Program Fund
(Sunny Day Fund)
($ in Millions)

Beginning Fiscal 2007 Balance	$22.0
Projected Fiscal 2007 Principal and Interest Repayment	2.8
Operating Expenses for Fiscal 2007	(0.7)
Committed Funds	(23.4)
Total Uncommitted Funds Available (as of October 26, 2006)	**$0.7**

Source: Department of Business and Economic Development

Economic and Community Development

Maryland Military Installation Council

Under the 2005 BRAC plans, Maryland stands to gain approximately 16,275 direct new jobs, in addition to over 40,000 indirect jobs. Preparations are underway at both the State and local levels to accomodate this significant influx of residents. Federal grant funds are currently being used to study how to make adjustments in a variety of areas, including housing and education needs.

The Maryland Military Installation Council

In 1990, in order to address an excess capacity of military facilities, the U.S. Congress created a process known as Base Realignment and Closure (BRAC). The final plans regarding military installations nationwide became effective in November 2005. The 2005 BRAC represents the first major base closure and realignment activity in 10 years.

After the BRAC process was activated, the State created the Maryland Military Installation Strategic Planning Council in 2003 (Chapter 335), consisting of 19 representatives of State agencies and federal military installations, to serve as an advocate for military facilities located in Maryland and coordinate State agency planning in response to changes caused by BRAC. After the approval of the 2005 BRAC plans, the State renamed the council to be the Maryland Military Installation Council (MMIC) and extended the termination date of the council through December 31, 2011 (Chapter 634 of 2006). The 2006 law also increased the membership of the council to 22 members by including representatives of local liaison organizations.

2005 BRAC Impact on Maryland

The 2005 BRAC impacts many of the federal military installations in the State, resulting in an estimated 16,275 direct new jobs and placing Maryland among the largest beneficiaries nationally. The changes (estimated as of September 2006) at each of the State's installations are detailed in **Exhibit 1** and are expected to be phased in over a five- to six-year period. With the bulk of the gains at Aberdeen, Fort Meade, and the National Naval Medical Center, most of these jobs are projected to be medical professionals, engineers, and management positions. An additional 40,000 or more indirect jobs could be created through contractors and related services.

Exhibit 1
Impact of BRAC on Maryland
Proposed Base Changes and Estimated Employment Changes

Base	Proposed Base Changes	Estimated Employment Change per BRAC Model
Aberdeen Proving Ground (Harford County)	Absorb Army Test and Evaluation Command currently located in Alexandria, VA. Become a center for electronic warfare research by absorbing functions currently performed at Ft. Monmouth (NJ) and Ft. Belvoir (VA) and absorb Army research institute now at Ft. Knox (KY)	Gain of 9,448 jobs
Fort Meade (Anne Arundel County)	Absorb the Defense Information Systems Agency as well as the Army's adjudication and media activities	Gain of 5,717 jobs
Martin State Air Guard Station (Baltimore County)	Reassign eight 130J cargo planes to other bases	Loss of 237 jobs (loss of 8 aircraft)
Naval Station (Annapolis)	Minor realignment	Loss of 25 jobs
Flair Army Reserve Center (Frederick)	Closed	Loss of 37 jobs
Fort Detrick (Frederick)	Minor realignment	Gain of 185 jobs
National Naval Medical Center (Bethesda)	Close the Walter Reed Medical Center (WRMC) in Silver Spring and move several WMRC functions to the National Naval Medical Center	Gain of 1,200 jobs
Naval Surface Weapons Station (White Oak)	Minor changes	Gain of 11 jobs
Army Research Laboratory (Adelphi)	Minor realignment	Loss of 82 jobs

Exhibit 1 (continued)

Base	Proposed Base Changes	Estimated Employment Change per BRAC Model
Ewvra Sheppard Air Guard Station (Hagerstown)	Minor realignment	Gain of 17 jobs
Defense Finance and Accounting Service (Patuxent River)	Closed	Loss of 123 jobs
Naval Air Station (Patuxent River)	Minor changes	Gain of 201 jobs

Source: Department of Business and Economic Development

Preparations by State Agencies

Under the coordination of MMIC, the State is taking steps to prepare for the significant influx of military personnel, civilian employees, contractors, and families. Since the bulk of this population increase will be concentrated in four geographical areas (primarily Harford, Anne Arundel, Howard, and Montgomery counties), there is the potential that the new residents will strain those local public services and profoundly impact the local area job market. With this forecast in mind, State agencies are taking steps to mitigate potential problems.

In fiscal 2007, the U.S. Department of Labor awarded a $1.2 million grant to the State for BRAC-related activities. The Department of Business and Economic Development (DBED) is using $800,000 of the grant to sponsor several studies reviewing infrastructure requirements, revenue projections, higher education requirements, and best practices. The department expects to complete the studies by December 2006. The remainder of the grant will be coordinated by the Department of Labor, Licensing, and Regulation for State and local workforce development programs.

Other State agencies are also actively participating in BRAC-related preparations. The Maryland Department of the Environment is engaged in assessing adequacy of water and wastewater systems and securing funding for necessary upgrades. The Maryland Department of Planning developed and distributed Maryland Military Installation Area Profiles to federal, State, and local officials which are designed to demonstrate the ability of communities to provide adequate schools, housing, commercial services, and employment for new residents. The Maryland Department of Transportation has assessed traffic and other transportation needs in the

growth areas; has held coordinating meetings with county planners, military alliances, and base personnel; and has begun work on specific BRAC-related traffic and transit projects. For example, the State recently announced plans for the development of major residential-retail town centers near the Savage and Odenton MARC train stations, both of which are proximate to Fort Meade. The Department of Housing and Community Development is also working to develop and market home ownership programs for the expected new residents.

Preparations by Local Governments

Representatives from Montgomery, Prince George's, Anne Arundel, Howard, Baltimore, Harford, and Cecil counties and Baltimore City have been meeting regularly with MMIC and DBED as part of that department's federally funded studies.

One of the counties that will be most significantly impacted by the 2005 BRAC, Harford County, has received its own grant from the U.S. Department of Labor to study BRAC-related workforce issues and has applied for other grants from the U.S. Department of Defense. The county also recently established a web site and hired a manager to deal specifically with BRAC preparations. Anne Arundel County also recently created the Anne Arundel County/Ft. George G. Meade Growth Management Committee for purposes of seeking similar federal financial assistance and addressing local BRAC-related issues such as transportation, housing, utilities, services, and public education.

Economic and Community Development

Task Force on the Status of Women and Information Technology

The Task Force on the Status of Women and Information Technology met during the 2005 and 2006 interims. It found that women are severely under represented in the information technology workforce and, while information technology jobs are booming, women are not enrolling in higher education computer science programs at a commensurate pace. The task force made specific recommendations about expanding educational opportunities and developing strategies for the investment of women in the workforce.

Chapters 489 and 490 of 2004 established the Task Force on the Status of Women and Information Technology to study the issues related to the declining percentage of women entering and remaining in information technology (IT) professions, the impact of the decline on the overall technology literacy of Maryland's workforce, and the future of the IT workforce in Maryland. The task force is required to submit an annual report to the Governor and the General Assembly on its findings and recommendations each October 1 beginning in 2004. The task force is scheduled to terminate on June 30, 2009.

Work of the Task Force

Although it was established in 2004, the task force was not appointed in time to meet until January 2005. In addition to the meetings of the full task force during the 2005 and 2006 interims, work groups met and collected data on a number of subjects and resources relevant to the task force's objectives.

Despite data limitations, the task force made several findings in 2005. The task force found that despite increasing gender parity in IT use, women are still severely underrepresented in the IT workforce. The task force also found that current IT outreach efforts have not significantly increased enrollment of girls in the courses required to pursue IT careers. Specifically, the task force found that there has been a declining percentage of female participation in the Advanced Placement assessment examination for computer science, a curriculum generally required to pursue a career in IT and related fields. In addition, the task force found that while jobs in engineering and IT are booming, the enrollment of women in most computer science programs offered at Maryland colleges and universities remains at or below 20 percent. In contrast, and an area deemed worthy of further evaluation by the task force, Coppin State and Morgan State universities average 50 percent enrollment of women in their computer science programs.

Task Force Recommendations

Maryland is poised to gain thousands of jobs through the federal Base Realignment and Closure plan, most of which will be in engineering and IT. With State unemployment at record lows and an aging technology workforce, the task force believes that the State must *today* investigate and develop a plan for implementation of strategies to address the challenges that will better meet the State's workforce demands in all career areas where technology is used.

Increasing women's study of IT and related technologies is the fastest and potentially most effective method for addressing workforce shortages. This strategy is helped by the fact that women are increasing their participation in the labor market and their enrollment in and graduation from colleges and universities throughout the country and in Maryland. From two years of study, the task force concluded that by focusing on the needs of those less likely to participate in the IT workforce, specifically women, Maryland could effectively address the issues affecting the general lack of participation in IT and related fields by other historically disadvantaged groups. In addition, the task force concluded that it is imperative for Maryland's economic future that the following outcomes be achieved:

- expand educational opportunities that will significantly increase student enrollment, retention, and graduation rates leading to increased employment, placement, and career growth for women in the IT workforce and related fields; and

- develop strategies that support the recruitment, retention, and advancement of women in IT and related technologies in the workforce.

The task force created a comprehensive plan to address the IT workforce shortage in Maryland that includes recommendations for K-12 education, post-secondary education, and workforce investment.

For K-12 education, the plan includes developing a targeted information campaign to be marketed to parents and community leaders stressing that (1) technology literacy has equal value and importance as reading and mathematics literacy; (2) diversity is valued and supported at all levels of education and in the workforce; and (3) IT careers are seen as viable career opportunities for all. At the post-secondary education level, the plan includes the development of student employment opportunities that provide access to electronic and/or traditional mentoring for every computer science and engineering student. The plan for workforce investment includes creating a network to support, mentor, nurture, and provide role models to women in the IT workforce.

In order to implement the plan, the task force recommends the creation of a public-private resource center entitled "The Maryland Women in Technology Collaborative" to plan, recommend policy, provide advocacy, and monitor efforts to achieve the recommendations of the task force. The task force recommends that funding for the collaborative be $500,000 each year for five years for start-up, staffing, and resource development. The task force

anticipates private-sector matching funds from corporations that have already indicated an interest in providing financial support for shared goals. Federal funding could also be sought to create a statewide resource with a national and international reach.

Business Regulation

Horse Racing

The horse racing industry in Maryland continues to experience challenges, mostly from video lottery terminals enhancing purses in neighboring states. With Pennsylvania joining Delaware and West Virginia in providing this type of gaming at racetracks, Maryland may lose its distinction as the major horse racing state in the region. Greater harmony is being achieved in the industry as controversial issues are resolved.

Maryland's Racing Industry at a Glance

Currently most thoroughbred racing in Maryland occurs at Pimlico in Baltimore City and Laurel Race Track in Anne Arundel County, both run by the Maryland Jockey Club. Standardbred racing occurs at Rosecroft Raceway in Prince George's County and Ocean Downs in Worcester County, which are independently owned. Limited racing also occurs at Timonium and Fair Hill. The State Racing Commission licenses each facility, and State law limits the number of track licensees. An additional track license was awarded to Allegany Racing in Allegany County, which has the same owner as Ocean Downs. Allegany Racing has yet to begin construction, however.

In addition to wagering at Maryland's racetracks, pari-mutuel wagering also occurs at off-track betting facilities located in Frederick, Cecil, and Dorchester counties. A fourth off-track betting facility located in Southern Maryland, which was destroyed during Hurricane Isabel in 2003, is expected to re-open late in 2006.

State Assistance and Actions Regarding Maryland Racing

Horse racing in Maryland's closest neighbors benefit from other forms of gaming, primarily slot machines, to enhance purses. Another way to enhance purses includes government grants. The General Assembly authorized the use of State funds to enhance racing purses for several years, most recently in 2002, when $3.7 million was designated for purses. **Exhibit 1** shows that thoroughbred racing purses in Maryland have become lower than Delaware and are significantly lower than West Virginia. The purse amounts for Maryland largely come from money wagered on Maryland races, while purses in Delaware and West Virginia consist of a combination of money wagered on races and, to a large extent, purse supplements from slots.

Although there have been no State funds provided for purse supplements in the past several years, the General Assembly passed legislation several years ago allowing for the redirection of some racing revenues for purses for the Maryland Million races.

Exhibit 1
Thoroughbred Purses* for Maryland, Delaware, and West Virginia

	2003	2004	2005
Maryland Racing	$40,419,961	$32,977,195	$35,622,202
Delaware Racing	32,879,917	33,909,303	37,689,765
West Virginia Racing	78,732,457	82,709,078	78,423,742

*Amount combines purses from amount wagered and purse supplements.

Source: Department of Legislative Services, Maryland Racing Commission Annual Reports, Delaware State Government Web Page and the State Thoroughbred Racing Commission, and West Virginia State Government Web Page

The Pennsylvania Effect

The most recent significant event affecting Maryland racing is occurring in Pennsylvania where the placement of up to 61,000 slot machines in specific locations across the State, including five racetracks, has been legalized. Starting at a harness track in the Pocono Mountains in late 2006, slot machine gambling will occur in Pennsylvania. The number of machines legalized in Pennsylvania far exceeds the number of machines in Delaware and West Virginia, which means the amount of revenue generated in Pennsylvania may be substantial, possibly eclipsing Maryland as the major racing state in the region. For example, per day purses at Philadelphia Park are projected to go from $135,000 to over $350,000. Purses at Laurel Park and Pimlico for 2005 were about $177,878 per day.

There is concern in the Maryland racing community that many horse breeders and horsemen may be lured to Pennsylvania. The impending bounty has led Pennsylvania to tighten its breeding rules by requiring that dams and foals spend more time in Pennsylvania to qualify for state-bred winnings. The most recent breeding statistics for 2006 indicate that while Maryland still leads in the total number of reported live foals (1,021) compared to Pennsylvania (997), Pennsylvania live foals increased by 13.2 percent from 2005 compared to a 2.4 percent increase in Maryland live foals. Maryland still has a significantly higher number of quality stallions, but that number has decreased from 92 in 2003 to 74 in 2005.

Some Growth and Hope for Maryland Racing

During 2002, the Maryland Jockey Club sold a majority interest to Magna Entertainment Corp, a company with racing interests across the nation. The sale gave Magna control over Pimlico and Laurel racetracks, a training facility in Bowie, and ownership of the Preakness. Magna has spent over $38 million renovating barn areas, roadways, landscaping, and water and electrical systems at Pimlico and renovating Laurel Park with the addition of a "state-of-the-art" turf course. The remodeled turf course has increased in-state and simulcast wagering on races at Laurel Park. Magna is also considering adding an off-track betting facility in Baltimore County. As a result of a new revenue-sharing agreement (discussed below), Magna has also experimented with limited twilight racing at Laurel, which received positive reviews.

While it appears that the State's major thoroughbred tracks are doing well, Maryland's major standard-bred track, Rosecroft Raceway, continues to experience difficulty. In mid-2002, the owners of Rosecroft Raceway decided to sell their beleaguered harness track after being courted by several suitors. As a result of these multiple suitors, the owners were involved with several civil suits; however, representatives of Rosecroft Raceway have reported that all litigation issues have been resolved and the racetrack is no longer for sale, unless an extraordinary bidder emerges. The number of live racing days has declined over the years at Rosecroft Raceway; in 2005 there were 97 live racing days, a decrease from 117 days in 2004. Currently, there are two live racing days per week at Rosecroft Raceway.

Harmony in the Industry

As mentioned earlier, Maryland was plagued by industry infighting between track owners, horse breeders and owners, and horsemen. An issue that significantly affected the industry was a revenue sharing agreement between the Maryland Jockey Club and Rosecroft Raceway. For several years, based on the amount of business generated, out of all revenues realized by both groups, the Maryland Jockey Club received 80 percent and Rosecroft Raceway received 20 percent. After the agreement expired in mid-2004, a subsequent agreement provided that Rosecroft Raceway pay the Maryland Jockey Club 12 percent of its revenues. In return the Maryland Jockey Club's tracks continued to receive simulcast signals after 6:15 p.m.; Rosecroft received simulcast signals during the day. That agreement expired at the end of 2004 but was continued through frequent contract extensions.

Members of the General Assembly have consistently urged the industry to halt its infighting as a condition for the State financial assistance. The Maryland Jockey Club and Rosecroft Raceway recently signed a 15-year agreement that is similar to the original agreement whereby, out of the revenues realized by both groups, the Maryland Jockey Club receives 80 percent and Rosecroft Raceway receives 20 percent. The agreement also eliminated the 6:15 p.m. rule that prevented any evening or night racing at Laurel Park or Pimlico racetracks. In return Rosecroft Raceway may conduct racing during the day. Legislation will be required to

formally repeal the 6:15 p.m. rule, and the agreement further holds that all parties will support the legislation.

Another point of contention within the thoroughbred industry was the number and scheduling of racing days. In mid-2005, the Maryland Jockey Club proposed a "Plan for Maryland Thoroughbred Racing – 2006 and Beyond." The plan proposed reducing the number of live racing days from 2005's 200 to 112 days in 2006. Racing days, however, must be approved by the Racing Commission. The Maryland Jockey Club felt the decrease was necessary to increase the daily purses. The Maryland horsemen and breeders opposed the reductions calling the cut in days draconian and unnecessary. The Racing Commission rejected the proposal and directed the parties to work out the differences.

Following the completion of the new revenue sharing agreement between the Maryland Jockey Club and Rosecroft Raceway, the Maryland Jockey Club and the thoroughbred horsemen agreed to a revised racing schedule for the remainder of 2006 and a 180-day racing schedule for 2007. No legislation is required for this agreement.

The second part to the "Plan for Maryland Thoroughbred Racing – 2006 and Beyond" proposal involved closing the Bowie Training Center. The proposal was controversial, particularly between the Maryland Jockey Club and the thoroughbred horsemen, and would have required legislation. Representatives of the Maryland Jockey Club have recently indicated that the Bowie Training Center will remain open.

Business Regulation

Retail Electric Restructuring and Electricity Rates

To mitigate the dramatic electric price increases effective July 1, 2006, the General Assembly reconvened in the 2006 special session to pass comprehensive energy legislation that addressed electric industry restructuring, standard offer service, rate stabilization plans, and the makeup of the Public Service Commission. Although the price of commodities used to generate electricity is trending lower, discussions regarding the electric restructuring system (based on the impact of the recent legislative changes and anticipated studies) are continuing. Nationally, restructured states are experiencing higher price increases than nonrestructured states.

Implementation of Electric Restructuring

The Electric Customer Choice and Competition Act of 1999 restructured the electric utility industry in Maryland, introducing "customer choice" of an electric supplier effective July 1, 2000. Before restructuring, also known as deregulation, the local electric utilities were vertically integrated monopolies. They "bundled" their three services (the *generation* of electricity; the *transmission* of that electricity on high-capacity lines to distribution networks; and the *distribution* of the transmitted electricity to customers) and provided them to their customers within their geographically defined monopoly service territories. Although the generation component is deregulated as to price, the transmission and distribution components remain regulated as monopoly services.

Customer choice allows the customer to purchase electricity generated by other sources and have the electricity delivered over transmission and distribution lines of the local electric utility. However, the customer has the option to retain the local electric utility as its supplier of electric generation under the "standard offer service" (SOS). After expiration of rate caps, customers who do not choose to purchase electricity from a competitive supplier are automatically provided electricity through SOS by the local electric utility at rates determined in an auction process. The auction mechanism and related features of customer choice have been implemented through orders and regulations of the Public Service Commission (PSC).

The 1999 Act enacted two mechanisms to protect customers from rate swings during the transition to customer choice: a mandated rate reduction, and a cap on the reduced rates. Settlement agreements between the utilities and interested parties established the actual amount of the rate reduction and the date for how long the rate caps would remain in place in each service territory and for each customer class. All rate cap restrictions have now expired for residential, commercial, and industrial customers except for Allegheny Power's residential SOS customers.

The apparent results of electric restructuring in a climate of rising fuel costs appear mixed. The cost of fuel as a commodity used to produce electricity is the largest factor in total operating costs for most generation facilities. Although electric restructuring was expected to reduce prices for most consumers, a number of factors in the intervening years have combined instead to increase the price of electricity nationwide. The Enron scandal and the failure of a poorly designed restructuring law in California scared many investors away from financing new generator construction. The cost of fuels increased with demand for these commodities on the world market and the impact of natural disasters. For example, the price of natural gas increased to an all time high spot-market price exceeding $18 per million BTU in part due to the reduction of supply caused by Hurricanes Katrina and Rita in the autumn of 2005.

2004-2006 Market Auctions

With the expiration of price caps, customers are subject to market rates. The exact amount of a price increase depends upon the results of annual SOS wholesale electric supply auctions which use a bid request process for the obligations of each utility. Bid offers with the lowest price are selected. In the past, approximately 18 suppliers have submitted bids, and 9 suppliers have won some portion of the load offered.

Due to significant increases in the prices of commodities used to generate electricity in late 2005, SOS rates significantly increased for the 2006 auctions. The magnitude of the increase was dramatic for BGE customers whose rate caps were expiring at this time. **Exhibit 1** shows the percent increases for the average total bill of a residential consumer for the auctions to procure power for the July 1, 2004, to May 31, 2007, period of the three investor-owned utilities whose rate caps expired during the period.

Exhibit 1
Percent of Rate Increase for the Average Total Bill
SOS Auctions for Residential Load
July 1, 2004 – May 31, 2007

	Date Rate Caps Ended	2004 Auction: July 1, 2004-May 31, 2005	2005 Auction: June 1, 2005-May 31, 2006	2006 Auction: June 1, 2006 for PEPCO/Delmarva/ July 1, 2006 for BGE – May 31, 2007
PEPCO	June 30, 2004	16%	4.5%	39%
Delmarva	June 30, 2004	12%	5.8%	35%
BGE	June 30, 2006	Not applicable	Not applicable	72%

Source: Public Service Commission

Efforts to Avoid Rate Shock

With the threat of significant electric price increases following the termination of rate caps for Central Maryland, PSC developed a mitigation plan to ease the transition of BGE residential customers to market-based rates. At the same time, the General Assembly as well as the Senate Special Commission on Electric Utility Deregulation Implementation discussed modifications to the electric restructuring law. Over the course of the 2006 regular session, several legislative rate stabilization proposals were developed for the BGE and PEPCO/Delmarva service territories, but none passed both chambers. As a result, the General Assembly reconvened in special session on June 14, 2006, to pass comprehensive energy legislation addressing electric industry restructuring, SOS, rate stabilization plans, and the makeup of PSC.

Governor Ehrlich vetoed the resulting legislation; however, the General Assembly overrode the veto, enacting the legislation as Chapter 5 "Public Service Commission – Electric Restructuring." Chapter 5 indefinitely continues the obligation of each local electric utility to provide SOS but alters the procurement of electricity for that service so as to limit price volatility and protect residential and small commercial customers. The procurement of supply for SOS must include a blended portfolio of short-, medium-, and long-term contracts to address different portions of customer load; include cost-effective energy-efficiency and conservation measures; and disclose the identity of successful bidders.

In order to mitigate significant increases of SOS between July 2006 and May 2007, Chapter 5 enacted a process to defer a portion of the increase with the deferred amount to be repaid in accordance with PSC proceedings. The deferral may be secured by bonds issued on behalf of the electric company and repaid in accordance with a qualified rate order. As discussed below, this process affects residential customers in the BGE service territory. PEPCO and Delmarva residential customers were offered the opportunity to defer a portion of costs imposed at the same time, without securing the deferred portion of the supply cost. Participating customers pay back the deferred expenses over 18 months, but the utilities are required to cover carrying costs.

Chapter 5 expanded the pool of applicants eligible for the Electric Universal Service Program and increased the total amount of funds collected for this fund each year to $37 million, with the industrial and commercial classes paying the additional amount. Lastly, the legislation altered the term of the PSC commissioners effective June 30, 2006. *(Note: The Court of Appeals ruled in September 2006 that the termination of incumbent commissioners is an unconstitutional usurpation of the removal power granted to the Governor.)*

BGE Rate Increases in the Reform Legislation

For the BGE service territory, Chapter 5 mandated a 15 percent cap on the rate increase on the total electric bill for residential customers. The Act requires BGE to defer collection of the difference between the capped rate and the full 72 percent rate for 11 months. BGE must

finance that deferral by creating a security interest and sell bonds with a term of 10 years. The difference is a credit applied to the distribution portion of the bill. The deferral, paid through a monthly charge for 10 years starting January 2008, is expected to cost the average customer approximately $5.02 each month. The mandatory nature of the deferral provides a sufficient value of security to make the rate stabilization bonds saleable on the financial markets, and to protect more vulnerable customers from still higher finance costs that may have resulted from an opt-in or opt-out deferral plan.

The interest and part of the principal, however, are offset by credits provided by BGE ($2.83 each month for the average customer) based on the SOS authorized return and the nuclear decommissioning charge so that the cost to the average customer who remains on SOS is approximately $2.19 each month. In total, approximately $386 million in credits are required. The legislation contemplated an additional $214 million, depending on whether the merger of Constellation and FPL was approved. *(Note: The proposed merger filing was terminated in October 2006 and, therefore, these additional credits will not be realized.)* All residential customers receive the monthly deferral credits and charges whether or not the customers select an alternative supplier; accordingly, all residential customers have the opportunity to save additional money by shopping for alternative electricity supply.

New Developments in Competition

During the transition period which aimed to give the electric industry time to switch to a competitive market, electric suppliers were unable to compete with the lower than market rates in effect under the rate caps. Although electric restructuring has primarily benefited big electricity users, such as industrial customers and State and local government operations, suppliers only slowly started to enter the market for residential customers as the price caps expired. For residential customers, in fiscal 2006, 57 companies were licensed with PSC as suppliers in the State; however, only a handful are actively seeking new residential customers.

Although a truly competitive market has not developed, as of July 2006, BGE customers have at least eight plan alternatives to SOS, offered by five suppliers. While most offer flat rates, several plans offer a variable rate where there is no protection from month-to-month increases if the price of wholesale power increases. Depending on the plan, estimated monthly savings range from $12 to $20 during summer months and from $1 to $6 during nonsummer months. As a result of the entrance of competitive suppliers, almost 11,100 BGE residential customers (1.0 percent of total customers), almost 26,000 PEPCO residential customers (5.5 percent of total customers), and a little over 300 Delmarva residential customers (0.2 percent) had switched from SOS by the end of September 2006.

Outlook for Electricity Needs

Chapter 5 mandates several reports to assist the General Assembly in assessing the impact of electric restructuring on the State and in altering it for the benefit of consumers. PSC

must study actions taken to implement restructuring and must study the impact of potential changes such as re-regulating electric generation or allowing local governments to aggregate residential demand. In addition to a review of the full requirements bid process, PSC must consider other changes to the wholesale procurement process such as allowing utilities to meet their SOS obligations through bilateral contracts and owning or leasing generation.

The U.S. Energy Department reported in October 2006 that the outlook in natural gas prices forecasts a decline in natural gas prices. The cause of the decline is due to a mild 2006 winter, followed by moderate 2006 summer high temperatures, a relatively calm Atlantic hurricane season, and restored output in the Gulf of Mexico. With supplies rebounding to adequate levels, natural gas future prices dipped to a low of $4 per BTU in September 2006; the last time natural gas futures settled below $5 was September 2004.

The price for unfilled power load to be secured in the 2007 bidding process will blend with the prices for the contracts which are currently in place. The percentages of residential load that are unfilled as of June 1, 2007, are as follows: BGE 50 percent; PEPCO 79 percent; and Delmarva 80.5 percent. *(Note: A recent PSC order altered the bidding process for residential SOS to include two bidding cycles each year rather than the single cycle used in 2004 through 2006, as well as making several other significant changes to the SOS procurement process.)*

National Status of Residential Electric Prices

The national status of retail access to electricity supply has been relatively unchanged for several years. At this time, 16 states and the District of Columbia have fully implemented legislation and commission orders to allow full retail access for all consumer groups. Eight states that have passed legislation have stepped back from restructuring.

As of July 2006, Maryland ranks thirtieth nationally in terms of the average retail price residential customers pay for electricity, with rates averaging 9 cents per kWh for all residential customers. Of the surrounding states, three states have restructured to some degree (Delaware, Pennsylvania, and Virginia) along with the District of Columbia, and West Virginia remains fully regulated. Delaware ranks fifteenth in average retail residential price, with average residential electricity rates of 10.46 cents per kWh. Pennsylvania ranks sixteenth in the nation, with prices averaging 10.41 cents per kWh. Virginia ranks thirty-fourth, with rates of 8.4 cents per kWh. West Virginia, which relies on domestic coal for generation and has not deregulated, has the second-lowest rates in the nation, with an average price of 6.24 cents per kWh for electricity.

From calendar 2002 to 2005, the nationwide average residential price for electricity rose by 11.35 percent. As shown in **Exhibit 2**, during this same time period, states that did not restructure saw an average residential price increase of 11.30 percent, nearly identical to the national average. For the same time period, the average residential price increase for the states that restructured was 12.10 percent, higher than the national average. From calendar 2002 to

2005, Maryland's residential electricity prices rose by an average of 6.33 percent, which was well below the national average. This small increase reflects rate caps that were imposed under the 1999 Act.

Exhibit 2
Percent Increase in Average Residential Retail Price
2002 to July 2006

	2002 Average Cents per kWh	2005 Average Cents per kWh	Percent Increase 2002-2005	July 2006 Average Cents per kWh	Percent Increase 2005 to July 2006
Nonrestructured States	7.83	8.71	11.30%	9.17	5.28%
Restructured States	9.64	10.80	12.10%	12.06	11.67%
Maryland	7.74	8.23	6.33%	9.00	9.36%
U.S. Total	**8.46**	**9.42**	**11.35%**	**10.30**	**9.34%**

Source: Department of Energy/Energy Information Administration

From the end of 2005 to July 2006, the nationwide average residential price for electricity rose by 9.34 percent. During this same time period, the average residential price increase for states that did not restructure was 5.28 percent. For the same time period, the average residential price increase for the states that restructured was 11.67 percent, higher than the national average price increase and higher than the increase for nonrestructured states. Maryland's residential electricity prices rose by an average of 9.36 percent, nearly identical to the national average. The higher increase in average prices for Maryland in 2006 from the earlier time period reflects the expiration of rate caps for BGE customers.

Business Regulation

Workers' Compensation

In early 2006, the Workers' Compensation Commission increased the reimbursement rate for orthopedic doctors who treat workers' compensation injuries, thus resolving a significant complaint from the medical community. Legislators may see proposals to address complaints from other sectors of the workers' compensation community, such as those related to subpoenas of medical records for workers' compensation cases and to the prompt payment for certain types of workers' compensation medical claims. A recent Court of Special Appeals ruling could produce legislation for the 2007 session.

Background

Many Maryland employers received good news in 2006 – their workers' compensation insurance premiums are likely to decrease in 2007. The pure premium rate filed by the National Council on Compensation Insurance reflects a 5.2 percent overall drop for most industries, compared to a 5.7 percent increase for 2006. Pure premium rates, one component of overall premium rates, are set at a level necessary to prefund projected claim loss payments to injured workers. The second component is a factor determined by each insurer to cover expenses and other costs that it may have to incur as a business. Other positive trends regarding workers' compensation activity in the State include a decline in the frequency of claims and a continued decrease in indemnity (wage replacement) loss, meaning insurers are receiving more in premiums than what they are required to pay for wage loss. According to an annual review of manufacturing industry costs by Actuarial & Technical Solutions, Inc., Maryland is the twelfth lowest in workers' compensation comparative costs in 2006, an improvement over 2005 when Maryland was the fourteenth lowest.

There are forces that are driving up some portions of workers' compensation costs; how they will balance in the long term is unclear. Due to projected wage increases and an aging workforce, indemnity benefits will likely become more expensive in the future. Medical fees are also rising, partly from a national trend of rising hospital and drug costs, as well as from the costs associated with treating older workers. Maryland's litigation costs and rate of attorney involvement are also higher than in many other states.

Overall, despite these concerns, significant complaints about the workers' compensation law are not being reported, particularly after orthopedic doctors obtained a substantially higher rate under the Medical Fee Guide (144 percent above the Medicare reimbursement amount, rather than the former 109 percent). The workers' compensation community is more likely to focus on procedural issues such as speeding up the process of obtaining medical records, as well as clarifying responsibility for insurance costs if the compensability of the claim is in question.

Among others, the State Workers' Compensation Benefit and Insurance Oversight Committee intends to discuss the issues listed below at its November 15, 2006, meeting.

Upcoming Legislative Issues

Subpoena of Medical Records

Chapter 503 of 2005 requires a doctor to receive either (1) written permission from a patient before releasing a patient's medical records in response to a subpoena or court order; or (2) a written assurance that any objections by the patient were resolved. The patient has 30 days to object to the release so that records are not accessible until that 30-day timeframe has passed.

Some concerns were raised that this law creates delays or postponements of hearings, which led to legislation during the 2006 session. The Senate Finance Committee passed a bill (Senate Bill 802) that would have allowed a doctor to release records after receiving authorization from the Workers' Compensation Commission. The authorization would have been approved by the employee and included as part of the initial filing of the workers' compensation claim. The legislation received an unfavorable report by the House Economic Matters Committee.

Prompt Payment

During the 2006 session, legislators heard testimony on two bills (House Bill 364/Senate Bill 303) that would have prohibited an insurer or health maintenance organization (HMO) from delaying payment for services that may be covered under a workers' compensation claim while the compensability of the claim is being determined. Although amendments were offered at committee hearings to allow the insurer or HMO to receive reimbursement if the Workers' Compensation Commission later determines that the injury is compensable or if the carrier or employer takes responsibility for the payment, no committee action was taken on these bills.

Permanent Partial Disability – Controversial Court Ruling

A decision by the Court of Special Appeals in June 2006 involving the calculation of permanent partial disability claims may produce legislation if the Court of Appeals affirms that ruling. The Court of Appeals is expected to hear arguments in January 2007 on *Del Marr v. Montgomery County*, which centers on an electrician who injured his back in 2001 while working for the county.

Paul Del Marr was originally awarded 50 weeks of disability benefits at the lowest rate under law (known as Tier 1 – $114 per week); later, the Workers' Compensation Commission determined that the injury had worsened and provided additional weeks, but the pay rate remained the same. Ultimately, upon petition, the commission ruled that the injury qualified for

45 more weeks of disability, for a total of 115 weeks. Due to the total number of weeks reached under the last commission ruling, Mr. Del Marr then qualified for a higher rate of pay known as Tier 2 (two-thirds of the average weekly wage).

At issue is whether Montgomery County owes Mr. Del Marr $25,645, which reflects the higher rate of pay for the entire number of weeks (including the weeks previously paid at the lower rate) awarded or $17,665, which reflects the higher rate of pay only for the additional weeks awarded in the last award. The Court of Special Appeals upheld the circuit court's decision that the county should receive credit for the weeks already paid and did not owe Mr. Del Marr any benefits retroactively. The law regarding the procedure for an award of additional compensation, upon reopening a claim, is silent when a subsequent award moves the claim from Tier 1 to Tier 2. The law, however, specifies that when a subsequent award moves the claim from Tier 1 or 2 to Tier 3 the additional compensation may not increase the amount of compensation previously awarded and paid.

Business Regulation

Security Freezes

Credit reporting agencies may release an individual's consumer report only under certain circumstances. As a way to prevent the information in an individual's consumer report from being used by an identity thief to obtain credit in the individual's name, about half of the states have adopted security freeze laws.

Background

An individual's consumer report contains information about the individual's use of credit. Banks and other potential creditors rely on this information when making a decision on whether to make a loan or otherwise extend credit. Information in a consumer report is also used to establish an individual's credit score, a numerical rating that is widely used to determine creditworthiness. Generally, higher credit scores indicate better creditworthiness.

When an identity thief fraudulently obtains credit in an individual's name, the victim can suffer severe harm. For example, debt collectors frequently seek to collect on the debt from the victim when the identity thief fails to make payments. Moreover, damaging information can become a part of an individual's consumer report and can lower the individual's credit score, thereby leaving an identity theft victim unable to obtain credit.

Under the federal Fair and Accurate Transactions Act (FACT Act), a consumer reporting agency must block information in a consumer's file that the consumer identifies as information resulting from an alleged identify theft under specified circumstances. Some consumer advocates feel that the FACT Act protections do not go far enough and that legislation is needed to allow an individual to place a "security freeze" on his or her consumer report. Generally, when an individual places a security freeze on his or her consumer report, the consumer reporting agency may not release the report. When an individual wants to obtain credit (*e.g.*, for a car loan, mortgage, or credit card), the individual must free the consumer report by temporarily lifting ("thawing" the freeze). By limiting the release of information in the consumer report, an individual can more fully protect against identity theft crime.

Actions in Other States

According to the National Conference of State Legislatures, 25 states have adopted some form of security freeze legislation. A list of these jurisdictions appears in **Exhibit 1** below. States have taken different approaches in authorizing a security freeze. Some allow any consumer to establish a freeze, while others limit the right to victims of identity theft. Most statutes authorize the freeze to be "thawed" temporarily for a specified time period or a specified

credit application, and all allow an individual to remove the freeze permanently. Consumer reporting agencies generally are authorized to charge a fee for establishing a security freeze and a separate fee for "thawing" the freeze. The amounts of the fees authorized vary.

Exhibit 1
States That Have Passed Security Freeze Legislation

California	Kentucky	North Carolina
Colorado	Louisiana	Oklahoma
Connecticut	Maine	Rhode Island
Delaware	Minnesota	South Dakota
Florida	Nevada	Texas
Hawaii	New Hampshire	Utah
Illinois	New Jersey	Vermont
Kansas	New York	Washington
		Wisconsin

Source: National Conference of State Legislatures

Legislation Introduced in Maryland

Legislation authorizing an individual to place a security freeze on the individual's consumer report was introduced during the 2005 and 2006 sessions. The bills varied slightly, but generally they authorized an individual to elect to place a security freeze on all or part of the individual's consumer report, temporarily lift ("thaw") the freeze, and permanently remove it. During 2006, the issue of possible federal preemption of state security freeze laws was raised under the National Banking Act as to the extension of credit by federally chartered financial institutions. Most state statutes, however, do not provide an exemption for financial institutions, and the Department of Legislative Services has not found any reported instances of a successful challenge to another state's security freeze legislation on preemption grounds.

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Business Regulation

Office of Cemetery Oversight

The Office of Cemetery Oversight terminates July 1, 2007, unless legislation is enacted to extend its regulatory authority. The Advisory Council on Cemetery Operations is studying a model approach to the restoration of abandoned and neglected cemeteries, as well as considering developing regulations requiring cemetery owners to prepare disaster plans. Legislation is anticipated during the 2007 session to address the pre-construction of mausoleums.

Sunset Evaluation

The Maryland Cemetery Act (Chapter 675 of 1997) established the Office of Cemetery Oversight within the Department of Labor, Licensing, and Regulation and created the Advisory Council on Cemetery Operations. The office enforces registration, permitting, and perpetual care requirements imposed on the owners and operators of cemeteries and burial goods businesses.

Pursuant to the Maryland Program Evaluation Act, the office underwent its first full sunset evaluation in 2005. The evaluation revealed significant concerns regarding data maintenance by the office, abandoned and neglected cemeteries, enforcement of its regulatory authority, and the office's fiscal fitness. The report issued at the conclusion of the evaluation made 18 recommendations. Chapter 348 of 2006 implemented a few of those recommendations by extending the application of perpetual care requirements and consumer disclosure requirements to *anyone* engaged in the sale of burial goods or services, rather than specifically to registered cemeterians and permit holders.

Although the sunset evaluation report also recommended extending the termination date of the office for five years from July 1, 2007 to July 1, 2012, the legislative proposals that would have carried out the extension (Senate Bill 387 and House Bill 862) both died in the House Economic Matters Committee. If legislation extending the termination date of the office is not passed during the 2007 legislative session, the office will terminate on July 1, 2007.

Abandoned and Neglected Cemeteries

Recently publicized cases of unearthed historic cemeteries in the Washington Metropolitan area highlighted concerns over the issue of abandoned and neglected cemeteries. In October 2005, a backhoe operator discovered a human skeleton in a small, previously undiscovered, Annapolis burial site. A local archaeologist speculates that the eighteenth century cemetery probably belonged to a prominent local family. The Maryland Historical Society will

rebury the remains after the State medical examiner's office has completed its analysis. Adjacent to the National Zoo in Washington's Walter C. Pierce Community Park, a nineteenth century cemetery is currently being surveyed by a Howard University anthropologist and his team of university students. The cemetery is believed to be the final resting place of post-Civil War African-Americans associated with the Colored Union Benevolent Association.

During 2006, the office's director and investigator visited 12 neglected and abandoned cemeteries throughout the State. The majority of these cemeteries were family cemeteries situated in residential communities. The office attributes the declining interest level in these cemeteries to the fact that descendants further removed from the family members interred are less likely to feel responsible for the maintenance of the family cemetery. Complaints and inquiries regarding abandoned and neglected cemeteries are recorded, but complainants are advised that the office is not responsible for abandoned cemeteries and a list of private and public resources from which assistance may be available is provided.

The director, investigator, and members of the advisory council received input from members of three cemetery preservation projects in the State: the Coalition to Protect Maryland Burial Sites, the Asbury and Green Chappel Conservation and Preservation Committee, and Peerless Rockville. The chair of the advisory council also contacted officials in New York to learn more about how the state and local officials finance abandoned cemetery maintenance efforts. The advisory council expects to provide the director with recommendations for establishing a model approach to the restoration of abandoned and neglected cemeteries by December 2006.

Disaster Planning

In the wake of the devastating 2005 hurricane season, the advisory council is considering developing regulations requiring cemetery owners to prepare disaster plans. In 2006, the advisory council considered the types of emergencies that would meet the definition of "disaster" and the importance of identifying cemeteries with large areas of undeveloped land for use in the event that mass burials are necessary.

The advisory council also suggested categorizing the disaster plans in accordance with the disaster level (pandemic, hurricane, flood, state of martial law, etc.). Depending on the disaster level, cemetery owners may be required to include contingency plans for (1) communication; (2) staffing; (3) power; (4) supplies; (5) storage capacity; (6) off-site and electronic recordkeeping; (7) securing subcontractors for assistance in operations; (8) corpse identification; and (9) transportation of corpses. Members of the federal Disaster Morticians Operations Team, the advisory council noted, will also be available to assist in the identification and burial of the deceased if the State is faced with mass casualties.

Given the advisory council's focus on disaster planning concerns, regulatory proposals requiring cemetery owners to prepare disaster plans may be introduced as early as 2007.

Pre-construction of Mausoleums

The office recently received several inquiries regarding the construction of mausoleums. In a few cases, a consumer who purchased a crypt within a mausoleum died during the construction of the mausoleum. To the dismay of family members, the deceased are usually placed in a temporary crypt until the mausoleum becomes available. Although other states currently impose a statutory timeframe within which a mausoleum must be made available to a consumer, Maryland does not have such a statute in effect.

The Assistant Attorney General assigned to the office developed a model legislative bill requiring the seller of a mausoleum to make the mausoleum available for use within a certain timeframe after which the sale is completed and briefed the advisory council on the statutes enforced by other states. A private association is also developing a legislative proposal addressing the pre-construction of mausoleums for introduction during the 2007 legislative session.

Online Sale of Burial Goods

The death care industry is not immune from the popularity of online shopping. With a recent increase in the online sale of caskets and markers, advisory council members foresee a dramatic increase in online burial goods sales in the coming years. Out-of-state monument dealers typically contract with the consumer's requested cemetery or a local monument dealer for installation of the monument. Cemeterians and monument dealers should only be dealing with out-of-state monument dealers that are registered in the State; otherwise, the office must rely on consumer complaints to report incidences of a prohibited sale.

Business Regulation

Committee on Unemployment Insurance Oversight

The Committee on Unemployment Insurance Oversight continues the work of the Unemployment Insurance Funding Task Force, which provided recommendations during the 2004 interim to reform the unemployment insurance tax system; those recommendations became law under Chapter 169 of 2005. Under the reformed tax system and based on the balance of the Unemployment Insurance Trust Fund, employers will pay from the tax table with the lowest rates, allowing employers to realize a savings of about $95.5 million in calendar 2007 over calendar 2006. At its January 2007 meeting, the committee intends to continue to monitor the status of the reformed system, review other recently enacted legislation that impacts the unemployment insurance operations, and discuss a recent audit of the Division of Unemployment Insurance.

State Unemployment Insurance Taxes Decrease

Chapter 169 of 2005 replaced the prior single schedule of experience tax rates and the flat-rated surcharge system with an overall more experience-rated system effective January 1, 2006, and increased the maximum weekly benefit from $310 to $340. The law, based on the Unemployment Insurance Funding Task Force's recommendations, was aimed at improving the solvency of the Maryland Unemployment Trust Fund and increasing fairness for both contributors and recipients. The average tax cost per employee dropped from $207 in calendar 2005 to $134 in calendar 2006 due to the implementation of the revised experience rating system.

Under the reformed tax system, a series of experience tax rate tables were developed. The tax rate table in effect for any calendar year hinges on the balance of the trust fund in relation to the total taxable wages for the prior year. During calendar 2006, employers were subject to the second lowest rates (Table B), which range from 0.6 to 9.0 percent on the first $8,500 of taxable wages. **Exhibit 1** summarizes the minimum and average tax rates and costs per employee from calendar 2004 to 2007.

Due to growth in trust fund revenues, the lowest possible rates (0.3 to 7.5 percent on the first $8,500 of taxable wages) will be in effect for calendar 2007. The balance of the trust fund on September 30, 2006, was approximately $1 billion. The average amount that will be paid by employers for calendar 2007 will be $99 per employee, a savings of $35 per employee. This translates to about $95.5 million in savings to employers during calendar 2006 (based on a labor force of approximately 2.7 million employees). Over half of all employers will see their taxes cut in half (to 0.3 percent or $25.50 per employee) during calendar 2007.

For two consecutive calendar years (2004 and 2005) and some previous years, employers had been required to pay a surcharge in addition to their tax payment because the trust fund was

not sufficiently solvent (less than 4.7 percent of the total taxable wages). That surcharge was eliminated under Chapter 169.

Exhibit 1
Tax Rates and Costs Per Employee
Calendar 2004-2007

	2004	2005	2006	2007
Minimum Tax Rate*	0.3%	0.3%	0.6% Table B	0.3% Table A
Surcharge on All Employers	1.1%	0.8%	N/A	N/A
Minimum Cost (with surcharge) Per Employee	$25.50 plus $93.50 (surcharge) = $179	$25.50 plus $68 (surcharge) = $93.50	$51.00	$25.50
Average Tax Rate **with surcharge	2.70%	2.44%	1.58%	1.17%
Average Cost (with surcharge) Per Employee	$229.50	$207.40	$134.00	$99.00

*Approximately 66.4 % of employers qualify for the minimum tax rate each year.

**The tax rate for an employer is based on the employer's chargeable benefits during the prior three fiscal years; accordingly, average tax rates, exclusive of surcharges, in calendar 2005 and 2006 were impacted by the period of higher unemployment that occurred during approximately late calendar 2001 through early calendar 2003.

Source: Department of Labor, Licensing, and Regulation (Division of Unemployment Insurance)

Committee on Unemployment Insurance Oversight

Although the Committee on Unemployment Insurance Oversight did not meet during the 2006 interim, the committee intends to meet in January 2007. In addition to monitoring the status of Chapter 169, the committee intends to review the status of Chapter 610 of 2005. Chapter 610, enacted as a part of an appropriation incentive under federal law, is intended to prevent companies from engaging in State Unemployment Tax Avoidance ("SUTA dumping"). As a form of leakage, "SUTA dumping" is the practice of an employer avoiding a high

unemployment insurance tax rate (based on its history in the unemployment insurance tax system) by either forming a new company to get a lower unemployment tax rate or buying an existing firm with a low number of unemployment claims and using the second firm's lower rate.

The committee also intends to review the status of Chapter 527 of 2006, which provides the Division of Unemployment Insurance with flexibility to use money from the special Administrative Expense Fund for specified administrative purposes related to the State's unemployment insurance program.

Audit Finds Overpayment of Benefits

The committee may discuss the recent audit of the Division of Unemployment Insurance (DUI). The Office of Legislative Audits concluded in April 2006 that DUI overpaid unemployed workers approximately $76 million through fiscal 2005, including $63 million of payments outstanding for at least one year. The auditors cited several factors that could have contributed to the overpayment of unemployment insurance benefits, including (1) failure to use all available collection options; (2) lack of follow-up with employers to obtain wage information when potential overpayments were identified; (3) lack of supervision over adjustments made to claimant data; and (4) discrepancies between the wage data in DUI's two automated systems. DUI concurred with several of the auditors' recommendations to improve the system but did not agree that it should refer more overdue payments to the Central Collection Unit (CCU), stating that DUI lacks the staff to prepare cases for CCU and that its collection rate is higher than CCU's.

Business Regulation

Cable and Telephone Industry Changes

Changes are emerging nationally in the telecommunications industries as local cable companies and local telephone companies enter each others' businesses to offer telephone, broadband (Internet), and television (cable video) services. Traditionally, cable franchises are awarded by local jurisdictions. Several states have passed legislation to allow statewide cable franchises, eliminating the time-consuming task of negotiating with each local jurisdiction. In Maryland, Verizon has successfully negotiated cable franchise agreements with several local jurisdictions.

Background

An historical analysis of the cable industry reveals that cable operators were regulated initially by local governments to ensure proper usage of public property and right-of-ways where cable operators needed to install cable. As the industry grew, the Federal Communications Commission (FCC), along with state governments, assumed some of the regulatory responsibilities and developed stringent rules on the cable operators. The 1992 Cable Act established a process under which cable equipment and basic tier cable rates would be subject to regulation by state and municipal governments in those areas where effective competition was absent. For regulatory purposes, basic tier service includes broadcast signals; local public, educational, and government access channels; and other services the system operator chooses to include in the same package with these channels.

Federal and state laws require cable operators to obtain franchise agreements with the local governments. Franchise agreements expire after several years, and the cable operators must then renegotiate them. Generally, a local government will award one exclusive franchise to serve its jurisdiction; however, large urban counties may award several franchises, each an exclusive franchise serving a different part of the county. Over the past few years, some jurisdictions have awarded more than one franchise to serve the same customers on a nonexclusive basis, thus, encouraging competition among cable operators for their residents. Generally, franchise agreements require cable providers to serve the entire territory for which they are seeking an agreement and make certain services available to the local government. Cable operators are subject to franchise fees which are assessed on cable operators for the privilege of exercising a cable franchise in a jurisdiction. The fee paid is based on a percentage of revenue (up to 5 percent under FCC regulations) and may be passed on to the subscribers.

Developments since the Passage of the Telecommunications Act of 1996

The Telecommunications Act of 1996 was the first major overhaul of the United States telecommunications law in nearly 62 years, amending the Communications Act of 1934. The Act primarily deregulated telecommunications services, but it also created new regulatory mechanisms. Congress forced local telephone companies to share their lines with competitors at regulated rates if the failure to provide access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer. Supporters of the Act claimed that it would foster competition, but instead it led to historic industry consolidation. However, after its passage, there have been dramatic reductions in transmission costs through the use of fiber-optic technology and other data processing advances, sparking competition in manufacturing, long distance, information services, and recently in local telephone services. In parallel, the wireless telephone industry grew, the Internet emerged, cable television achieved high market penetration, and satellite broadcasting entered the market.

Over the years, the cable TV market began to realize intense competition as cable operators competed among themselves and with other industries. Further, as envisioned more than 10 years ago, local telephone service providers are now potential competitors in cable TV because telephone systems can carry the same electronic data transmission as a cable system. Regional Bell telecommunications companies, such as AT&T, Verizon Communications, BellSouth, and Qwest Communications International, have been laying fiber-optic cable for many years in anticipation of entering both the cable TV and Internet businesses. At the same time, cable operators, such as Comcast, Time Warner Cable, Cablevision, and Millennium Digital Media, have made inroads in entering both the telephone and Internet businesses, sparking an intense rivalry between these industries and a battle for telephone, broadband, and television customers.

Congress is currently considering legislation to reform the 1996 Act. When long distance telephone service became competitive in the early 1980s, prices quickly dropped and new packages of services appeared. A similar situation is predicted in the cable TV market. According to a 2003 study by the General Accounting Office, *Telecommunications: Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, prices are about 15 percent lower in areas where there is more than one cable franchise than in areas with exclusive cable franchises.

With the intense rivalry between telecommunications companies and cable operators, there has been lobbying at the federal level, as well as at the state level, to change how lucrative cable TV franchises should be awarded in the future. Telecommunications companies are seeking to expedite their entry into the marketplace by convincing Congress to grant them nationwide franchises. Their rivals in the cable industry, who traditionally have provided service by winning local franchises on a municipality-by-municipality basis, stress that the franchising process should not be eased for new competitors, unless it is eased for them as well. One core feature proposed in both H.R. 5252, which passed the House on June 8, 2006, and S. 2686 is relief for telecommunications companies from local cable franchise laws.

Other States

Most likely the battle over cable franchising will be decided in statehouses as opposed to on Capitol Hill. Obtaining local cable franchise agreements is one of the biggest hurdles telecommunications companies face in providing video service in other states, since the current process significantly slows the introduction of service. Before a telecommunications company rolls out service around the nation, it must first negotiate hundreds of individual franchise agreements with county, city, and other local jurisdictions. Even after its fiber network is completed at a location, it must still convince customers to sign up with a new entrant in a mature market already served by incumbent cable operators and satellite broadcasting operators.

According to Verizon which operates landline telephone services in 29 states, the company plans to have its network ready in 16 states, including Maryland, by the end of 2006. The new fiber optic network, known as FiOS, will have video capabilities in addition to its current telephone and Internet services. However, as companies, such as Verizon, enter the video services market, cable companies, such as Comcast, are simultaneously entering the Internet and telephone markets traditionally served by telephone service providers, resulting in the convergence of several services into a single set of services for customers.

In mid-2005, Texas was the first state to pass a law authorizing statewide cable franchises. As of 2006, similar legislation has passed in California, Indiana, Kansas, New Jersey, North Carolina, South Carolina, and Virginia. Legislation is pending in Michigan and New York. So far, statewide legislation has failed in Florida, Iowa, Missouri, Pennsylvania, and Tennessee. Legislation passed in Louisiana was vetoed by the Governor. Connecticut has ruled that a franchise is not needed for services on any level.

To ensure that the local jurisdiction retains its traditional revenue source from cable franchise fees, operators with a statewide franchise agreement pay a franchise fee to the local jurisdiction served. Consumer rights groups have expressed concerns that a statewide franchise would reduce the leverage that consumers have through the power of city and county officials to ensure that companies provide good and equitable service. Further, there is concern about the utilization of the public rights-of-way without proper local oversight, management, and compensation.

Maryland

Cable operators are subject to franchise fees assessed by the local jurisdiction for the privilege of exercising a cable franchise in that jurisdiction. The fee is based on a percentage of revenue, not to exceed 5 percent, and is passed on to the subscribers. Most jurisdictions collect the maximum tax rate, resulting in an overall tax yield of over $42 million in fiscal 2006.

Competition in Maryland is not new to cable operators. Comcast currently offers cable service in 16 Maryland jurisdictions where they have been competing for 10 years with other

cable operators and with satellite broadcasting operators. In early 2006, Verizon entered the cable market in Maryland by negotiating franchises with several local jurisdictions. To date, the company has concluded agreements with Howard County, Anne Arundel County (except Annapolis), and parts of Prince George's County (City of Bowie and City of Laurel). Tentative agreements have been reached in Annapolis and also in Prince George's and Montgomery counties where individual municipalities in those counties may choose to be included in the agreement once approved by the respective county councils.

In November 2006, Verizon reached agreement with Montgomery County after a year-long process which included the filing of a suit in U.S. District Court asking the court to declare that Montgomery County's cable franchise process and requirements violate federal communications and antitrust laws, as well as the First Amendment to the U.S. Constitution. In exchange for the right to provide cable television services to county residents and businesses under a five-year franchise agreement, Verizon is committed to supporting county public education and government channels and providing cable television services to public use buildings, such as schools, libraries, and fire stations. In addition, Verizon has agreed to pay the county 5 percent of gross revenues as a franchise fee and 3 percent of gross revenues for public access programming and other cable television needs. Verizon will also pay $1 million under the agreement over the course of five years for other cable-related investments.

Business Regulation

Task Force on Common Ownership Communities

The Task Force on Common Ownership Communities was established in 2005 to study the challenges that common ownership communities face. The task force issued its recommendations in November 2006.

Overview

Common ownership communities (COCs) are designed to give homeowners control over services and amenities that might otherwise be provided by a local government. COCs are widespread in Maryland and can include single-family dwellings, townhouses, rowhouses, or units in an apartment type building. Forms of ownership may be condominiums, cooperative housing corporations, and homeowners associations.

In a COC, each unit owner has an interest in common elements such as a clubhouse, swimming pool, or landscaping. COCs have governing boards that are responsible for collecting assessments from owners and overseeing maintenance and improvements for common elements. Sometimes there is confusion about how COCs operate, and there are conflicts among residents, owners, property managers, and association leadership. Chapter 469 of 2005 established a Task Force on Common Ownership Communities to study challenges confronting COCs. The task force met 10 times and also held five public hearings during June and July 2006 in Ocean City, College Park, Annapolis, Frederick, and Baltimore City.

Task Force Recommendations

The task force issued its final report in November 2006. Some recommendations would require legislation. The following are the major points:

- **Education and Training:** The task force recommended that an appropriate State agency host a web site with information about the rights and responsibilities of living in a COC. The site also would contain best practices for COC governing boards and links to other resources. A brochure outlining this information should be produced and distributed to real estate licensees, mortgage bankers, and others. Furthermore, the Maryland Higher Education Commission should offer – to the extent that funding allows – materials and educational services on how to be a homeowner in, or board member of, a COC.

- **Alternative Dispute Resolution:** Most COC disputes are not alleged violations of law but of COC bylaws. The task force recommended that local governments, either

individually or regionally, should be required to provide COC alternative dispute resolution services such as ombuds programs, mediation, and arbitration.

- **Uniform Common Interest Ownership Act:** The National Conference of Commissioners on Uniform State Laws (NCCUSL) developed the Uniform Common Interest Ownership Act to serve as a model for laws governing how COCs are formed, managed, and terminated. NCCSUL is currently considering revisions to the model act; thus, the task force recommended that consideration of the Act be deferred until a final revised version has been completed.

- **Aging Communities:** Some COCs struggle with maintaining common elements because of the way control is transferred from a developer to the COC governing board. When control is transferred, the developer deposits funds into a reserve account that supports costs associated with common elements. The task force recommended that an independent reserve study be required to determine how much the developer should deposit into the account. Furthermore, COCs should be able to refuse control of unusable common elements, such as small strips of land between two homes.

  The task force also recommended that COC boards be required to conduct a reserve study at least once every five years to determine the amount of funds needed to maintain common elements. On a related subject, the task force recommended that COCs be allowed to change their governing documents at least once every five years under specified conditions.

- **Collection of Assessments:** If an owner is delinquent in paying assessments, COCs may have to establish a lien against the owner's unit. The task force recommended that COC assessments be given lien priority under specified conditions. The task force also recommended that COCs be authorized to suspend delinquent owners' privileges to use common elements under specified conditions.

- **Resale of Units:** The seller of a COC unit is subject to different requirements (depending on the nature and size of the COC) concerning the information that must be disclosed to a prospective buyer. The task force recommended that all COCs use a uniform, one-page checklist of disclosure documents, developed in consultation with the Maryland Real Estate Commission, for the sale or resale of COC units. Furthermore, current law requires a homeowners association to maintain a set of up-to-date governing documents in its circuit court, and the task force recommended that this requirement be expanded to include condominiums and cooperatives.

Public Safety

Sex Offenders

Shortly after Maryland enacted far-reaching legislation to strengthen the monitoring of and penalties against sex offenders, new federal standards were enacted that states must meet by July 2009 to avoid the loss of federal law enforcement assistance grants.

Background

Cases of horrible sexual assaults, including one involving a Florida child named Jessica Lunsford, have intensified public fear of and antipathy toward sexual offenders. The result has been far-reaching State and federal legislation to more strongly punish and more closely monitor sex offenders.

2006 Maryland Legislation

Chapter 4 of the 2006 special session, enacted on June 22, 2006, increased the State's oversight of and penalties against sex offenders. Among its many provisions, the Act:

- subjects specified offenders to extended parole supervision for at least three years to a maximum of life, with the ability to petition for discharge after the minimum period;

- requires the Parole Commission to enter into agreements with offenders that set specific conditions of parole supervision, which may include global positioning system (GPS) monitoring, geographic restrictions on residence or presence, restrictions on employment or other activities, participation in sex offender treatment, a prohibition from using illicit drugs or abusing alcohol, an authorization for a parole agent to access the offender's personal computer, a consent to take polygraph exams, and a prohibition against contacting specific individuals or categories of individuals;

- creates a Sexual Offender Advisory Board, with specified reporting requirements, to review technology for tracking offenders, review this State's and other jurisdictions' laws, review the way in which the Parole Commission and the Division of Parole and Probation supervise and monitor offenders, review developments in the treatment and assessment of offenders, and develop standards for conditions of extended parole supervision;

- imposes stricter requirements for registration as a sex offender;

- provides for more comprehensive community notifications;

- prohibits, with specified exceptions, a registrant from knowingly entering on real property used for elementary or secondary education or on which a registered family day care home or a licensed child care home or institution is located; and

- requires, when the victim is under age 13, a mandatory minimum, nonsuspendable 25-year sentence for a person at least 18 years old convicted of first degree rape or first degree sexual offense. A similar 5-year minimum sentence is required under the same circumstances for a second degree rape or second degree sexual offense.

2006 Federal Legislation

On July 27, 2006, President George W. Bush signed the Adam Walsh Child Protection and Safety Act of 2006 to protect the public, in particular children, from violent sex offenders through a more comprehensive, nationalized system for registration of sex offenders. The Act calls for conformity by the states with various aspects of sex offender registration, including registration by specified juvenile offenders, information that must be collected from registrants, duration of registration, verification of registry information, access to and sharing of information, and penalties for failure to register. The U.S. Attorney General is required by the Act to issue guidelines and regulations to interpret and implement the legislation. Proposed regulations are expected to be issued in December 2006, followed by a period of two to three months for public comments.

The failure of a state to substantially implement the federal requirements within three years (July 2009) and one year from the development by the federal government of software for uniform offender registries and web sites could result in a 10 percent reduction in the Byrne law enforcement assistance grant to that state. (Total fiscal 2007 Byrne fund revenue for Maryland is $7.25 million.) The U.S. Attorney General may authorize up to two one-year extensions of the deadline. The Act also provides a funding bonus of 10 percent or 5 percent to a state complying within one year or two years, respectively. A number of new grant programs are authorized under the Act to assist states in improving sex offender registration and related requirements of the Act.

Maryland's Compliance with Federal Requirements

Until the final regulations are issued by the U.S. Attorney General, a definitive determination of what administrative and legislative changes may be necessary to comply with the new federal law is not entirely clear. However, it appears that among the current State statutory provisions concerning the registration of sex offenders, the following provisions may require modification to meet the new federal standards:

- deadline for registration;
- length of registration for specific offenders;
- frequency of re-registration;
- application of registration requirement to specific juvenile offenders; and
- penalties for failure to register.

Due to the complexities of the Act and the many issues it involves, a collaborative approach involving public safety, public health, law enforcement, victims' rights, and judiciary representatives will likely be necessary to substantially implement the federal standards.

Public Safety

State Prison System Update

The Department of Public Safety and Correctional Services faces challenges relating to the capacity of State correctional facilities and assaults within those facilities.

Background

The Department of Public Safety and Correctional Services (DPSCS), primarily through the Division of Correction (DOC), has the responsibility for operating State correctional facilities. Offenders with sentences of more than 18 months must be incarcerated in a State correctional facility. For offenders with a sentence of more than one year but not more than 18 months, the sentencing judge has the discretion to commit the defendant to a State correctional or a local correctional facility. An offender sentenced to 12 months or less must be committed to a local correctional facility.

Each local correctional facility is operated and funded by the county in which it is located. However, in Baltimore City, the State operates and funds the Baltimore City Detention Center. Therefore, all offenders sentenced in Baltimore City are committed to a State correctional facility, regardless of the length of the offender's sentence.

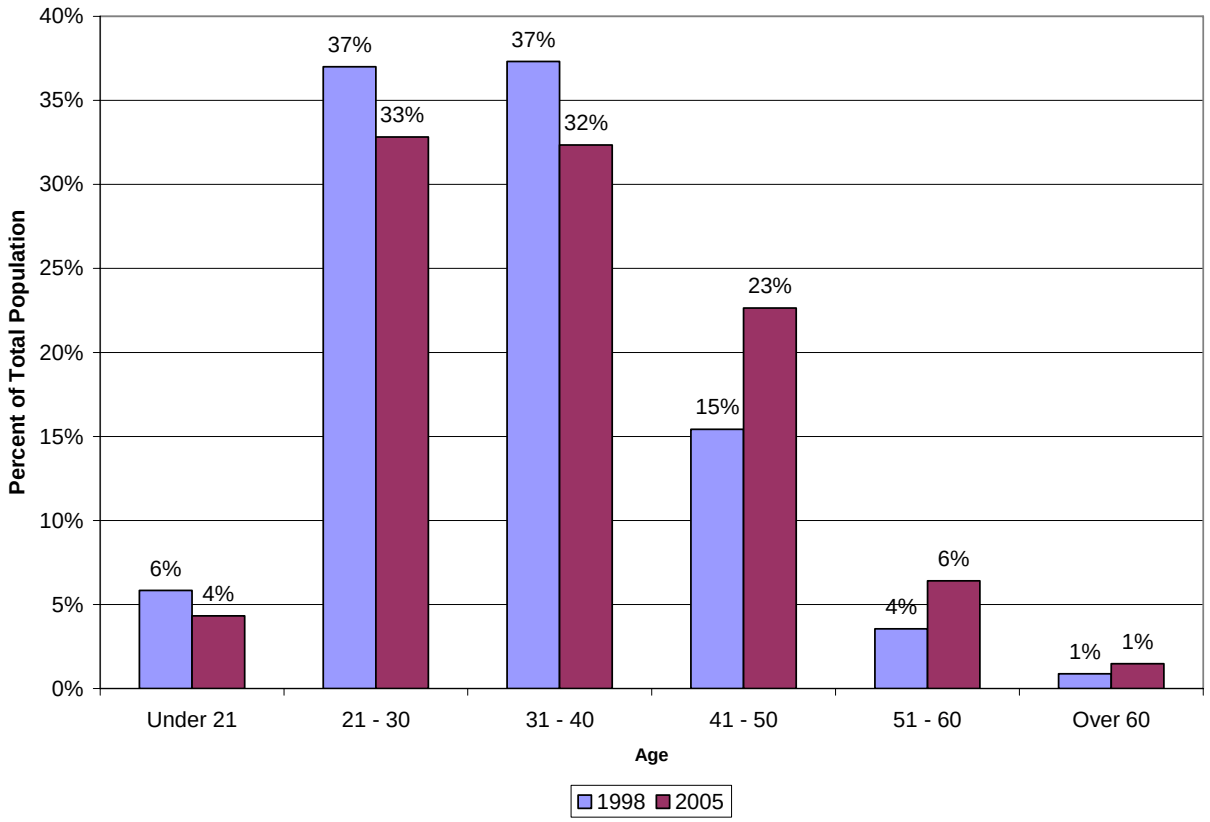
Inmate Demographics and Population Trends

Inmate Characteristics

The prison population is aging. As **Exhibit 1** shows, the average age of an inmate was 35.2 years in fiscal 2005 compared to 33.2 years in fiscal 1998. There has also been a gradual increase in the segment of inmates over 40, increasing from 20 percent of the total population in 1998 to 30 percent in 2005. While this trend may not have serious implications for housing in the future, ultimately an older prison population will require more health care and other age-related services.

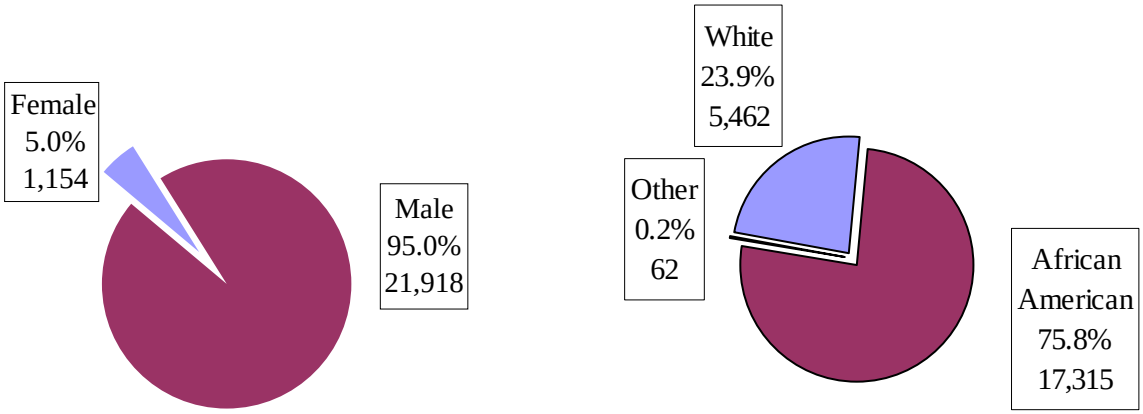
Exhibit 2 contains sex and race data for the inmate population. As of July 2005, 95.0 percent of the population was male and 5.0 percent was female. African Americans composed 75.8 percent of the inmate population, Whites composed 23.9 percent, and all other races made up less than 1.0 percent. In addition, as of 2005, about 62 percent of offenders were natives of Maryland, and about 64.5 percent were convicted in Baltimore City courts.

Exhibit 1
Age Data for the Inmate Population
Fiscal 1998 and 2005



Source: *Inmate Characteristic Report*, Department of Public Safety and Correctional Services, July 1998 and 2005

Exhibit 2
Sex and Race Data for the Inmate Population
Fiscal 2005



Source: *Inmate Characteristic Report*, Department of Public Safety and Correctional Services, July 2005

Population Trends

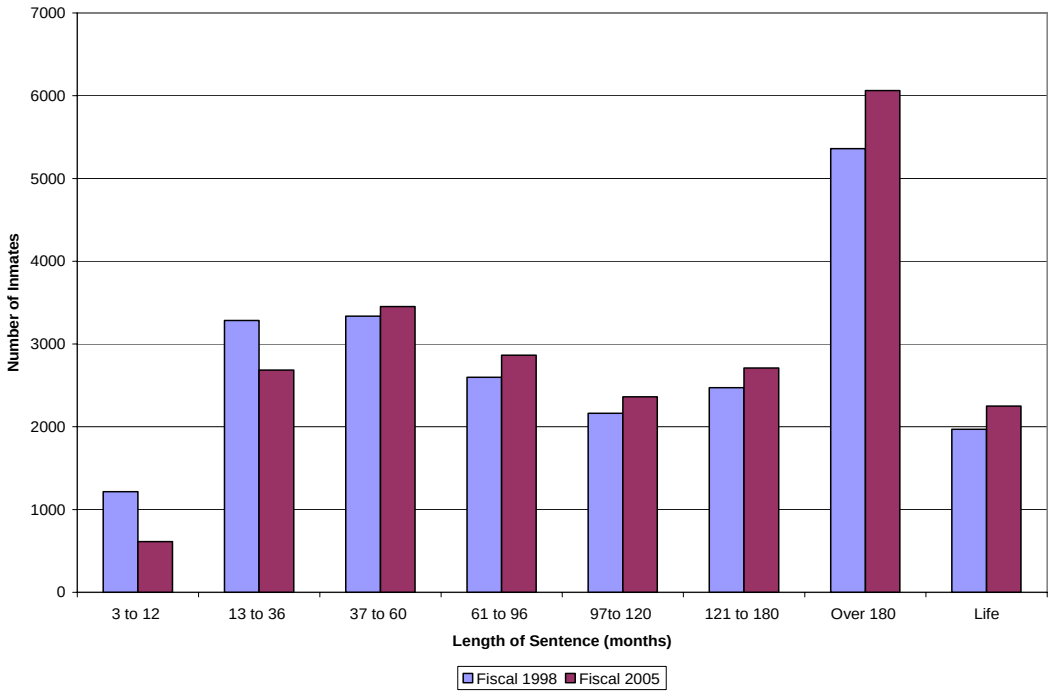
Population Growth

Because intakes have consistently exceeded releases, the inmate population has expanded from an average of almost 22,000 in 1998 to over 23,000 in 2005. On average, over 15,000 inmates have come into the correctional system each year over the past 10 fiscal years. At the same time, the average length of stay has been increasing. **Exhibit 3** demonstrates how the length of sentence among inmates has increased from 149.5 months in fiscal 1998 to 167.3 months in fiscal 2005. As illustrated in **Exhibit 4**, average daily population (ADP) for all sentenced State inmates grew 12.9 percent from fiscal 1991 to 2006. ADP hit an all-time high in fiscal 2003 at 28,811. Since then it has declined 9.9 percent to 25,951 in fiscal 2006. DPSCS is anticipating a slight increase in fiscal 2007.

Increased ADP has resulted in nearly all DOC facilities housing more inmates than they were designed to house. In addition, inmates of different security classifications are placed in

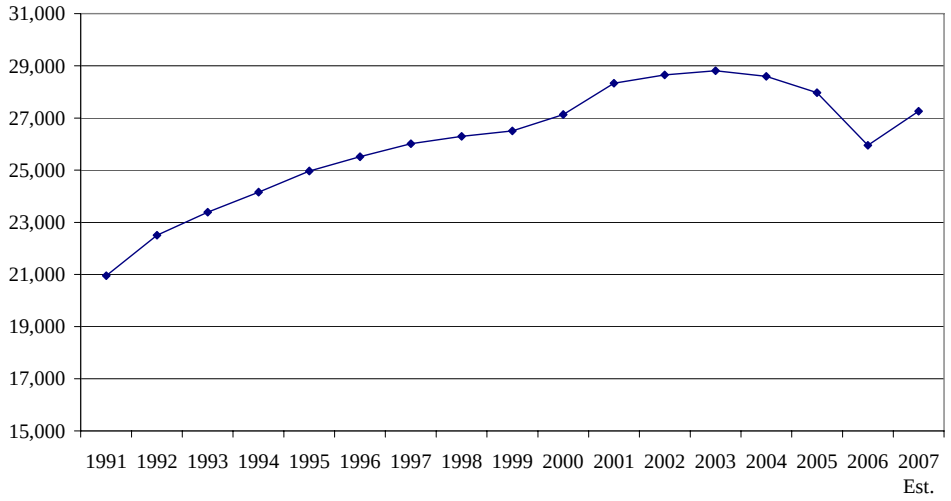
the same institution in some instances, which is not desirable. DPSCS has implemented a variety of measures to address overcrowding, including creating dormitory-style housing within facilities, placing two inmates in cells originally designed for one, employing the use of nontraditional housing (*e.g.*, Quonset huts), and undertaking capital projects.

Exhibit 3
Inmate Population by Sentence Distribution
Fiscal 1998 and 2005



Source: *Inmate Characteristic Report*, Department of Public Safety and Correctional Services, July 1998 and 2005

Exhibit 4
Average Daily Population
Inmates Sentenced to State Correctional Facilities
Fiscal 1991-2007

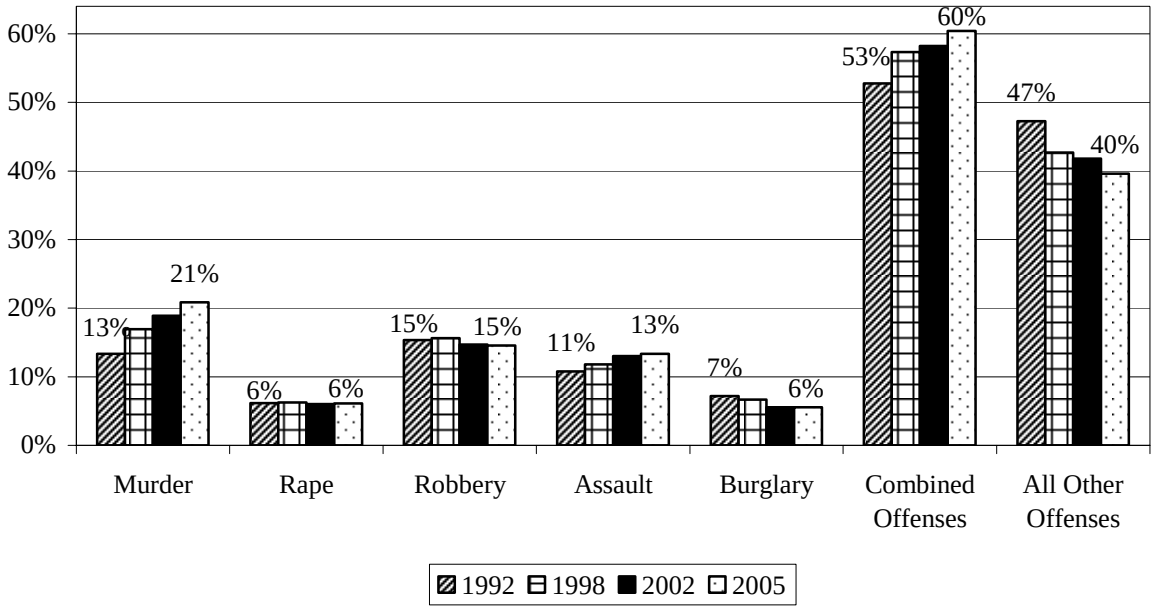


Source: Department of Public Safety and Correctional Services

Concurrent with growth in the total prison population in recent years, the composition of the prison population has shifted. **Exhibit 5** illustrates the various categories of offenses as a percentage of the total population of State inmates as of July 1 for the years 1992, 1998, 2002, and 2005. The combined offenses of assault, burglary, murder, rape, and robbery increased from approximately 53 percent of the total population in 1992 to 60 percent in 2005. The offense of murder constituted the most notable increase, growing from approximately 13 percent of the total offense population in 1992 to 21 percent in 2005.

Among the current population, the combined major crime categories of assault, burglary, murder, rape, and robbery increased significantly in number from 10,300 to 13,901, as well as proportion (from 52 percent in 1992 to 60 percent in 2005).

Exhibit 5
Offense Distribution for State Inmates
As of July 1, 1992, 1998, 2002, and 2005



Source: Department of Public Safety and Correctional Services, October 2006

Maximum Security Housing

The second housing unit of the North Branch Correctional Institution (NBCI) in Cumberland is scheduled to open in February 2007. This unit is designed to house 256 maximum security inmates, with the ability to increase to 512 inmates if the unit is double-celled. Construction of the third and fourth housing units is expected to be completed in 2008.

In response to recent increased assaults on both staff and inmates, DPSCS is now in the process of converting the Maryland House of Correction (MHC) to a minimum security prison. Medium security inmates being held at MHC are being transferred to other institutions as beds become available. When the second housing unit opens at NBCI, maximum security inmates at MHC will be the first to be transferred there, and MHC will then be used as a minimum security prison, until it can be demolished. Inmates at the Maryland Correctional Adjustment Center (Supermax) will be moved to NBCI once the third and fourth units are completed, making NBCI the primary maximum security prison in the State.

Prison Safety

Two on-duty correctional officers and multiple inmates have been killed in prison facilities since January 2006. Inmate-on-staff assault rates have increased since fiscal 2004, especially among maximum and medium security inmates. Two legislative hearings were held during the interim to address this issue.

Reasons attributed to the increase in violence include the age and structural condition of MHC; inadequate staffing, training, and security equipment for corrections officers; increased gang activity and inmate idleness; and the increased presence of cell phones and other contraband within the prison facilities. DPSCS has appointed a new commissioner for DOC and will request a $5.2 million fiscal 2007 deficiency appropriation for security equipment and cameras. In addition, the new DOC commissioner has sent corrections officials to Connecticut to observe that state's nationally recognized gang management program.

DPSCS also intends to seek reintroduction of legislation during the 2007 session that would establish a separate criminal offense for unauthorized possession of contraband in a correctional facility. The legislation would prohibit a person in a correctional facility from knowingly being in possession of contraband to effect an escape, a weapon, an alcoholic beverage, a controlled dangerous substance, or a "telecommunications device." Currently, possession of some contraband (*e.g.*, an alcoholic beverage or cell phone) by an inmate is punishable only by loss of diminution credits that an inmate may earn toward reduction of the inmate's sentence. Also, the possession by a noninmate of such contraband is not currently prohibited in the absence of an intent to provide the contraband to an inmate.

Public Safety

Assault Weapons

The federal assault weapons ban expired in 2004 although most of the previously banned weapons are subject to the State's restrictions on the transfer and possession of "regulated firearms." Legislative proposals to ban these types of weapons in the State were introduced but failed to be enacted in each session of the 2003-2006 term.

Expiration of Federal Assault Weapons Ban

A federal assault weapons ban took effect on September 13, 1994. The ban prohibited the manufacture, transfer, or possession of 19 specific models of semiautomatic weapons, and their copies, as well as weapons that have a combination of certain military characteristics, such as large capacity ammunition magazines, flash suppressors, pistol grips on a rifle or shotgun, and barrel shrouds to cool gun barrels during multiround firings. The federal ban also applied to the manufacture and sale of ammunition magazines capable of holding more than 10 rounds. The ban did not extend to weapons and magazines that were manufactured before the ban.

The federal ban terminated on September 13, 2004, but most of the specific models previously banned remain subject to the State's restrictions on the transfer and possession of "regulated firearms" as discussed below.

Maryland Assault Weapon Laws

Assault Weapons as "Regulated Firearms"

The State regulates the transfer and possession of 45 specific semiautomatic assault weapons, and their copies, in the same manner as handguns, both of which are defined together as regulated firearms. Before a person purchases, rents, or transfers a regulated firearm in the State, the person must submit to the State Police or other designated law enforcement agency a firearm application that identifies the applicant and the firearm that is the subject of the transaction. Applications are investigated by the State Police and are subject to a seven-day waiting period before the transaction may take place.

An applicant for a regulated firearm must be at least 21 years old; have never been convicted of a felony, crime of violence, or misdemeanor that carries a penalty of more than two years' imprisonment; and must not be addicted to drugs or alcohol or have a history of mental disorder. An applicant is required to complete a certified firearms safety course through the Police Training Commission. An application may be denied by the Secretary of State Police if the Secretary determines that the application contained false information or was not properly

completed or if the Secretary receives notice from a physician that the applicant suffers from a mental disorder and is a danger to the applicant or others.

Assault Pistols and Machine Guns

Maryland bans the sale and possession of "assault pistols," defined as 15 specific semiautomatic pistols, and their copies. The State also maintains a registration system for the possession of machine guns (fully automatic weapons). The possession or use of a machine gun for an offensive or aggressive purpose is a crime.

Recent Developments

In Maryland, a proposed ban on assault weapons was introduced each session of the 2003-2006 term in response to the lifting of the federal assault weapons ban and a notorious crime spree in the Washington area by snipers. In April 2006, the mayors of several large cities nationwide called for stricter gun laws, including the reenactment of the federal ban on assault weapons. It is expected that a proposal to ban assault weapons in Maryland will be reintroduced during the upcoming session.

Public Safety

Project RESTART

RESTART, an ambitious correctional program to reduce recidivism, is in the process of slowly progressing beyond the pilot site phase to include prerelease services as it competes for public safety resources.

Background

Funds for Reentry Enforcement Services Targeting Addiction, Rehabilitation, and Treatment (RESTART) were first released in November 2004, establishing two pilot sites: one at the Maryland Correctional Training Center (MCTC) in Hagerstown and the other at the Maryland Correctional Institution for Women (MCI-W) in Jessup. RESTART initiative programs include expanded educational offerings, addictions treatment, and group counseling, in addition to assistance from social workers, Division of Parole and Probation employees, and community partners to provide individualized reentry and transitional services before and after release to the community.

Current Status

To date, staffing for RESTART services at the two pilot sites is near full, although the Department of Public Safety and Correctional Services (DPSCS) has struggled to fill addictions counselor and social worker positions. Since the inception of RESTART, there have been a total of 4,553 program participations involving 2,109 inmates, which accounts for inmates participating in more than one program at the same time or over the full course of treatment. Despite a 61 percent participation rate at the two sites combined, preliminary data show 38.9 percent of inmates at MCTC and 35.0 percent of inmates at MCI-W enrolled in program modules do not finish all lessons in the module due to disruptive behavior, release to the community, transfer to another institution, or withdrawal from the program.

Beginning in fiscal 2007, DPSCS is expanding RESTART services to the prerelease system for those participants who had received a minimum of 12 months of services at either of the two pilot sites. Continued reinforcement of cognitive behavior concepts and substance abuse treatment aftercare will be available to these inmates. The fiscal 2007 working appropriation includes $4.1 million for the two RESTART pilot programs and the additional prerelease services.

Future Expansion

DPSCS recently submitted a report on its plans for further expansion of RESTART. In the short term, the agency plans to create a "therapeutic milieu" within the male RESTART pilot site (MCTC), providing therapeutic programming to approximately 1,200 inmates of the total population of 3,000. Remaining inmates will participate in education/vocation programs and other structured "nontreatment" programs until they can be cycled through the therapeutic program. Disruptive inmates and those designated as not conducive to receiving treatment will be housed separately from participating inmates, or transferred to other facilities, so as not to negatively influence the RESTART population. In the long term, DPSCS would like to complete the expansion of RESTART services to the prerelease system and begin expanding to the Eastern Correctional Institution Annex in fiscal 2009. Expansion to the Maryland Correctional Institution – Hagerstown, Eastern Correctional Institution (east or west side), and Western Correctional Institution is anticipated by fiscal 2011.

Criminal Law

Methamphetamines

Methamphetamine has been called "the fastest growing drug threat in the United States." While the known number of abusers in Maryland is small compared with abusers of cocaine and heroin, the drug has created new public safety and health problems.

Background

Methamphetamine, also known as "speed" or "meth," is one of the nation's most dangerous illegal drugs. Chronic methamphetamine abuse leads to long-term health problems for the addict, including significant weight loss, psychotic and violent behavior, heart problems, and brain damage. In addition, methamphetamine presents serious public health and environmental problems for the community.

Methamphetamine is produced by "cooking" over-the-counter cold medicines containing pseudoephedrine with reagents, such as iodine, and solvents, such as paint thinner. While methamphetamine is relatively simple and inexpensive to manufacture, production of the synthetic drug is hazardous. Eighty percent of the methamphetamine manufactured in the U.S. is produced in sophisticated super labs; however, makeshift labs make smaller quantities under conditions that often result in toxic explosions, fires, hazardous waste dumping, and child endangerment.

Nationwide Problem

Problems associated with methamphetamine use were first observed in the Southwest over 20 years ago and have been advancing steadily across the country. Surveys of county law enforcement officials conducted by the National Association of Counties (NaCO) in 2005 and 2006 concluded each year that methamphetamine is the leading drug-related law enforcement problem in the country. The 2006 survey supported the assertion that the problem has been advancing eastward by showing a marked increase in the methamphetamine problem in southeastern states with a smaller increase in the northeastern states.

Methamphetamine in Maryland

So far methamphetamine's impact in Maryland is minimal. In 2005, 8 methamphetamine labs were identified in the State, 1 dumpsite was found, 10 parcels were seized, and 4 residential searches occurred. To date, 5 labs have been seized in the State. According to the federal Drug Enforcement Administration, surrounding states report many more methamphetamine lab

incidents. In Virginia, 52 labs were seized in 2005 compared to 5 in 2001. Methamphetamine lab incidents in West Virginia increased from 17 to 213 from 2001 to 2004 and from 18 to 79 during the same period in Pennsylvania.

Regulation of Precursor Chemicals

Common cold remedies such as Sudafed and Contac contain pseudoephedrine, the main precursor chemical needed to manufacture methamphetamine. Forty-four states place some restrictions on the sale of ephedrine or pseudoephedrine products, including requiring a prescription for the purchase of pseudoephedrine and making the possession of precursor ingredients with the intent to manufacture methamphetamine a crime.

NaCO's 2006 survey questioned law enforcement officials about the effect of precursor limitation laws. The officials report that the laws are working. Ninety percent of the surveyed counties had precursor legislation in effect, and almost half of the agencies state that the number of methamphetamine lab seizures is down. Officials also report that the methamphetamine in their counties comes more frequently now from out of state. Seventy-one percent of the sheriffs report that methamphetamine imported from Mexico is replacing the supply of methamphetamine from local labs in their counties.

As of September 30, 2006, federal law requires retail stores to keep over-the-counter medications containing pseudoephedrine behind the counter or in a locked cabinet. Purchasers must show photo identification and sign a log book. Federal law also limits the quantities of cold medication that a consumer may purchase daily. As a result of the federal law, the practice of crossing state lines to buy pseudoephedrine, also known as "pseudo-smurfing," will become less lucrative for drug dealers. The new federal law does not preempt state laws that have stricter provisions concerning pseudophedrine purchases or possession.

Methamphetamine's Impact on Children and the Environment

Manufacturing methamphetamine poses significant danger to children and to the environment. Methamphetamine labs can be anywhere – from abandoned buildings in rural areas to apartments and even cars in more populated areas. Children who are near these labs face risks from inhaling and absorbing the toxic substances, from potential lab fires and explosions, and from parents preoccupied with their addictions who may subject them to neglect or abuse. Some states have expanded their child endangerment laws to include exposing a child to an illicit chemical substance or established a separate offense of drug manufacturing in the presence of a child to address these problems.

When methamphetamine is manufactured, poisonous gases are released into the environment as the highly flammable and explosive chemicals are "cooked." Five to seven pounds of toxic waste are generated for every pound of methamphetamine produced. Lab

operators dump the toxic waste down household drains, in fields, in yards, and on rural roads. Training first responders for the appropriate cleanup of labs is critical.

Some states, like Kentucky, have made methamphetamine producers civilly liable for clean-up costs. Other states, including Virginia, have established standards for the clean up of methamphetamine labs. In Maryland, House Bill 812 of 2006, requiring the Maryland Department of the Environment to develop such standards, did not pass. There are no federal guidelines to advise property owners or state or local governments on the clean up of former methamphetamine labs. Congressional efforts this year to authorize the Environmental Protection Agency to develop scientifically based voluntary clean-up standards were also unsuccessful.

Maryland's Response to the Methamphetamine Crisis

Maryland law subjects a person convicted of manufacturing methamphetamine to maximum imprisonment of 5 years while a person convicted of the importation of methamphetamine may receive up to 25 years imprisonment. House Bill 474 and Senate Bill 259 of 2006 were introduced, in part, to increase the manufacturing penalty, but the bills did not pass.

Chapter 327 of 2006 (House Bill 474) authorizes a court to order a person convicted of an offense related to a controlled dangerous substance, or a juvenile adjudicated delinquent of an offense or the juvenile's parents, to pay restitution for the costs incurred in cleaning up laboratories or other facilities operated for the illegal manufacture of the controlled dangerous substance.

Criminal Law

Human Trafficking

Human trafficking has been described as a growing underground industry fueled largely by extreme economic hardship in many parts of the world. In addition to the international and national responses to the problem, some states have passed criminal statutes or created task forces to address the problem.

What Is Human Trafficking?

Human trafficking is a lucrative criminal enterprise that includes the recruitment, transportation, and sale of individuals, usually members of vulnerable populations from other countries, for forced labor or forced sexual exploitation.

Human trafficking takes many forms. It involves transporting people within or across borders to, among other things, labor in sweatshops, perform domestic work, work in the sex industry, or work in agricultural fields or other workplaces for little or no wages. In their countries of origin, victims of trafficking commonly experience poverty, oppression, persecution, civil unrest, and lack of opportunity. Recruiters often deceive victims into believing that the opportunity offered will bring them and their loved ones a better life.

According to the U.S. State Department's 2005 *Trafficking in Persons Report*, 600,000 to 800,000 men, women, and children are trafficked across international borders each year. The report estimates that 80 percent are women and girls. The country of destination for an estimated 18,000 people annually is the U.S. The majority transported here come from Asia, Latin America, and Eastern and Central Europe.

Victims of human trafficking suffer horribly. The labor and exploitation of the victims is perpetuated through violence, threats, and coercion. Living conditions for victims are often harsh and include poor sanitation, malnourishment, excessive heat or cold, and sleep deprivation. They may be subdued with drugs and subjected to extreme physical and psychological trauma. Victims trafficked for sexual exploitation face exposure to sexually transmitted diseases. Children who are unable to attend school experience reduced economic opportunities and increased vulnerability to being retrafficked in the future.

Victim assistance for trafficked persons is constrained by factors such as laws barring undocumented immigrants from receiving victim-related services and benefits. Trafficked persons may not seek help because they fear deportation by U.S. Immigration and Customs Enforcement or arrest and imprisonment by local law enforcement agencies. Traffickers exploit victims' fear of removal to keep them isolated, fearful, and under control. Trafficked persons may in fact be viewed as illegal aliens or may be seen as accomplices to trafficking by the legal

system. Other barriers, including culture, language, fear of violence against family in the country of origin, shame, and physical or emotional trauma, must also be addressed in order to serve trafficking victims appropriately.

International, National, and State Solutions

Remedies to address human trafficking have been adopted on the international and national levels. The United Nations adopted the Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children in February 2000. The U. S. Congress passed the Trafficking Victims Protection Act of 2000 (TVPA) in October 2000. This law is designed to prevent trafficking, prosecute traffickers, and protect and assist trafficked persons. TVPA extends assistance and benefits to victims of "severe forms of trafficking in persons" which is defined as either "sex trafficking in which a commercial sex act is induced by force, fraud, or coercion, or in which the person induced to perform such act has not attained 18 years of age; or the recruitment, harboring, transportation, provision, or obtaining of a person for labor or services, through the use of force, fraud, or coercion for the purpose of subjection to involuntary servitude, peonage, debt bondage, or slavery." TVPA was reauthorized in 2003 and 2005. In 2005, Congress made the finding that runaway and homeless children are highly susceptible to being domestically trafficked for commercial sexual exploitation. Congress appropriated new money for grants to state and local law enforcement agencies to enhance their efforts to combat trafficking and to establish a pilot program to operate residential treatment facilities in three sites for juvenile victims of trafficking.

Proponents of state laws against human trafficking contend that current laws prohibiting kidnapping, rape, and prostitution do not adequately address human trafficking, in part because of the psychological aspect of the coercion to which trafficking victims are subjected. Proponents of state laws also contend that state law enforcement agencies have more opportunities to encounter victims and uncover trafficking cases in their jurisdictions. Twelve states enacted criminalization statutes in 2006, bringing the total to 24 states that now have laws making human trafficking a felony offense. In 2006, Hawaii, Iowa, and Maine joined six other states in establishing task forces to study the issue of human trafficking.

Since 2000, federal authorities in Washington, DC and its Maryland suburbs have successfully prosecuted international human trafficking and domestic interstate child sex trafficking cases under TVPA. The District of Columbia Human Trafficking Task Force, started in late 2004, has initiated over 30 investigations and won 17 convictions against juvenile sex traffickers.

Legislation introduced in the 2005 and 2006 sessions sought to prohibit human trafficking in Maryland; however, no bills were passed.

Criminal Law

Identity Theft

Published statistics have placed the total value of identity theft at over $56 billion in 2006 alone. In response, some states have enacted security-breach notification laws and credit freeze laws. Various federal legislative proposals, some of which may preempt state legislation, are under consideration. A Maryland task force to study identity theft may ask for additional time to complete its work.

Background

Despite the highly publicized cases of security breaches in large companies and governmental agencies, identity theft is most commonly the result of data being obtained directly from individual victims. In addition to the physical theft or loss of credit cards, Social Security numbers, driver's licenses, or other personal information, identity information can be stolen directly from the consumer by "phishing" (impersonating a trusted organization in an electronic communication) and "pharming" (redirecting an Internet user without knowledge or consent to an illegitimate web site that records personal information for fraudulent purposes). According to a 2005 Javelin Strategy & Research survey, for the 50 percent of victims of identity-based fraud who knew where their information had been obtained, the most common source was a lost or stolen wallet, checkbook, or credit card. Several years ago, Congress limited consumer liability for credit card fraud to $50, and the industry practice is to waive that charge.

Security breaches of information held by a business or public agency can occur several ways: • the loss of information by the business or public agency collecting data; • hacking of unencrypted information from a database; • theft of account information by unmonitored company insiders; • inadvertent sale or transfer of information to fake entities; and • the loss or theft of computer records during transport.

Over 400 cases of sensitive personal data being lost or stolen were publicly disclosed in the past year and half, the majority of which involved federal, state, or local agencies, according to the Privacy Rights Clearinghouse. Since the beginning of 2005, the group has documented over 97 million records of personal information that have been subject to unauthorized exposure due to security breaches.

State Legislatures Respond

More than half the states have enacted laws aimed at preventing criminal exploitation of personal data held by businesses and public agencies.

Security-breach Notification Laws

States are cracking down on identity theft by requiring businesses and public agencies to notify persons whose personal information has been compromised because of security breaches. California was the first state to require consumer notification of such breaches when it enacted legislation in 2003. Since then, 32 other states have adopted security-breach notification laws according to the National Conference of State Legislatures.

Only 23 states with such notification laws, however, impose the requirement on government agencies according to Consumers Union, a nonprofit consumer protection organization. The 10 states with notification laws that do not apply to government agencies are Colorado, Connecticut, Delaware, Georgia, Maine, Montana, North Carolina, North Dakota, Texas, and Utah. On the other hand, the notification laws enacted in Indiana and Oklahoma apply only to state agencies.

Credit Freeze Laws

Attempting to block potential identity thieves, 25 states have passed laws allowing consumers to freeze their credit reports, which are used by banks and businesses to grant loans or lines of credit. A freeze is designed to lock down a consumer's credit report, preventing anyone – including the consumer – from immediately opening new credit cards or taking out loans. With a freeze in place, credit files cannot be processed, and instant credit (like retail credit cards or point-of-sale car loans) cannot be authorized. Credit is granted only after additional identity evidence (like a PIN number) is produced by the consumer – a "thawing" process that can last up to three days.

The retail industry and the nation's credit bureaus have generally opposed credit freeze legislation. Critics argue that eliminating point of sale credit transactions is bad for commerce and impracticable for consumers.

The effectiveness of credit freeze legislation in combating identity theft has yet to be documented. According to Experian, a credit reporting agency, there is evidence that, where available, the number of consumers who have asked for their credit to be frozen has been relatively small.

Only 8 states had credit freeze laws in place before 2006: California, Illinois, Louisiana, Nevada, North Carolina, Texas, Vermont, and Washington. Credit freeze laws went into effect in 2006 in 11 other states: Colorado, Connecticut, Delaware, Florida, Kentucky, Maine, Minnesota, New Jersey, New York, Rhode Island, and South Dakota. Five more states adopted credit freeze laws this year that begin by 2007: Hawaii, Kansas, New Hampshire, Oklahoma, and Wisconsin. Utah enacted a credit freeze law that becomes effective in 2008.

Twenty states will allow any consumer to have the option of initiating a credit freeze. However, five states (Hawaii, Kansas, South Dakota, Texas, and Washington) give the option only to identity theft or security breach victims.

Possible Federal Preemption of States' Laws

Pending Congressional legislation would preempt state notification and credit freeze laws, including measures far stricter than the federal proposals. Some bills would standardize breach disclosure requirements to counter what some critics have argued is a "hodgepodge" of laws adopted in 33 states that confuse companies and consumers. These bills seek to clarify and streamline the process of alerting customers when their private information is determined to be at risk. Congress has also debated several bills that would preempt laws in 20 states that allow anyone to freeze his or her credit and instead would allow only identity theft victims that privilege. The federal legislation also would set national criteria for data protection and breach disclosures and put banking and U.S. Treasury officials in charge of enforcing compliance. Critics say the federal bills trample states' rights and strip consumer protection authority from state attorneys general.

In May 2006, President Bush signed an executive order creating the nation's first Identity Theft Task Force, the goals of which are to develop a strategic plan to better prevent identity theft, coordinate prosecution, and ensure recovery for victims. The task force is chaired by the U.S. Attorney General and the Chairman of the Federal Trade Commission. The task force is scheduled to submit recommendations to the President in November 2006.

Maryland Response

Notification and credit freeze bills have been introduced in recent sessions but have not been successful. However, Chapters 241 and 242 of 2005 established a 21-member Maryland Task Force to Study Identity Theft. The task force is required to study the problems associated with identity theft in Maryland and privacy laws in other states, consult with identity theft experts and federal and other state agencies, determine compliance by State agencies with laws relating to the collection and use of Social Security numbers, and make recommendations for legislation. A final report is due by December 31, 2006, although the task force did not meet until November 2006. The task force is expected to recommend that its mandate be extended beyond its 2006 termination date.

Criminal Law

Death Penalty

Countervailing bills to repeal and expand capital punishment in the State are expected to be reintroduced in the 2007 session against a backdrop of recent judicial decisions and pending cases concerning the death penalty.

Maryland Court of Appeals

A recent decision of the Court of Appeals centered around the results of a 2002 study conducted by Raymond Paternoster, a professor of criminology and criminal justice at the University of Maryland, examining the influence of race (of both the victim and the offender) and geography (where the crime occurred and was prosecuted) on the imposition of the death penalty.

The Paternoster study concluded that there appeared to be disparities in the imposition of the death penalty based on the race of the victim and geography. Vernon Evans, Jr., an African American sentenced to death in Baltimore County for the contract killing of two white people, challenged his death sentence collaterally as being an illegal sentence based on the Paternoster study. However, the Court of Appeals, as it had done in an earlier case, rejected the challenge without fully addressing the constitutional issues that the court appeared to state may be more squarely presented to the court in a direct appeal.

Recent Federal Court Cases

On June 12, 2006, the U.S. Supreme Court decided in *Hill v. McDonough* that a death row inmate may challenge lethal injection procedures as a civil rights claim. In the Florida case, Hill claimed that the chemicals used in the lethal injection could inflict severe and unnecessary pain. The court also held that a civil rights action brought to challenge the manner of execution does not entitle the defendant to an automatic stay of execution but that the defendant must still satisfy all the requirements for a stay. Hill was executed on September 20, 2006, without having had an evidentiary hearing in federal court on his challenge to the lethal injection procedure. Also of note is the fact that on May 22, 2006, in the case of *Abdur'rahman v. Bredensen*, the U.S. Supreme Court denied *certiorari* to a lethal injection challenge that was in the proper procedural position possibly because of an intent that these challenges be considered more thoroughly by the lower courts.

Vernon Evan, Jr., who was the appellant in the Maryland case discussed above, also filed a civil rights claim in the U.S. District Court for Maryland arguing that the use of lethal injection violates the U.S. Constitution's ban on cruel and unusual punishment. The basis of the argument

is that the execution is performed by correctional officers who are not medically trained and the combination of chemicals is inhumane. Evans also argued that his veins are so badly damaged from years of drug abuse that the lethal injection could cause extreme pain without careful attention. The federal claim is still pending.

In addition, the U.S. Supreme Court has heard several cases in the past year addressing various procedural aspects of the death penalty. Those appeals have dealt with subjects including jury instructions, the weighing aggravating and of mitigating circumstances, ineffective assistance of counsel, and evidentiary issues.

Legislative Proposals

Several bills were introduced in the 2006 session related to the death penalty, none of which passed. Two would have added to the list of aggravating factors that make an individual eligible for the death penalty (1) the commission of three or more murders in the first degree in a four-year period; and (2) the murder of a person under a protective order. Also, bills were introduced to repeal the death penalty and to establish a moratorium on the imposition of the death penalty.

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Criminal Law

Gangs

The proliferation of gang activity in Maryland has prompted several federal, State, and local initiatives. The General Assembly likely will consider legislation, including a State "little RICO" law, aimed at further combating the problem.

Background

Maryland law defines a "criminal gang" as a group or any association of three or more persons that forms to engage in criminal activity for pecuniary gain or to create an atmosphere of fear and intimidation and whose members have an identifying sign, symbol, or name. A person who threatens an individual, or a friend or family member of an individual, with physical violence with the intent to coerce, induce, or solicit the individual to participate in or prevent the individual from leaving a criminal gang is guilty of a misdemeanor. It is also a separate crime to make such threats in a school vehicle or within 1,000 feet of a school.

Local jurisdictions in Maryland are reporting an increase in gang activity and gang-related crime. Local law enforcement agencies cite several contributing factors, including (1) the infiltration of predominantly West Coast gangs into the Maryland area; (2) the regional growth of Mara Salvatrucha (MS-13), a Central American gang; and (3) the increasing organization and structure of gangs in the area.

Initiatives

The proliferation of gang activity in the State has prompted several initiatives designed to address the problem.

Joint County Gang Prevention Task Force

In 2004, in response to increasing gang activity in the suburban Washington area, the county executives of Montgomery and Prince George's counties created the Joint County Gang Prevention Task Force. Among the task force's recommendations were (1) public awareness campaigns; (2) implementation of after-school programs; (3) development of a standardized information collection and data management system; and (4) establishment of a gang activity anonymous tip line.

In fiscal 2007, Montgomery and Prince George's counties are offering Joint County Gang Prevention Initiative Community Mobilization and Outreach Grants for nonprofit organizations to promote gang prevention.

Gang Summit

In May 2006, the U.S. Attorney General provided $30 million in grants to the states through its Project Safe Neighborhoods (PSN) program to support antigang efforts nationwide and requested that U.S. Attorneys throughout the nation host local Gang Prevention Summits.

In response, the Maryland Gang Summit was held in June 2006. At the summit, the Governor announced the establishment of a coordinating committee to create a statewide database of gang activity containing statistics and details of gang activity in order to adequately assess the extent of the gang problem. Maryland has secured $2 million in federal funds other than PSN grants to create a statewide antigang initiative.

State Programs and Grants

The Governor's Office of Crime Control and Prevention and the Maryland U.S. Attorney's Office offered $15,000 grants for counties to assess local gang-related problems and develop a strategy to address them. Thus far, 12 counties and Baltimore City have applied for the grants.

Budget Initiatives

The fiscal 2007 budget includes $4 million for the Department of Juvenile Services (DJS) to support operating and capital grants for antigang activities. These grants may be administered to public or private nonprofit entities for programs that "provide gang prevention education or alternative activities to children at risk of being drawn into gang-related violence and crime."

The fiscal 2007 budget also includes • $647,414 in funds for DJS-administered capital grants to public agencies for improvements to public recreational facilities in areas experiencing, or at risk of experiencing, gang-related violence and crime; and • a $200,000 grant for the Maryland Alliance of Boys and Girls Clubs of America to fund youth development programs at 13 clubs across Maryland.

Prison Summit

In October 2006, the Division of Correction held a two-day information summit to develop procedures for tracking gangs within the prison system. According to the division, as of June 2006, there were 1,900 confirmed gang members within the prison system.

In addition, as part of the Governor's Gang Prevention Initiative, correctional officers and staff will receive gang awareness training and implement technology to link public safety units to reported gang activity inside and outside of prisons.

Racketeer Influenced and Corrupt Organizations Act (RICO)

Noting the growing organizational structure of gangs, federal prosecutors are increasingly opting to prosecute gang members under the Racketeer Influenced and Corrupt Organizations Act (RICO). Enacted in 1970 in an effort to fight the infiltration of organized crime into businesses engaged in interstate commerce, RICO was traditionally used against the Mafia. To obtain a RICO conviction, prosecutors must prove that the crimes committed by the gang members were part of an organized criminal enterprise. A prosecutor in a RICO case may introduce evidence of a gang's activity regardless of the defendant's level of involvement in the alleged activities. In August 2005, 22 members of MS-13 were indicted in Maryland on federal racketeering and other related charges, including murder, assault, and rape.

Many states, including California, Florida, New Jersey, and Washington, have enacted state RICO statutes, often referred to as "little RICOs," to address gang problems at the state level.

Proposed Legislation

A number of bills were introduced during the 2006 session that addressed criminal gang activity in the State; none were successful.

Criminal Law

Arrests without Charges in Baltimore City

Baltimore City's arrest policy has been criticized as overly aggressive policing that has resulted in thousands of arrests for minor offenses that never lead to the filing of charges.

Background

Critics argue that Baltimore City police have been utilizing a policy pioneered in New York City known as "order maintenance" policing and that it has led to thousands of arrests each year. Under this policy, police often arrest citizens for misdemeanors and "quality of life" crimes such as loitering, possession of an open alcoholic beverage container, and failure to obey a police officer. Although the Baltimore City Police Department contends that all arrests are legal and based upon probable cause, the Baltimore City State's Attorney declined to prosecute approximately 30 percent of all arrests without a warrant in 2005 because there was insufficient evidence to support an arrest or obtain a conviction or the time already served in jail was deemed sufficient.

A public hearing sponsored by the Baltimore City Delegation to the General Assembly was held on this issue on January 4, 2006. Numerous people attended the hearing, and testimony was given by elected officials, law enforcement officials, expert witnesses, advocates, community association representatives, and other individuals. Critics of the current arrest policy maintained that overaggressive police tactics erode public trust in law enforcement and an arrest record can foreclose employment, educational, housing, and social opportunities for a person even if the charges are ultimately dismissed. They called for full disclosure of complaint and arrest data by police and zero tolerance of illegal arrests with strict discipline for abuse of police power.

Subsequently, a grand jury in Baltimore City issued a report regarding what can be done to address the lack of confidence in the Baltimore City Police Department that exists within communities in Baltimore City. The report discussed the high numbers of arrests without charges and made a number of recommendations, including retraining of police officers, collaboration between the Baltimore City Police Department and the State's Attorney's office, and a 50 percent reduction in arrests without merit by the end of 2006.

In June 2006, the Maryland American Civil Liberties Union and the National Association for the Advancement of Colored People filed a class action lawsuit alleging that the Baltimore City Police Department systematically arrests people and holds them for hours without charge in violation of the U.S. Constitution and Maryland Declaration of Rights. The plaintiffs seek, among other things, monetary damages, the expungement of their arrest records, the permanent

enjoinment of the police from making illegal arrests, and a court declaration that the Baltimore City anti-loitering ordinance is unconstitutional.

Legislative Initiatives

A number of bills were introduced during the 2006 session addressing this issue. Chapter 499 expanded the authority of the Baltimore City Civilian Review Board to include the processing, investigation, review, and evaluation of allegations of false arrest and false imprisonment by Baltimore City law enforcement officers. The Baltimore City Civilian Review Board is a 12-member permanent, statutory agency established with the authority to process, investigate, review, and evaluate allegations made by members of the public against police officers in Baltimore City. Prior to Chapter 499 taking effect in October 2006, the board was only empowered to address allegations involving abusive language, harassment, or excessive force. The legislation also requires each board member to receive training on the issues of abusive language, false arrest, false imprisonment, harassment, and excessive force.

Other bills addressed the issue of expungement of police records. Maryland law entitles a person who is arrested, detained, or confined by a law enforcement unit and later released without being charged with the commission of a crime to request that the police records relating to the matter be expunged. A person seeking expungement must either wait until the statute of limitations expires for all tort claims that arise from the incident (generally three years) or submit a legal waiver and release of all tort claims arising from the incident. Expungement must be requested within eight years after the date of the underlying incident.

The expungement bills introduced during the 2006 session would have made expungement automatic and free of charge for police records of an arrest for which no charge is filed. None were successful.

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Civil Proceedings

Medical Malpractice

Since the passage of medical malpractice insurance legislation during the 2004 special session, medical malpractice premiums have not increased and an additional insurer has entered the market.

Background

In December 2004, the General Assembly was called into special session to address what many called a medical malpractice "crisis." Rate increases in malpractice insurance premiums (28 percent in 2004 and 33 percent in 2005) had been approved by the Maryland Insurance Commissioner for the Medical Mutual Liability Insurance Society of Maryland (Medical Mutual), which insures over three-quarters of physicians in private practice in the State. According to Medical Mutual, the increases stemmed from, among other factors, an increase in the severity of paid claims. In response to the increases, doctors threatened to quit, limit their practices, or leave the State. Over a veto by the Governor, the Maryland Patients' Access to Quality Health Care Act of 2004 (Chapter 5 of the 2004 special session) became law.

Chapter 5 established a fund financed by the repeal of the 2 percent premium tax exemption applicable to health maintenance organizations. The purposes of the fund were to limit insurance premium increases, increase fee-for-service rates paid by the Maryland Medical Assistance Program to health care providers, and increase capitation rates for managed care organizations participating in the Maryland Medical Assistance Program. Chapter 5 also included numerous other reforms, including • freezing the cap on noneconomic damages at $650,000 for four years; • eliminating the "double cap" for noneconomic damages in death cases; • limiting noneconomic damages in death cases with more than one claimant to $812,500 for four years; • restricting evidence of certain apologies by health care providers; • imposing stricter qualifications for medical expert witnesses; • requiring alternative dispute resolution before trial; • requiring a party who does not accept an "offer of judgment" to pay the offeror's costs incurred after making the offer if the verdict is not more favorable than the offer; • lowering the standard of proof for physician disciplinary actions by the Maryland Board of Physicians; • authorizing the board to fine hospitals for failure to report a disciplinary action against a doctor; • establishing a "people's counsel" to represent consumers in some insurance rate hearings; • requiring medical malpractice insurers to report claims information to the Insurance Commissioner; and • requiring the Insurance Commissioner to report to the General Assembly annually on the availability of medical malpractice insurance.

Chapter 5 was modified by Chapter 1 of the 2005 session, which took effect without the Governor's signature. Among other provisions, the new Act replaced the special fund and

disbursement mechanism in Chapter 5 with the Maryland Health Care Provider Rate Stabilization Fund and established a method for using the fund to directly subsidize insurance premiums of doctors and nurse midwives.

Maryland's Improving Medical Liability Climate

Rate Stabilization

Chapter 1 created a formula for State subsidies that anticipated that insurers would apply for rate increases for the foreseeable future, with the amount allocated for subsidies decreasing gradually over time as follows:

FY 2006	$52 million for 2005 policies
FY 2007	$45 million for 2006 policies
FY 2008	$35 million for 2007 policies
FY 2009	$25 million for 2008 policies

Under the formula, a "subsidy factor," expressed as a percentage, is calculated by dividing the aggregate amount of money available for the subsidy by the aggregate amount of premiums that would have been paid at the rate approved during the prior year. In its 2005 report, the Maryland Insurance Administration (MIA) advised that Medical Mutual was unexpectedly not seeking any rate increase for 2006. As a result, the subsidy factor for policies renewing in calendar 2006 was determined to be 25 percent. This resulted in over 62 percent of Medical Mutual policyholders receiving a larger rather than a smaller subsidy in 2006 than in 2005.

To date, subsidies of approximately $35.9 million have been approved for 2005 policies and $35.6 million for 2006 policies. The amount for 2005 could increase slightly as some policies for that year may not yet be paid in full. It is anticipated that the amount for 2006 policies will approach or slightly exceed the $45 million allocation due in large part to the entrance of a new medical professional liability insurer to Maryland's market. In addition, some policies for 2006 have not been paid in full, but some amount of subsidy will be paid. If the subsidy amount exceeds the fiscal 2007 allocation, it is assumed that the extra subsidy would be paid from the remaining amount of the fiscal 2006 allocation.

On October 17, 2006, MIA announced that it had determined the 2007 subsidy factor to be 17 percent. Medical Mutual recently announced an 8 percent reduction in its base rate for 2007 policies. When combined with the anticipated 2007 subsidy, Medical Mutual's policyholders should not experience a rate increase in 2007. The effect of the 17 percent subsidy factor on the policyholders of other insurers is unknown.

A 2005 survey conducted by the Maryland Hospital Association found that 66 percent of responding hospitals reported that the State's medical liability climate had stabilized as a result

of Chapter 5 of the 2004 special session. For fiscal 2006, the average increase in medical liability costs was 18 percent, down from a 34 percent increase in 2005 and a 55 percent increase between 2002 and 2004.

Increased Competition Among Insurers

On May 3, 2006, the Maryland Insurance Commissioner announced that the Maryland Healthcare Providers Insurance Exchange had been newly authorized to insure physicians and surgeons, as well as other health care providers. Its entry into the State marketplace may help keep costs from rising. Another Maryland provider, NCRIC, after acquisition by ProAssurance, made a business decision to limit policies to the District of Columbia. The Commissioner advised, however, that another admitted insurer, Medical Assurance Company, Inc., would be available to provide insurance for NCRIC's insureds. As of May 2006, Maryland's physicians and surgeons have six admitted insurers from which to choose when considering professional liability insurance.

MIA Data Collection to Study Trends

MIA has begun collecting claims data pursuant to the recent legislation, although MIA warns that "this data will not be collected overnight." Once a database is built, it should be useful in monitoring trends and reviewing the relationship between insurance rates and payouts.

National Medical Malpractice "Crisis" Fading?

The American Medical Association (AMA) has claimed that the "nation's out-of-control legal system" is forcing physicians in some areas of the country to retire early, relocate, or give up performing high-risk medical procedures. However, a 2006 study by Public Citizen, a consumer watchdog organization, disputes that the nation is facing a physician supply crisis and reports that the number of physicians practicing grew 203 percent from 1965 to 2004, four times faster than population growth. Even in the 21 states identified by AMA as experiencing a "full-blown" medical liability crisis (Maryland not included), the population of physicians expanded faster than the population. During the same period, the number of "high risk" specialists also increased, including years when medical malpractice premium rates spiked. Public Citizen notes that the 2005-06 class entering U.S. medical schools is the largest on record. Even the physician-population ratio for office-based ob/gyns has risen steadily since 1980, showing an overall increase of 32 percent.

Pointing out that there was no increase in the national average rate hike for doctors over the previous six months, Americans for Insurance Reform (AIR), a project of the Center for Justice & Democracy, announced in February 2006 that the insurance "crisis" is "officially over." AIR disputes those who blame prior increases in liability insurance on malpractice lawsuits and instead points to "insurance cycles" in rates for all types of insurance which "erupt" following severe drops in investment income for insurers and periods of under pricing.

Legislative Proposals

Although several additional medical malpractice tort reforms were introduced in the 2006 session, none passed. It is expected that some of the proposals may be reintroduced, including • mandatory structured settlements of awards so that large payouts are distributed over time rather than in a lump sum; • a stronger "apology" provision so doctors can freely discuss unexpected outcomes with their patients; • a "Good Samaritan" provision to give emergency room staff additional liability protections; • making out-of-state medical expert witnesses accountable to the Maryland Board of Physicians for false testimony; • requiring, on motion by a party, a court to appoint a neutral expert witness on the issue of future economic damages; • limiting noneconomic damages to $500,000 regardless of the number of claims, plaintiffs, or defendants; • basing future medical expense awards on Medicare reimbursement rates; and • increasing the size of juries in civil actions.

Civil Proceedings

Same-sex Marriages and Civil Unions

The Court of Appeals will review the case of *Deane v. Conway*, in which a circuit court held that Maryland's prohibition of same-sex marriages is unconstitutional. The General Assembly will again grapple with the issue as the appellate decision is reached.

Background

In 1993, the legal status of individuals of the same sex who enter into familial relationships garnered national attention when the Hawaii Supreme Court ruled that its law denying same-sex couples the right to marry violated state constitutional rights. In 1998, voters in Hawaii adopted a constitutional amendment effectively overturning the decision by authorizing the legislature to reserve marriage to couples of the opposite sex.

In 2000, Vermont became the first state to recognize a parallel system of "civil unions," which provide to same-sex partners the same legal benefits, protections, and responsibilities as married couples. In 2005, Connecticut became the second state to do so.

In 2003, the Supreme Judicial Court of Massachusetts held that barring an individual from the rights and obligations of civil marriage solely because that individual would marry a person of the same sex violates the Massachusetts Constitution. In 2004, the court ruled that authorizing civil unions for same-sex couples while prohibiting them from marrying also was unconstitutional. As a result, Massachusetts became the first and only state to issue marriage licenses to same-sex couples.

In 2006, the highest courts in New York and Washington upheld state laws that limit marriage to heterosexual couples, and the Supreme Court of Georgia reinstated the constitutional ban against same-sex marriage that had been struck down by a lower court. Similarly, the U.S. Court of Appeals for the Eighth Circuit in 2006 reversed the decision of a federal district court that held that the prohibition against same-sex marriage in the Nebraska Constitution violated the U.S. Constitution.

Also in 2006, the New Jersey Supreme Court held that under the state constitution same-sex couples must be afforded on equal terms the same rights and benefits enjoyed by opposite-sex couples under the state's civil marriage statutes. The court stated that the legislature must either amend the marriage statutes to include same-sex couples or adopt a separate statutory structure, such as a civil union, that provides full rights and benefits to same-sex couples.

In the 2006 midterm elections, seven states (Colorado, Idaho, South Carolina, South Dakota, Tennessee, Virginia, and Wisconsin) passed constitutional amendments to ban same-sex marriage. However, Arizona defeated a similar proposal.

According to the National Conference of State Legislatures, 41 states (including Maryland) have laws that either prohibit same-sex marriages or deny recognition of same-sex marriages solemnized in another jurisdiction. Twenty-seven states have adopted constitutional amendments defining marriage as a union only between a man and a woman.

Federal Law

The federal Defense of Marriage Act of 1996 defines marriage as a legal union between a man and a woman only and allows a state to deny recognition of a public act, record, or judicial proceeding of any other state respecting a relationship between persons of the same sex that is treated as a marriage under the laws of the other state.

Maryland Law

Maryland law provides that only a marriage between a man and a woman is valid in this State. This law was enacted by Chapter 213 of 1973, after the Attorney General issued an opinion stating that marriage licenses were not to be issued to members of the same sex.

Maryland law does not address civil unions. However, the Court of Appeals has held that the extension of health insurance benefits by a county to same-sex domestic partners of the county's employees is valid under State law. *Tyma v. Montgomery County*, 369 Md. 497 (2002).

Deane v. Conway

In July 2004, nine same-sex couples sued, in Baltimore City, the clerks of the circuit courts from five counties contending that the State law banning same-sex marriage is unconstitutional. The plaintiffs alleged violation of the prohibition against discrimination based on sex under the Maryland Declaration of Rights, along with violations of due process and equal protection rights. A hearing was held on August 30, 2005.

The lawsuit asked the court for a ruling (1) declaring that the failure of the Maryland statutory code to permit same-sex couples to marry constitutes unjustified discrimination based on sexual orientation and an unjustified deprivation of fundamental rights, including the fundamental right to marry, and therefore constitutes a violation of Article 24 of the Maryland Declaration of Rights; and (2) enjoining the clerks of the courts from refusing to issue marriage licenses to plaintiff couples or other same-sex couples because they are same-sex couples.

On January 30, 2006, the Circuit Court for Baltimore City held that the State statute defining marriage is unconstitutional and violates Article 46 of the Maryland Declaration of Rights because it discriminates based on gender against a suspect class and is not narrowly tailored to serve any compelling governmental interests. Article 46 of Maryland's Declaration of Rights is commonly referred to as "Maryland's Equal Rights Amendment" and prohibits abridgment of equal rights under State law because of sex.

The ruling was stayed pending an appeal which the Office of the Attorney General immediately filed. The Court of Appeals granted *certiorari* and will hear arguments on December 4, 2006.

Recognition of Same-sex Marriages and Civil Unions from Other States

Under the Full Faith and Credit Clause of the U.S. Constitution, states are required to give full faith and credit to the public acts, records, and judicial proceedings of every other state. Therefore, Maryland generally will recognize foreign marriages that are validly entered into in another state. For example, Maryland will recognize a common law marriage from another jurisdiction, although common law marriages are not valid in Maryland. *Henderson v. Henderson*, 199 Md. 449 (1952).

However, the Full Faith and Credit Clause does not require a state to apply another state's law in violation of its own legitimate public policy. See *Nevada v. Hall*, 440 U.S. 410 (1979) and *Henderson*, 199 Md. at 459 (stating that Maryland is not bound to give effect to marriage laws that are "repugnant to its own laws and policy"). The Office of the Attorney General has advised that the Maryland law prohibiting the performance of same-sex marriages in this State would also prohibit the recognition in Maryland of same-sex marriages from other states and would create a valid public policy exception to the general rule that marriages valid where performed are valid anywhere.

By contrast, according to the Office of the Attorney General, current Maryland law does not prevent the State, in applying the law of other states, from giving recognition to civil unions created in those states.

Proposed Legislation

Legislation relating to same-sex marriage is not new in Maryland. In the past several years, numerous proposals to ban recognition of lawful out-of-state marriages by same-sex couples and proposals to amend the Maryland Constitution to define a valid marriage as a marriage between a man and a woman only have all been unsuccessful. Measures to legalize same-sex marriage have been proposed infrequently and without success.

Environment and Natural Resources

Air Quality

Air pollution continues to threaten the health of the public and the Chesapeake Bay. In 2006, the General Assembly addressed air pollution from power plants with the passage of the Healthy Air Act. Legislation to limit air pollution from mobile sources by adopting the standards of the California Low Emission Vehicle Program has been proposed but not passed.

Background

Although Maryland continues to make progress towards its clean air goals, air pollution from stationary sources (such as power plants) and mobile sources (such as motor vehicles) continues to threaten the health of the public and the Chesapeake Bay. During the 2006 session, the General Assembly took steps to reduce air pollution from coal-fired power plants with the passage of the Healthy Air Act. Legislation addressing air pollution from new motor vehicles has been introduced in several previous sessions but has not been successful. Some advocacy groups argue that reducing motor vehicle emissions is one of the next biggest steps Maryland can take toward meeting its clean air goals.

Stationary Sources: An Update on the Healthy Air Act

Chapter 23 of 2006, the Healthy Air Act, established specified limits on the emissions of nitrogen oxides (NO_x), sulfur dioxide (SO_2), and mercury from seven coal-fired power plants in the State. The Act requires the Maryland Department of the Environment (MDE) to set emissions budgets for each facility but gives owners and operators of affected facilities the authority to determine how best to achieve the collective emissions requirements for NO_x and SO_2. As of early November 2006, MDE is drafting proposed regulations to implement the Act's provisions regarding NO_x, SO_2, and mercury.

The Healthy Air Act also addresses carbon dioxide (CO_2) emissions by requiring the Governor to include the State in the Regional Greenhouse Gas Initiative (RGGI). RGGI is a seven-state coalition (Connecticut, Delaware, Maine, New Hampshire, New Jersey, New York, and Vermont) created to discuss the design of a regional cap-and-trade program[10] to reduce

[10] A regional cap-and-trade program is a market-based approach used to control pollution by providing economic incentives for achieving reductions in the emissions of pollutants. The group of states within the region sets a limit or cap on the amount of a pollutant that can be emitted. States that emit the pollutant are given credits or allowances which represent the right to emit a specific amount. The total amount of credits cannot exceed the cap, limiting total emissions to that level. States that pollute beyond their allowances must buy credits from those who pollute less than their allowances. This transfer is referred to as a trade. In effect, the buyer is being fined for polluting, while the seller is being rewarded for having reduced emissions. The more states that need to buy credits, the higher the price of credits becomes – which makes reducing emissions cost effective in comparison.

emissions of greenhouse gases, such as CO_2, from power plants in the region. On August 15, 2006, the participating states issued a model rule for RGGI, which details the proposed program. Pursuant to Chapter 23, the Governor must include the State as a full participant in RGGI no later than June 30, 2007. Chapter 23 requires MDE to contract with an academic institution in the State for a study of whether there will be an adverse impact on the State economy, the reliability of the State's energy supply, and the cost of energy for consumers as a result of the State's entry into and continued participation in RGGI. The findings of the study are due to the Governor and the General Assembly by January 1, 2008. The Act provides that the State may withdraw from the initiative at any time after January 1, 2009.

Mobile Sources and California's Low Emission Vehicle Program (CALEV II)

Background

In order to limit mobile source pollution, the federal Clean Air Act (CAA) requires the U.S. Environmental Protection Agency (EPA) to set standards to regulate emissions from new motor vehicles. The federal standards currently in effect nationwide, and in Maryland, are the Tier 2 standards. The CAA preempts individual state authority to require specific on-board pollution controls. Congress made an exception, however, for California and allows other states to adopt California's more stringent CALEV II standards. To date, 10 states (Connecticut, Maine, Massachusetts, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, Vermont, and Washington) have adopted CALEV II.

New motor vehicles must be certified by the manufacturer under either the federal Tier 2 program, or CALEV II. However, a manufacturer may choose to "dual certify" the vehicle under both programs so that vehicles may be sold in all jurisdictions. Both programs are designed to:

- limit ozone-producing emissions from new motor vehicles by establishing limits on emissions of NO_x, particulate matter, non-methane organic gases (NMOG), formaldehyde, and carbon monoxide;
- certify vehicles into categories, based upon vehicle emissions; and
- establish mandatory fleet-wide average emissions standards.

According to MDE, the CALEV II standards and the Tier 2 standards are similar for most vehicles. CALEV II, however, focuses on NMOG reductions because ozone formation in California is controlled by NMOG concentrations. On the other hand, Tier 2 focuses on NO_x reductions to address ozone formation in the Northeast. In addition, two components of CALEV II that are not included in Tier 2 include (1) the Zero Emission Vehicle mandate, which requires that a certain percentage of all vehicles sold be zero emission vehicles; and (2) the greenhouse gas component, which requires manufacturers, beginning in 2009, to limit emissions

of gases linked to climate change. Automobile manufacturers have sued California to prevent the implementation of the greenhouse gas component, arguing that it would essentially regulate fuel economy, which is the province of the federal government and not the states. California, in turn, has sued six automobile manufacturers for damages caused by greenhouse gas emissions.

Clean Cars Legislation

Legislation to adopt CALEV II in Maryland was introduced during the 2003, 2004, and 2005 sessions; however, none of the bills passed their house of origin.

Proponents of the legislation argued that adoption of CALEV II would result in greater emissions reductions when compared to the federal Tier 2 program. They claimed that adoption of CALEV II in Maryland would reduce atmospheric deposition of air pollutants into the Chesapeake Bay and would result in a decrease in pollution-related health conditions. Proponents downplayed the argument that adopting CALEV II would result in increased costs for new motor vehicles by asserting that the standards are a cost-effective way to limit dangerous air pollution.

On the other hand, opponents of the legislation argued that adoption of CALEV II would produce limited benefits over the federal Tier 2 program and would not help Maryland attain federal air quality standards by 2010. In addition, opponents argued that adoption of CALEV II in Maryland would:

- increase the cost of purchasing new motor vehicles;
- potentially limit the ability of Maryland consumers to purchase certain vehicle models; and
- encourage consumers to purchase vehicles in other states.

Opponents also claimed that any strategy to adopt CALEV II should be regional in nature to address pollution transported to Maryland from other states and that Maryland does not need to adopt CALEV II in order to obtain advanced technologies such as hybrid-electric or fuel cell vehicles.

Environment and Natural Resources

The Status of Chesapeake Bay Restoration

While progress has been made, the State still has a long way to go to meet its nutrient and sediment reduction goals by 2010 and to maintain those goals in the face of continued growth and development.

Background

While the Chesapeake Bay is America's largest and most productive estuary, its health has declined significantly over the past several decades due to nutrient and sediment pollution. In 1999, the U.S. Environmental Protection Agency (EPA) identified the bay as an impaired water body. In 2000, the Chesapeake Bay partners (the bay states, the District of Columbia, the Chesapeake Bay Commission, and EPA) negotiated the Chesapeake 2000 Agreement (C2K), which specified restoration goals to improve the bay and remove it from the EPA's List of Impaired Waters. As part of C2K, specific pollution reduction goals have been allocated to the various bay states. Maryland's reduction goals are summarized in **Exhibit 1**. In 2004, Maryland contributed approximately 20 percent of the bay's total nitrogen, phosphorus, and sediment load. The largest source of Maryland's nutrient and sediment pollution is runoff from agricultural lands, followed by urban runoff and point sources.

Exhibit 1
Maryland's Pollutant Reduction Goals

Pollutant	1985 Loads	2004 Loads	2010 Goal
Nitrogen (million lbs/yr)	82.4	56.9	37.3
Phosphorus (million lbs/yr)	6.8	3.8	2.9
Sediment (million tons/yr)	1.3	1.0	0.7

Source: U.S. Environmental Protection Agency's Chesapeake Bay Program

Strategies

In April 2004, the Department of Natural Resources (DNR) released Maryland's Tributary Strategy, which outlines basin-specific nutrient and sediment control actions necessary to reduce pollution from every source. In February 2006, the Governor's Chesapeake Bay

Cabinet released a draft of Maryland's Chesapeake Bay Tributary Strategy Statewide Implementation Plan. Although a final implementation plan has not been released as of October 2006, numerous efforts are underway to help Maryland achieve C2K goals. Examples of these efforts include:

- **Bay Restoration Fund:** The Bay Restoration Fund was created in 2004 (Chapter 428) to provide grants for Enhanced Nutrient Removal (ENR) upgrades at the State's 66 major publicly owned wastewater treatment plants (WWTPs). The fund is financed by a bay restoration fee on users of WWTPs, septic systems, and sewage holding tanks. While ENR grants are the fund's primary expenditure, funds are also being dedicated to sewer infrastructure grants, septic grants/loans, and the Maryland Department of Agriculture's (MDA) Cover Crop Program. While the estimated capital costs for ENR upgrades were originally $750 million, current estimates suggest that costs could exceed $1 billion. In addition to concerns about a possible funding shortfall, in recent months, concern has also been raised regarding the use of the fund and whether it encourages growth.

- **Targeted Watersheds:** A new initiative to restore entire watersheds and remove them from EPA's List of Impaired Waters was initiated by Governor Robert L. Ehrlich in September 2005. The Corsica River Pilot Project in Queen Anne's County was selected as the first targeted watershed project; since 2005, DNR has targeted $2.7 million to the watershed. In November 2006, Governor Ehrlich named the Magothy River in Anne Arundel County, the Lower Gunpowder River in Baltimore County, the Port Tobacco River in Charles County, and Bynum Run in Harford County as the four candidate watersheds for the State's second targeted watershed project.

- **Stormwater Utility Fees:** Due to the significant costs of implementing and retrofitting stormwater management systems, stormwater utility fees are gaining popularity in some communities as a funding source. For example, the City of Takoma Park assesses a stormwater management fee based on factors that influence runoff, such as land use and the amount of impervious surface on a property. This type of fee may encourage landowners to reduce the amount of impervious surface on their properties.

- **Phosphorus Reduction in Home Lawn Care Products:** In an effort to reduce phosphorus runoff into the bay, in September 2006, Maryland, the District of Columbia, Pennsylvania, and Virginia pledged to reduce, by 2009, half the amount of phosphorus used in home lawn care products. While the agreement does not mandate reductions, two large companies have agreed to reduce the phosphorus content in their products.

- **Financial Incentives for Farmers:** A variety of efforts are underway to encourage farmers to use best management practices. For example, MDA administers several financial assistance programs to help farmers pay the cost of installing best management practices such as cover crops. Among other things, the Agricultural Stewardship Act of 2006 (Chapter 289) mandates and recommends increased funding for these programs. In addition, a 2006 report released by the Maryland Agricultural Commission, *A*

Statewide Plan for Agricultural Policy and Resource Management, includes several recommendations to help keep productive agricultural land in agricultural use, such as reducing the tax burden on farmers.

- **Forest Conservation:** The Chesapeake Executive Council signed a directive in September 2006 to develop a collective goal for forest lands conservation and expansion in an effort to protect water quality. In October 2006, the Governor's Commission on Protecting the Chesapeake Bay through Sustainable Forestry issued its final report, *Maryland's Strategic Forest Resource Plan 2006,* which contains several recommendations. Among other things, the report suggests that greater use be made of Maryland Agricultural Land Preservation Foundation funds for forest land conservation and that financial incentives be offered to encourage landowner retention of forests, such as tax credits for forest easement donations.

- **Planning for Growth:** Chapter 381 of 2006 made several changes to local government planning in an effort to plan for future growth. Among other things, Chapter 381 requires local governments to include a water resources element in their local comprehensive plans; the element must identify suitable receiving waters and land areas that support stormwater management and wastewater treatment and disposal needs of existing and future development.

Achieving and Maintaining Reduction Goals Will Be Difficult

While numerous efforts to restore the bay's water quality are underway, at this time Maryland is not well positioned to achieve its C2K commitments. According to a draft Tributary Strategy funding analysis, Maryland's existing funding sources will cover only 39 percent of the estimated $10 billion needed to implement the State's implementation plan through 2010. Also, several of the recent strategies described above may not have an impact for several years, and others could end up costing more than originally anticipated. Finally, a lack of funding to provide the technical assistance necessary to implement several of the strategies, as well as a lack of enforcement of existing laws, appears to be hindering bay restoration efforts.

Another significant challenge in meeting and maintaining the nutrient and sediment reductions is the anticipated increase in Maryland's population. By 2030, Maryland's population is expected to increase by over one million. Over the next few years, the Base Realignment and Closure recommendations are expected to bring an additional 40,000 to 60,000 defense-related personnel to the State. Maintaining nutrient reduction levels under the pressures of increasing population growth and rapid development will be difficult. The Maryland Department of the Environment is currently exploring approaches for managing nutrient load caps for point sources, in light of growth; concepts include nutrient trading and the establishment of nutrient offset fees.

Implications for the 2007 Session

As a result of the challenges facing current bay restoration efforts, it is likely that several bills will be introduced during the 2007 session in an effort to bolster those efforts. Possible legislative initiatives are discussed below:

- In September 2006, the Chesapeake Bay Foundation (CBF) unveiled its four-year legislative blueprint. CBF's priorities for the next term include (1) implementing tax policies that reward agricultural stewardship; (2) planning for growth at a regional level and enforcing State planning laws; (3) requiring pollution limits in stormwater runoff permits; and (4) creating a dedicated "Green Fund" to benefit bay restoration.

- The Agricultural Stewardship Act of 2006 (Chapter 289) established the Incentives for Agriculture Task Force. Although the task force is not due to issue its final report until October 1, 2007, legislation addressing tax incentives for farmers may be introduced during the 2007 session in response to CBF's recommendation and legislative initiatives in other states. For example, the Resource Enhancement and Protection Act of Pennsylvania is a plan to support pollution reduction projects on Pennsylvania farms by providing tax credits to farmers to finance conservation practices.

- Recommendations of the Maryland Agricultural Commission and the Governor's Commission on Protecting the Chesapeake Bay through Sustainable Forestry could result in legislation aimed at maintaining or expanding the State's agricultural and forest lands.

- Given the recent concerns regarding the use of the Bay Restoration Fund and its impacts on growth, legislation clarifying the use of the fund may be introduced during the 2007 session.

- Finally, growth management in general will likely continue to be a significant issue. Chapter 381 of 2006 established the Task Force on the Future for Growth and Development in Maryland. Although the task force is not due to issue its final report until December 1, 2007, legislation may be introduced during the 2007 session as a result of increasing concerns about the impact of growth on the bay restoration effort.

Conclusion

While progress has been made, the State still has a long way to go to meet its nutrient and sediment reduction goals by 2010 and to maintain those goals in the face of continued growth and development. A significant increase in resources coupled with the implementation of more cost-effective, high-impact bay restoration strategies could steer the State closer to meeting and maintaining the C2K goals.

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Environment and Natural Resources

Fisheries Management

Concerns remain regarding the water quality in the Chesapeake Bay and the depletion of certain fisheries, such as the native oyster. Of most pressing concern in the upcoming session, however, will likely be turtle conservation and shellfish harvesting.

Status of State Fisheries

While some of the State's fisheries continue to struggle, there has been positive news for others. **Exhibit 1** shows data on harvests of three major commercial fisheries.

Exhibit 1
Selected Commercial Fishery Annual Harvests
(in Thousands of Pounds)

	CY 1995	CY 2000	CY 2005	CY 1995-2005 Change
Blue Crab	42,162	21,661	32,060	-24.0%
Native Oyster	1,311	2,389	738	-43.7%
Rockfish (Striped Bass)	1,281	2,412	2,095	63.5%

Source: Department of Natural Resources

Blue Crab

In 2005, the statewide commercial harvest of blue crab was 32 million pounds; while this represents a decrease of 24 percent from the 1995 harvest, it is a 48 percent increase over the 2000 harvest. In addition, in 2005, for the first time, harvest pressure on the blue crab (the exploitation rate) met the 2001 target set by the Bi-State Blue Crab Advisory Committee; that target sets crab harvesting rates at a point that will conserve 20 percent of the spawning stock. According to the most recent winter dredge survey conducted by the Department of Natural Resources (DNR), however, the number of crabs in the bay continues to remain at low levels.

Oysters

Native Oysters: The 2005 oyster harvest was nearly 44 percent below the 1995 harvest and 69 percent below the 2000 harvest. However, the 2004-2005 season harvest increased from the previous season, reversing a five-year trend of declining catches. At its peak, the bay's

oyster population acted as a natural filter, removing 133 million pounds of nitrogen annually. Largely due to two diseases, MSX and Dermo, the oyster stock has been severely depleted. Today, the oyster population has dropped to less than one-half of 1 percent of its original population; the few remaining oysters remove only about 250,000 pounds of nitrogen from the bay each year. On a positive note, in DNR's 2005 fall survey, observed oyster mortality was 17 percent, the lowest it has been since 1989 and much lower than its peak in 2002.

Nonnative Oysters: Maryland, Virginia, and the U.S. Army Corps of Engineers are voluntarily preparing an environmental impact statement (EIS) on the possible introduction of the Suminoe oyster to the Chesapeake Bay. The draft EIS is expected to be released in May 2007.

Rockfish (Striped Bass)

Largely as a result of conservation measures, including a five-year moratorium in the late 1980s, rockfish is now one of the strongest fisheries in the bay. The rockfish harvest increased 63.5 percent between 1995 and 2005, although the 2005 harvest decreased 13.0 percent from 2000 levels. Recently, rockfish reproduction has been reported as being lower than usual. DNR advises, however, that this decline is not yet cause for alarm, as it is normal for rockfish reproduction to vary from year to year.

Recent Policy Concerns

Turtle Conservation

Snapping Turtles: According to DNR, in the past few years there has been a significant increase in landings of snapping turtles; landings have ranged from a low of 800 pounds in 1993 to a high of 92,581 pounds in 2004. Although commercial fishermen have been required to report landings since 1992, there are no data that show the size of the individual turtles being harvested. DNR believes that the significant increase in harvests in recent years warrants additional research and the implementation of conservation measures. However, current law only provides DNR with the authority to regulate methods of harvest, not to adopt conservation measures for snapping turtles.

Diamondback Terrapin: Chapter 477 of 2006 required DNR to adopt a fishery management plan for diamondback terrapin. In addition, the Act required DNR to adopt regulations governing diamondback terrapin that are consistent with the recommendations of the Maryland Diamondback Terrapin Task Force that were issued in 2001. The approved regulatory measures, which became effective August 1, 2006, are intended to reduce the commercial harvest until a more comprehensive population assessment and management plan are completed. Specifically, the regulations establish a slot limit for which the harvest of terrapin smaller than four inches and larger than seven inches is prohibited; this slot limit is designed to protect and

conserve reproducing female terrapins. The regulations also shorten the commercial season and establish a permit system with mandatory reporting measures.

Shellfish Harvesting

Hard Clams Aquaculture: Over the past decade, hard clam population densities in the Atlantic Coastal Bays have remained relatively stable. Recently, however, there has been a decline in clam harvests, largely due to blue crab predation and the sedimentation of old oyster bars. Despite the decline in harvests, concerns have been raised regarding hard clam aquaculture. One of the best locations for clam farming is the zone within 300 feet of the shoreline, where water depths and bottoms are especially suitable for clam aquaculture. In addition, the use of submerged lands in this 300-foot zone avoids conflicts with commercial clammers who are prohibited from working in that area. Many property owners adjacent to these leased submerged lands, however, object to the proximity of clam farming activities, due to aesthetic and water access issues. DNR is considering its options to work with property owners to address the concerns regarding these leased areas.

Dredging: Another issue regarding shellfish harvesting in the Atlantic Coastal Bays relates to hydraulic clam dredging. Among other things, recreational anglers and landowners have raised concerns about the noise created by the use of hydraulic dredges and the impact of the dredges on recreational fishing. One way to address this issue would be to establish a limited entry system for hydraulic clam dredging in the coastal bays area. In fact, the fishery management plan for the coastal bays that was adopted by DNR calls for a limited entry system; however, under current law, DNR does not have the authority to implement such a system.

Landing Licenses: Harvesters that catch shellfish in out-of-state waters (the Atlantic) and land the shellfish in Maryland are not required to be licensed by the State; therefore, they are not required to report harvest information. This makes it difficult for DNR to monitor the population and implement conservation measures when appropriate. According to DNR, one way to address this would be to require unlicensed persons who land shellfish caught in out-of-state waters to obtain the landing license established by Chapter 231 of 2005. That Act required individuals not already licensed to commercially fish in the State to obtain a seafood landing license in order to land finfish caught in out-of-state waters.

Environment and Natural Resources

Enforcement in the Chesapeake and Atlantic Coastal Bays Critical Area

A 2006 report by the Environmental Law Clinic at the University of Maryland School of Law raised concerns regarding the enforcement of the critical area law. The commission's authority is limited and local implementation is inconsistent. Nevertheless, the commission has sufficient authority to prevent certain development in the critical area as demonstrated in its recent action concerning the Blackwater Resort Communities project.

Background

The Maryland General Assembly established the Chesapeake Bay Critical Area Protection Program in 1984 to minimize damage to water quality and wildlife habitat by fostering more sensitive development activity along the shoreline areas of the bay and its tributaries. Although local jurisdictions are primarily responsible for the enforcement of the critical area law, they may request assistance from the Critical Area Commission or request that the commission refer the enforcement issue to the Attorney General to obtain legal or equitable relief. Moreover, if the commission believes that the local jurisdiction is failing to enforce its own critical area laws, the commission must serve notice on that jurisdiction. If the jurisdiction fails to correct the problem or punish the violator within 30 days, the commission may refer the matter to the Attorney General. Finally, the chair of the commission is authorized to commence or intervene in any administrative, judicial, or other proceeding or appeal in the State that involves project approval in the critical area.

Enforcement in Maryland's Critical Area: Perception in Practice

In May 2006, the Environmental Law Clinic at the University of Maryland School of Law released a report entitled *Enforcement in Maryland's Critical Area: Perception in Practice*. The report identified a number of limitations and weaknesses in enforcing the critical area law. The limitations and weaknesses described in the report are summarized below.

Local Implementation: The clinic found that local implementation of the law has led to critical area programs that are different throughout all 63 participating jurisdictions. These inconsistencies create less predictability for landowners throughout the State.

Limited Role and Authority of the Commission: The commission is almost solely an advisory body, with very few of the powers that a typical State agency holds. The commission may only approve local critical area programs, grant or deny the approval of certain limited types

of development, and review and make recommendations on development applications. The commission has no authority to adopt its own regulations.

Enforcement: There is no requirement for the State government to step in and enforce the laws on behalf of local jurisdictions. In addition, unlike many federal environmental laws, there is no citizen suit provision that would allow a citizen to challenge a violation in the absence of local or State enforcement. Further, the commission is under no duty to refer violations to the Attorney General, and there is no duty on the Attorney General to pursue compliance with the critical area law.

Grandfathering Clause: The clinic identified the grandfathering clause, which allows the continuation of a land use that was in existence at the time of program approval even though the use is inconsistent with the critical area program, as the largest loophole in the critical area law. An overwhelming number of existing waterfront properties are subject to grandfather clauses. The critical area law does not provide for the termination of these clauses at a future date. Also, nearly all development requests on grandfathered lots go through a relaxed variance process.

Variance Procedures and the Retroactive Granting of Permits and Variances: Although the standard for the granting of variances requires that the landowner experience "unwarranted hardship," both the courts and the legislature have struggled with the interpretation of this standard. This situation has led to inconsistent implementation throughout the State. Furthermore, retroactive variances provide an unfair advantage to a landowner because it is time consuming and costly for a jurisdiction to force a structure to be torn down. Retroactive variances also allow a landowner to avoid the pre-permitting exchange between local officials and commission members that may result in beneficial pre-construction project modifications.

Annexation and Land Reclassification: The reclassification of land in the critical area from one land use designation to another is authorized under critical area law on proof of a mistake in the existing zoning. However, there is no termination provision or statute of limitations to limit the time period in which a landowner may allege a mistake and petition for reclassification.

An Update on Blackwater Resort Communities

Each county and municipal corporation that is subject to the critical area law may use a finite portion of the resource conservation area under its jurisdiction for development, subject to State guidelines and commission approval. To obtain the final approval required to begin construction of the proposed Blackwater Resort Communities, Dorchester County and the City of Cambridge submitted a "program amendment" to use some of the county's remaining growth allocation. A panel of commission members reviewed the growth allocation request, which included a number of meetings, public hearings, and the opportunity for public comment. On October 4, 2006, the panel recommended that the proposed growth allocation program amendment be denied; on the same date, the full commission voted unanimously to deny the program amendment, effectively prohibiting construction of the Blackwater Resort Communities

anywhere in the critical area. On November 6, 2006, the matter was settled as the State agreed to purchase and preserve a majority of the land in question.

Environment and Natural Resources

Baltimore County Liquefied Natural Gas Task Force

Chapter 285 of 2006 established the Baltimore County Liquefied Natural Gas Task Force to study conditions surrounding the potential siting of a liquefied natural gas terminal on the site of the former Sparrows Point shipyard in eastern Baltimore County. The task force is expected to submit a report of its findings and recommendations to the Governor and the General Assembly by December 31, 2006.

Background

Chapter 285 of 2006 established the Baltimore County Liquefied Natural Gas Task Force to study conditions surrounding the potential siting of a liquefied natural gas (LNG) terminal on the site of the former Sparrows Point shipyard in eastern Baltimore County. Concerns have been raised by area communities and State and county leaders regarding the safety of locating an LNG facility at the site. The 14-member task force consists of representatives from several State agencies; members of the scientific, environmental, and energy communities; and local citizens from surrounding residential areas.

Specifically, the task force is charged with studying:

- the risks and hazards of an LNG production, storage, or regasification facility;
- the kind and use of the proposed production, storage, or regasification facility;
- the current and projected population and demographic characteristics of the location of the proposed facility;
- the current and proposed land use near the proposed facility;
- natural and physical aspects of the proposed location;
- the emergency response capabilities near the proposed facility location;
- the need and appropriate distance for remote siting;
- the effect of the proposed facility location on recreational and commercial boating and fishing and crabbing in the area;
- the impact on the environment, especially on water quality, due to the quality of the dredged material from the large scale dredging that is intended for the project; and

- the impact on the ability of residential property owners near the proposed facility to retain access to their properties by way of the waterway.

The task force consists of three subcommittees focused on land use, risk and safety, and environmental impacts. As of November 2, 2006, the full task force had met four times and had covered a variety of topics ranging from land use and zoning of the industrial site and nearby residential areas to the current status of water quality in the Sparrows Point area. The task force anticipates meeting one or two additional times during the 2006 interim. Pursuant to Chapter 285, the task force is expected to submit a report of its findings and recommendations to the Governor and the General Assembly by December 31, 2006.

Policy Implications

Because the task force has not yet completed its work, specific recommendations are unknown at this time. However, some policy implications are apparent. AES Corporation, the power company that announced the plan to build the proposed LNG facility, is challenging a county law placing siting restrictions on LNG facilities, arguing that the Federal Energy Regulatory Commission has sole authority to determine the suitability of LNG sites. Because of this federal preemption issue, it is unlikely that legislation will be introduced during the 2007 session addressing the siting of proposed LNG facilities. However, the work of the task force could result in legislation relating to other issues. State legislators from Baltimore County, the Governor, the County Executive, and citizens have all expressed opposition to the proposed LNG facility. As a result, it is possible that the task force could propose introducing a joint resolution that would affirm the legislature's opposition to the location of the facility. In addition, the task force could develop recommendations addressing other issues, such as dredged material disposal and funding for emergency response activities.

Environment and Natural Resources

Ethanol and Other Renewable Energy Sources

Due to ongoing concerns about the nation's dependence on foreign oil and the environmental impacts associated with traditional energy sources, the federal government and several states, including Maryland, have taken steps to encourage renewable energy sources, such as ethanol. Recently, however, several concerns have been raised regarding the production and use of ethanol.

Background

As oil prices reach all-time highs and concerns about global warming become more widespread, government officials are exploring ways to encourage the production and use of renewable energy sources, such as wind, solar, and biomass. Biomass now accounts for 45 percent of the renewable energy used in the United States; it can be burned like coal in power plants to produce heat or electricity or fermented to produce fuels, such as ethanol. The use of renewable fuels such as ethanol can decrease dependence on foreign oil, strengthen rural economies, reduce the use of methyl-tertiary butyl ether (MTBE) in gasoline, and reduce air and water pollution.

In recent years, the General Assembly has taken several actions to encourage the production and use of renewable energy in Maryland. For example, in 2004, the legislature established a Renewable Energy Portfolio Standard (Chapters 487 and 488 of 2004). In that same year, the General Assembly established a Solar Energy Grant Program (Chapter 128 of 2004) to provide grants to individuals, local governments, and businesses to offset a portion of the costs associated with the installation of solar energy equipment. In 2005, the legislature passed the Renewable Fuels Promotion Act of 2005 (Chapter 332 of 2005), which authorized the payment of credits for the production of ethanol and biodiesel, beginning in 2008.

Federal and State Incentives for Renewable Fuels

The federal government has established several incentives in order to encourage the production and use of renewable fuels. Although a federal excise tax credit for the production of ethanol has been in effect for decades, the federal Energy Policy Act of 2005 contained numerous additional provisions encouraging the use of ethanol and other biofuels, such as:

- requiring that by 2012, 7.5 billion gallons of renewable fuel be used annually;
- encouraging research into and development of alternatives to corn-based ethanol;

- providing loan guarantees and grants for the construction of certain types of ethanol production facilities and demonstration products, and for research into renewable fuels production; and

- increasing eligibility for the small ethanol producer federal income tax credit ($.10 per gallon up to $1.5 million) to include producers who produce between 30 million and 60 million gallons annually.

In addition to some mandates regarding the use of renewable fuels, many states now provide incentives for the production, distribution, and use of renewable fuels. Examples include:

- **Production and Distribution Incentives:** Maine offers a corporate income tax credit of $.05 per gallon for the production of biofuels intended for use in motor vehicles or as liquid fuels. Florida exempts materials used in the distribution of ethanol from the sales tax and offers a state sales and use credit of 75 percent for most capital costs associated with the production, storage, and distribution of ethanol and biodiesel.

- **Mandates and Use Incentives:** Minnesota mandates that nearly all gasoline contain 10 percent ethanol by volume. Montana will require that nearly all gasoline contain 10 percent ethanol once certain ethanol production goals are met. Iowa has enacted a series of incentives for retailers (gas stations) and producers so that, by 2020, 25 percent of fuels used will be renewable.

Ethanol – Boom or Bust?

As of October 2006, there were 105 ethanol plants operating in the United States, with 45 under construction. According to the Renewable Fuels Association, an estimated 30 plants have been built since October 2005. In Maryland, several plants are in the permitting process but have not yet been approved. The recent boom in ethanol production can be attributed to a number of economic and environmental benefits. Some of the direct and indirect economic benefits associated with the increased production of ethanol include:

- **Job Creation and Increased Household Income:** According to the Maryland Department of Agriculture, one new ethanol production plant would create new jobs for Maryland workers in plant construction, plant operation, grain transportation, and fuel distribution. This, in turn, should lead to an increase in household income.

- **Increased State and Federal Tax Revenues:** An increase in household income should lead to an increase in retail sales, resulting in increased tax revenues for the State and the federal government.

- **Increased Income for Farmers:** Farmers who grow the small grains needed to produce ethanol would benefit from increased grain values as a result of increased demand.

The use of ethanol has also been linked to several environmental benefits, such as:

- **Reduced Nutrient and Sediment Runoff:** Growing small grains for harvest helps to reduce the runoff of nitrogen and sediment from agricultural lands into the waters of the State. Excess nutrients are reabsorbed by the crop instead.

- **Reduced Levels of Air Pollution and Groundwater Contamination:** Ethanol has a higher oxygen content than most fuels, which results in lower emissions of ozone-forming pollutants and greenhouse gases when it is burned. In addition, ethanol, used in place of MTBE, results in air quality benefits without the threat of groundwater contamination.

Despite the economic and environmental benefits noted above, significant concerns have been raised regarding the mass production and use of ethanol. Examples of such concerns and other issues are listed below:

- **Impact on Pipelines and Engines:** Fuel blends containing ethanol are corrosive and could damage existing pipelines, resulting in concerns regarding the use of existing pipelines for distribution. Ethanol can also bond with water and pick up impurities, which could ultimately damage engines.

- **The Amount of Energy That Can Be Generated from Corn-based Ethanol May Be Less Than the Amount of Energy Used to Produce It:** Scientists disagree about how much energy is created by corn-based ethanol relative to the energy needed to produce it. While the U.S. Department of Agriculture (USDA) has concluded that corn-based ethanol produces approximately 35 percent more energy than it consumes, other studies indicate that the net energy generation is lower, and in some cases, even negative.

- **Meeting the Demand for Corn:** A gallon of ethanol has approximately two-thirds of the energy that a gallon of gasoline does, requiring more ethanol to achieve the same end. Accordingly, meeting a substantial portion of U.S. gasoline demand would require the use of a significant percentage of current U.S. corn production. USDA projects that 23 percent of domestic corn production could be used for ethanol by 2015/2016. In order to meet this demand, USDA projects a decrease in corn exports for food.

- **Corn Still the Preferred Crop:** Most ethanol production facilities use corn as feedstock and are located in the midwest, not on the coasts, where demand for fuel ethanol is increasing. In corn-deficient states, such as Maryland, ethanol production would preferably be barley-based because it is costly to ship corn from the midwest to a local ethanol plant. However, barley currently produces fewer gallons of ethanol per bushel than corn does.

Conclusion

Although the federal government and several states, including Maryland, have taken steps to encourage the production and use of renewable energy, there are some who question whether renewable energy, and ethanol in particular, will ever be capable of reducing the nation's dependence upon foreign oil.

State Government

Election Administration

Amid continuing concerns about the reliability, accuracy, and security of the State's touch screen electronic voting system and the call for further enhancements to the system, the September 2006 primary election revealed a number of other administrative, organizational, and equipment defects and the need for further refinements of the election process in Maryland.

Early Voting

The high turnout and long waits in many jurisdictions across the U. S. during the 2004 presidential election caused a push by jurisdictions to institute early voting or expand existing early voting programs. Although the duration of early voting varies from state to state, 10 to 15 days prior to an election generally is the average length of time in which voters are allowed to cast their ballots.

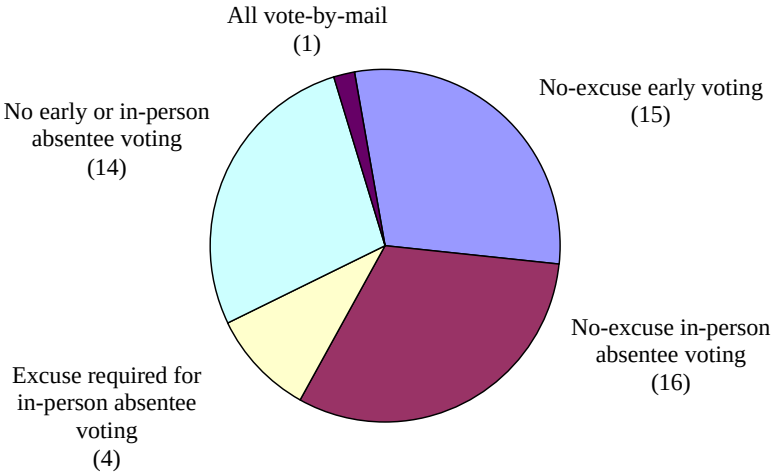
More than 30 states and the District of Columbia currently offer some form of early voting. **Exhibit 1** describes the type and prevalence of the early voting models among the states and the District of Columbia.

During the 2005 session, legislation was passed that significantly expanded early voting in Maryland. Senate Bill 478 of 2005 (Chapter 5 of 2006) established an early voting period of eight hours each day extending from the Tuesday to the Saturday before an election. The measure also required the establishment of at least three early voting polling sites in each of the State's "big seven" counties and one early voting polling site in each of the other 17 counties. In addition, another measure, House Bill 622 of 2005 (Chapter 6 of 2006), allowed any voter to vote by absentee ballot without providing an excuse. Although the Governor vetoed both bills, the General Assembly overrode the Governor's vetoes at the beginning of the 2006 session.

During the 2006 session, the General Assembly made further refinements to the early voting process when it passed House Bill 1368 (Chapter 61 of 2006) and then overrode the Governor's veto of that legislation. In addition to specifying the early voting sites in each local jurisdiction, Chapter 61 extended early voting from 8 to 13 hours each day by directing that early voting be conducted from 7 a.m. to 8 p.m. each day (and thus mirror the standard time period for voting at the polls on election day) and required the State and local election boards to conduct voter outreach to educate voters about early voting and the location of early voting polling sites. Chapter 61 also required all polling places to be equipped with electronic poll books (e-pollbooks) to make early voting more efficient and to guard against voter fraud in the event a voter attempted to vote more than once.

On August 11, 2006, the Anne Arundel County Circuit Court ruled that early voting as enacted in Chapters 5 and 61 of 2006 violated the Constitution of Maryland. The State immediately appealed the decision to the Maryland Court of Appeals, which upheld the ruling on August 25, 2006, and declared that early voting violates the Constitution of Maryland. The court's rationale for the decision will be stated in an opinion to be filed at a later date. As a result, early voting, which was scheduled to begin on September 5, 2006, in conjunction with the September 12, 2006, primary election, was cancelled.

Exhibit 1
State Early Voting Laws



No excuse early voting	Arizona, Arkansas, California, Colorado, Florida, Georgia, Illinois, Louisiana, Nevada, New Mexico, North Carolina, North Dakota, Tennessee, Texas, West Virginia
No-excuse in-person absentee voting	Alaska, Hawaii, Idaho, Indiana, Iowa, Kansas, Maine, Montana, Nebraska, Ohio, Oklahoma, South Dakota, Utah, Vermont, Wisconsin, Wyoming
Excuse required for in-person absentee voting	(District of Columbia), Kentucky, Minnesota, Missouri, Virginia
No early or in-person absentee voting	Alabama, Connecticut, Delaware, **Maryland**, Massachusetts, Michigan, Mississippi, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, South Carolina, Washington (34 of 39 counties in Wash. vote-by-mail)
All vote-by-mail	Oregon

Source: electionline.org

Absentee Voting

Although early voting was cancelled following the Court of Appeals decision, Maryland voters could still vote early by absentee ballot under Chapter 6 of 2006. Prior to this enactment, State law dictated that a voter could request an absentee ballot only on account of (1) absence on election day from the jurisdiction; (2) accident, illness, or physical disability; (3) death or serious illness of a family member; (4) service in the armed forces; (5) confinement in an institution; (6) status as a full-time student at a college or university located outside the voter's regular precinct but within the student's county of registration; or (7) employment by or service as an official of the State Board of Elections (SBE) or a local board on election day. Chapter 6 repealed all these eligibility requirements for absentee voting. **Exhibit 2** lists the 29 states including Maryland that allow no-excuse absentee voting.

Exhibit 2
States with No-excuse Absentee Voting

Alaska	Georgia	Maryland	North Carolina	Utah
Arizona	Hawaii	Montana	North Dakota	Vermont
Arkansas	Idaho	Nebraska	Ohio	Washington
California	Iowa	Nevada	Oklahoma	Wisconsin
Colorado	Kansas	New Jersey	Oregon	Wyoming
Florida	Maine	New Mexico	South Dakota	

Source: electionline.org

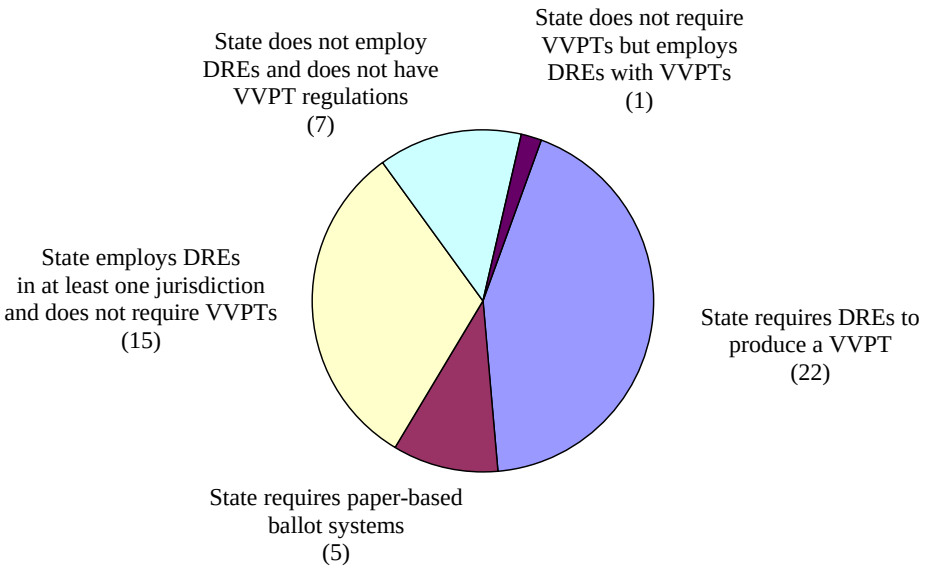
Following a number of unsettling developments in conjunction with the September 12, 2006 primary, some State and local officials proposed abandoning the State's electronic voting system entirely and reverting to an optical scan voting system – of the type already used by local election boards to count absentee ballots – to electronically scan paper ballots for the general election. No doubt in part due to the entreaties of these officials, the already existing general lack of confidence of some voters in the Diebold electronic voting system, and the more liberal absentee voting law, over 193,000 voters requested absentee ballots for the November 7, 2006 general election.

Prior to the general election, some local election boards ran out of absentee ballots (which also are used as provisional ballots for the general election). In some cases, fresh supplies of absentee ballots arrived less than one week before the general election. The delays caused local election officials to express concern that they would not be able to mail the ballots back to voters on time (and, as a result, some voters would be unable to return their ballots on time), and that they would have difficulty packing the election kits that contain the provisional ballots that are used in the precincts on election day.

Voter Verified Paper Trail/Audit

Chapter 564 of 2001 required SBE to select a uniform, statewide voting system. In January 2002, SBE entered into a contract to purchase direct-recording electronic (DRE) touch screen voting units and services from Diebold Election Systems, Inc. These units were used statewide for the first time during the 2006 gubernatorial primary election. As **Exhibit 3** indicates, Maryland is 1 of 15 states and the District of Columbia that employs an electronic voting system but does not require a voter-verified paper trail (VVPT).

Exhibit 3
State VVPT Usage



State requires DREs to produce a VVPT	Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Hawaii, Idaho, Illinois, Maine, Missouri, Montana, Nevada, New Jersey, New York, North Carolina, Ohio, Oregon, Utah, Washington, West Virginia, Wisconsin
State requires paper-based ballot systems	Michigan, Minnesota, New Hampshire, New Mexico, Vermont
State employs DREs in at least one jurisdiction and does not require VVPTs	Delaware, (District of Columbia), Florida, Georgia, Indiana, Iowa, Kansas, Kentucky, Louisiana, **Maryland**, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, Wyoming
State does not employ DREs and does not have VVPT regulations	Alabama, Massachusetts, Nebraska, North Dakota, Oklahoma, Rhode Island, South Dakota
State does not require VVPTs but employs DREs with VVPTs	Mississippi

Source: electionline.org

Several studies have reported on the vulnerability of the Diebold system to hackers or substandard computer code. The reports noted security concerns within the machines involving the possibility of physical tampering and electronic modification of election results. Some computer scientists analyzing the issue of computer software driven electronic voting machines have called for the use of "open-source" software, or software developed in the public arena with input from many programmers and test users.

Maryland has received extensive media coverage about the security and accuracy of electronic voting systems which, together with a generally heightened level of public concern, have caused some voters to request an add-on printer that produces a VVPT for such voting systems. VVPT would allow a voter to review a paper printout of the voter's selections and change the selections before casting a final vote. A number of proponents suggest the paper record should serve as the official ballot and be used in the event of a recount, maintaining that if a voter specifically verified the document it would be the best indication of voter intent.

During the summer of 2005, SBE commissioned a two-part study on various independent voter verification systems, including VVPT. In January 2006, the University of Maryland, College Park recommended, as a result of its study, that the State not purchase any of the systems reviewed, citing tradeoffs "between usability and other considerations, including the security of the vote." Similarly, the University of Maryland, Baltimore County in February 2006, recommended that the State not adopt any voter verification systems available at the time, including Diebold's system, because none of them were fully developed.

Diebold has developed a printer add-on prototype that may be used with the electronic touch screen voting system currently in use in Maryland, though it is unclear whether the printer add-on option would be entirely feasible. Diebold also has developed an electronic voting system with an integrated printer. Federal voluntary voting system standards adopted by the U.S. Election Assistance Commission in 2005, which for the first time include requirements for a VVPT system, will take effect in December 2007. Modification or replacement of the existing Diebold electronic touch-screen voting system would require that the system undergo State certification again, and State law requires that a voting system be tested and shown to meet certain federal standards as a condition of State certification.

Over the past few years, a number of legislative proposals have been put forth to address this issue. Senate Bill 393/House Bill 53 of 2004 and House Bill 107 of 2005 would have required the State's electronic touch-screen voting system to produce a VVPT record of each vote. House Bill 244 of 2006 would have required SBE to lease an optical scan voting system for use in the 2006 gubernatorial elections and select and certify a voting system that would produce VVPT records for use in subsequent elections. Senate Bill 713 of 2006 would have retained the State's current electronic system, but would have required that a voting system capable of producing VVPT be implemented for elections occurring on or after January 1, 2008. None of these bills passed.

2006 Primary Election Concerns

Maryland received extensive media coverage concerning the administration of the September 12, 2006 primary election. Several jurisdictions were plagued with difficulties including too few election judges, malfunctioning e-pollbooks, and human error.

Election Judges

Prior to the September 12, 2006 primary election, local elections officials struggled to fill vacancies for election judges. Baltimore City in particular experienced a severe shortage of election judges for the primary election, which resulted in many of its polling places opening late. One difficulty the city encountered was a shortage of Republican judges; State law generally requires each polling place to have an equal number of judges from each of the two major political parties. In other polling places, election judges reported they were not adequately trained to manage technical problems with the electronic voting system and the e-pollbooks.

Prior to the general election, elections officials aggressively recruited additional judges, particularly young, technology-savvy individuals who likely would be more comfortable in monitoring and operating the electronic voting machines and the e-pollbooks. In addition, the chief election judges in all jurisdictions were retrained and in some jurisdictions all election judges were retrained. Election judges generally receive $100 to $150 for working on election days and often must work 15 or more hours. Chief judges receive slightly more pay, approximately $200 in most cases, for working on election days. Election judges also are paid to attend training sessions.

Electronic Voting System and Human Errors

During the administration of the September 12, 2006 primary election, technical problems primarily with the e-pollbooks coupled with instances of human error, caused confusion in several jurisdictions. In Montgomery County, for example, local election officials failed to distribute voter access cards to polling sites to activate the voting machines in the precincts. In other jurisdictions, election judges reported technical problems that resulted in a few voting machines freezing, many e-pollbooks crashing, and voter access cards working intermittently or not at all. In addition, some jurisdictions reported problems transmitting election results from precincts to the county election office.

During hearings to investigate the primary election failings, the State Elections Administrator and representatives from Diebold reported that the e-pollbook technical problems were caused by a special computer code, but that the code would be disabled prior to the November general election. On October 3, 2006, Diebold conducted a simulated day-long test election using the e-pollbooks and declared that all glitches had been repaired. In response to the testing, SBE decided to continue to use the e-pollbooks for the November 7 general election where reports indicate that they functioned without apparent problems.

Voter Identification and Proof of Citizenship

Voter identification and proof of citizenship requirements have been considered recently in a number of state legislatures and in Congress. State-enacted measures, most notably those requiring photo identification (photo-ID) in order to vote, also have led to litigation in several states. Proponents generally argue that the use of photo-ID and proof of citizenship increases the integrity of elections and helps to reduce fraud and voting by noncitizens or other ineligible voters. In contrast, opponents argue that otherwise eligible voters who cannot afford, or do not have access to, the required photo-ID or proof of citizenship are denied the right to vote.

Voter Identification

According to the Election Reform Information Project, a nonpartisan, nonadvocacy group, 24 states currently require or request some form of identification before a voter is issued a ballot. Five, Florida, Hawaii, Indiana, Louisiana, and South Dakota, exclusively require or request a photo-ID. Indiana and Louisiana make photo-ID cards available at no charge. States that "require" identification generally give a voter the option of casting a provisional ballot if the voter cannot show the required identification. However, before the provisional ballot can be counted, the voter's identity must be verified. Other states that "request" identification generally provide an alternative for a voter to affirm the voter's identity, such as signing an affidavit, and then allow the voter to vote a regular ballot.

In Maryland, a voter generally must only provide his or her name, date of birth, and address in order to vote a regular ballot, provided the person's name is found on the voter registration list. During the 2006 session, measures were introduced to tighten the State's identification requirements, the most restrictive of which would have required government-issued photo-ID of all voters (Senate Bill 803 and House Bill 1194). Two measures also provided for photo-ID voter cards to be available from the Motor Vehicle Administration at no charge for individuals at least 18 years old (Senate Bill 803 and Senate Bill 804). All these bills failed.

In the months leading up to the November 7, 2006 election, legal challenges were made to voter identification laws in a number of other states. For example, laws in Georgia and Missouri (both requiring photo-ID) were challenged in court by voters who lacked a photo-ID, and the laws were struck down on state constitutional grounds. Similar challenges were made to voter identification laws in Arizona and Indiana but were unsuccessful in stopping the implementation of the laws during the November 7, 2006 election. A challenge also was made to a voter identification law in Ohio, alleging, among other things, that the law was being applied inconsistently. Although a federal appeals court ruling kept the Ohio law in place for the November 7, 2006 election, a consent order entered into between the parties to the lawsuit allowed absentee ballots not meeting the law's requirements to be counted to account for confusion caused by the litigation. Some of these cases have been appealed and are not entirely resolved.

Of the states that currently do not require voter identification, at least 13 including Maryland considered voter identification legislation in 2005 and 2006. During the same period, legislation was introduced in five states that already had voter identification requirements that would have limited acceptable forms of identification to photo-ID.

In addition to state legislation, a bill creating a photo-ID requirement for federal elections was introduced in Congress (H.R. 4844) in March 2006, and passed by the House of Representatives in September 2006. The Senate did not act on the bill before its adjournment at the end of September. H.R. 4844 proposes to amend the Help America Vote Act to require voters in federal elections to present government-issued photo-ID in order to vote in the November 2008 general election and present government-issued photo-ID for which proof of citizenship was required as a condition of issuance in order to vote in the November 2010 general election and subsequent federal elections. The bill requires states to provide photo-ID, specifically for the purpose of voting, for individuals that do not otherwise have government-issued photo-ID and allow indigent individuals to obtain free photo-ID, the cost of which would be covered by federal funding. **Exhibit 4** describes the range of state voter identification laws around the country.

Proof of Citizenship

Arizona and New Hampshire have laws that require an individual to provide proof of citizenship in order to register to vote.

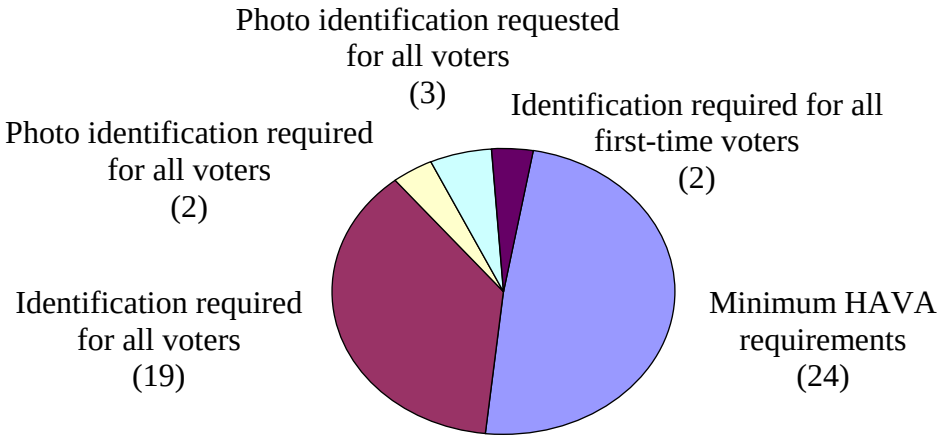
Arizona's requirement was enacted along with the state's voter identification requirements as part of a 2004 voter initiative generally aimed at reducing public benefits provided to illegal immigrants. The requirements were challenged in court by voters and Native American and other groups claiming the requirements disenfranchised voters. The case was eventually appealed to the U.S. Supreme Court. Although the court did not in its October 2006 ruling decide the validity of the law, it allowed the requirements to remain in effect for the November 7, 2006 general election while the case was resolved in the lower courts.

The New Hampshire proof of citizenship requirement is somewhat less stringent than Arizona's law, allowing voters to fulfill the requirement by signing and having notarized a citizenship affidavit as an alternative to providing a birth certificate, naturalization papers, or other citizenship documentation.

In Maryland, an individual may register to vote if the individual is a citizen of the United States; at least 18 years old or will be on or before the day of the next general or special election; and a resident of the State. Exceptions apply in cases where an individual has been convicted of certain crime or is under guardianship for mental disability. An individual is not required to provide proof of citizenship, though the individual signs the registration application under penalty of perjury. House Bill 1212 of 2006 would have required a prospective Maryland voter to submit along with a voter registration application a copy of a birth certificate, a current or expired passport, or copies of naturalization documents. Similar bills were introduced in 2004 and 2005. None passed.

In 2005 and 2006, roughly 13 states including Maryland considered legislation related to voter registration proof of citizenship. The congressional proposal, H.R. 4844, also would indirectly require proof of citizenship before voting by mandating, beginning with the November 2010 general election, that an individual present a government-issued photo-ID for which proof of citizenship was a condition of issuance before the individual would be allowed to cast a ballot.

Exhibit 4
State Voter Identification Laws



Minimum HAVA (Help America Vote Act) requirements (identification required of first time voters who registered by mail and did not provide identification with their registration application)	California, (District of Columbia), Idaho, Illinois, Iowa, Maine, **Maryland**, Massachusetts, Michigan, Minnesota, Mississippi, Nebraska, Nevada, New Hampshire, New Jersey, New York, North Carolina, Oklahoma, Oregon, Rhode Island, Utah, Vermont, West Virginia, Wisconsin, Wyoming
Identification required for all voters	Alabama, Alaska, Arizona, Arkansas, Colorado, Connecticut, Delaware, Georgia, Kentucky, Missouri, Montana, New Mexico, North Dakota, Ohio, South Carolina, Tennessee, Texas, Virginia, Washington
Photo identification required for all voters	Florida, Indiana
Photo identification requested for all voters	Hawaii, Louisiana, South Dakota
Identification required for all first-time voters	Kansas, Pennsylvania

Source: electionline.org

Local Government

State Aid to Local Governments

State aid to local governments is projected to increase by 14.6 percent in fiscal 2008, a record increase that will provide local governments with an additional $844.6 million to fund education, libraries, community colleges, and transportation projects.

Record State Funding Increase in Fiscal 2008

Local government programs and services will continue to benefit from large increases in State support in fiscal 2008. State aid to local governments is projected to total $6.6 billion in fiscal 2008, representing an $844.6 million or 14.6 percent increase over the prior year, the largest increase in recent years. Most of the increase is targeted to public schools, libraries, and community colleges. State aid for public schools will increase by $805.1 million or 18.0 percent; library aid will increase by $6.3 million or 11.3 percent; and community college aid will increase by $39.5 million or 19.2 percent. Local health departments will realize a slight increase of $2.0 million, while county and municipal governments will realize an $8.3 million or 0.8 percent decrease in State aid. **Exhibit 1** shows the change in State aid by governmental entity.

Exhibit 1
State Aid to Local Governments
($ in Millions)

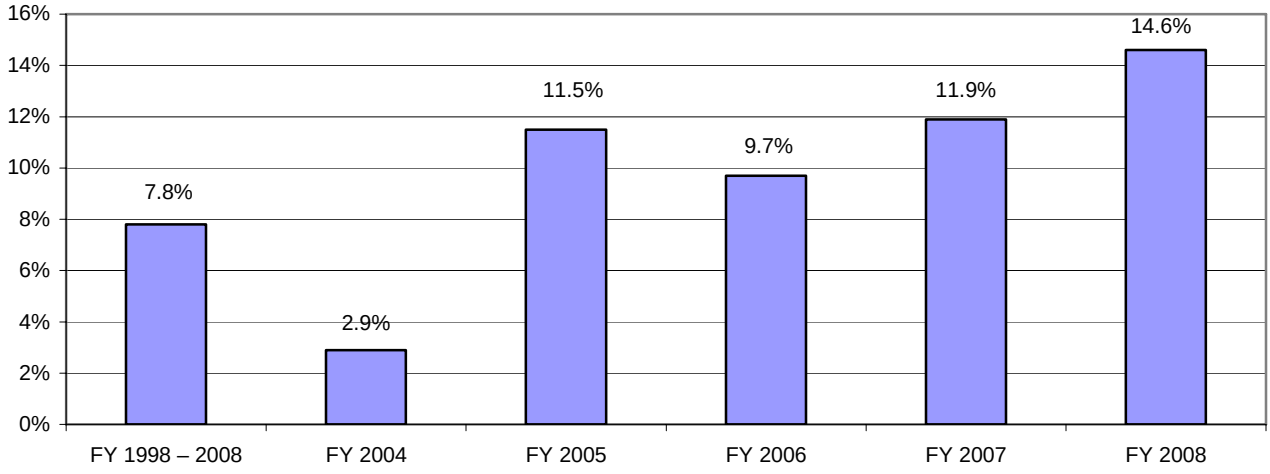
Governmental Entity	FY 2007	FY 2008	$ Difference	% Difference
Public Schools	$4,479.5	$5,284.7	$805.1	18.0%
County/Municipal	986.4	978.1	-8.3	-0.8
Community Colleges	205.9	245.4	39.5	19.2
Local Health	63.1	65.1	2.0	3.2
Libraries	55.4	61.7	6.3	11.3
Total	**$5,790.3**	**$6,634.9**	**$844.6**	**14.6%**

Source: Department of Legislative Services

State aid to local governments continues to be one of the largest and fastest growing components of the State budget. It currently accounts for 28 percent of total State expenditures (general and special funds) and 40 percent of State general fund expenditures. The 14.6 percent increase in State aid exceeds most other State programs. For example, funding for State agencies is projected to increase by 6.2 percent in fiscal 2008 with total State expenditures increasing by 5.0 percent. In addition, the projected increase in State aid in fiscal 2008 is higher than the annual

growth rate in prior years as shown in **Exhibit 2.** Since fiscal 1998, State aid has increased at an average annual rate of 7.8 percent.

Exhibit 2
Annual Growth in State Aid to Local Governments
General and Special Funds



Source: Department of Legislative Services

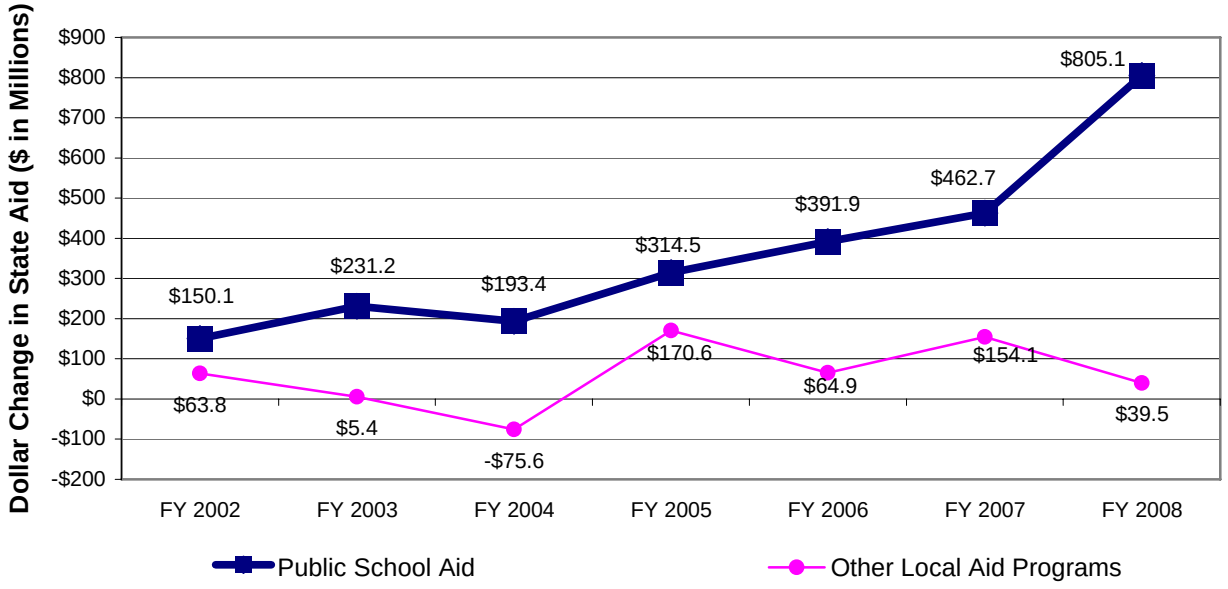
Public Schools Account for Most of the State Aid Increase

Almost 80 percent of State aid goes to support public schools. In fiscal 2008, public schools are projected to receive $5.3 billion in State funding, representing an $805.1 million or 18.0 percent increase over the prior year, the largest single year increase in State funding for public schools. In comparison, funding for public schools increased by $193.4 million in fiscal 2004, $314.5 million in fiscal 2005, $391.9 million in fiscal 2006, and $462.7 million in fiscal 2007.

The anticipated increase in State aid reflects the final implementation of Chapter 288 of 2002, commonly referred to as the "Thornton" legislation." Chapter 288 ● enhances per pupil State aid through the foundation program; ● enhances per pupil funding for three special needs populations; ● provides incentives to low wealth counties to contribute more than minimum required funding; and ● phases out certain education programs over a five-year period. Although the phase-in will be complete, the new formulas established in Chapter 288 will continue after fiscal 2008 and will be adjusted each year to reflect inflation and changes in enrollment and local wealth. Since Thornton's

enactment, State funding for public schools has increased by $2.4 billion. **Exhibit 3** compares the annual increase in State aid to public schools with other local aid programs.

Exhibit 3
Growth in Education Aid Exceeds Other Programs
General and Special Funds



Source: Department of Legislative Services

County and Municipal Governments May Receive Less State Aid

Approximately 15 percent of State aid is allocated to county and municipal governments to finance transportation, public safety, public works, and recreation projects. County and municipal governments will receive $978.1 million in fiscal 2008, representing an $8.3 million decrease over the prior year. While highway user revenues are projected to increase by $10.1 million and disparity grants are projected to increase by $5.1 million, Program Open Space funding is projected to decrease by $25.2 million. This decrease is due to the slow down in the real estate market which has resulted in a downturn in State transfer tax collections and a smaller prior year revenue over-attainment adjustment in fiscal 2008 than in fiscal 2007. **Exhibit 4** shows the change in State aid by major aid programs.

Exhibit 4
State Aid by Major Programs
Fiscal 2007-2008
($ in Millions)

	FY 2007	Baseline FY 2008	Difference	Percent Difference
Public Schools				
Foundation Program	$2,493.2	$2,796.8	$303.6	12.2%
Compensatory Aid	726.7	898.9	172.2	23.7%
Student Transportation	202.1	219.5	17.4	8.6%
Special Education – Formula	231.8	285.6	53.8	23.2%
Special Education – Nonpublic	116.5	124.0	7.5	6.4%
Limited English Proficiency	88.8	117.9	29.1	32.7%
Guaranteed Tax Base	60.5	82.9	22.4	37.1%
Geographic Cost Index	0.0	95.7	95.7	
Other Education Programs	113.8	96.9	-16.9	-14.9%
Subtotal Direct Aid	**$4,033.4**	**$4,718.2**	**$684.8**	**17.0%**
Retirement Payments	446.1	566.4	120.3	27.0%
Total Public School Aid	**$4,479.5**	**$5,284.7**	**$805.1**	**18.0%**
Libraries				
Library Aid Formula	$31.0	$33.7	$2.6	8.5%
State Library Network	15.2	16.3	1.0	6.9%
Subtotal Direct Aid	**$46.2**	**$49.9**	**$3.7**	**8.0%**
Retirement Payments	9.2	11.8	2.6	28.2%
Total Library Aid	**$55.4**	**$61.7**	**$6.3**	**11.3%**
Community Colleges				
Community College Formula	$164.8	$197.4	$32.6	19.8%
Other Programs	23.5	25.6	2.2	9.2%
Subtotal Direct Aid	**$188.3**	**$223.1**	**$34.8**	**18.5%**
Retirement Payments	17.6	22.3	4.7	26.8%
Total Community College Aid	**$205.9**	**$245.4**	**$39.5**	**19.2%**
Local Health Grants	**$63.1**	**$65.1**	**$2.0**	**3.2%**
County/Municipal Aid				
Transportation	$592.0	$602.1	$10.1	1.7%
Public Safety	104.3	105.7	1.3	1.3%
Program Open Space/Recreation	136.4	111.1	-25.2	-18.5%
Disparity Grant	109.5	114.6	5.1	4.7%
Utility Restructuring Grant	30.6	30.6	0.0	0.0%
Other Grants	11.7	11.8	0.1	0.5%
Subtotal Direct Aid	**$984.6**	**$975.9**	**-$8.6**	**-0.9%**
Retirement Payments	1.8	2.2	0.3	18.7%
Total County/Municipal Aid	**$986.4**	**$978.1**	**-$8.3**	**-0.8%**
Total State Aid	**$5,790.3**	**$6,634.9**	**$844.6**	**14.6%**

Source: Department of Legislative Services

Local Government

Local Tax and Salary Actions

A majority of county governments reduced local tax rates in fiscal 2007, while all county governments provided salary enhancements to their employees.

Local Government Tax Rates

Nineteen jurisdictions decreased various local tax rates in fiscal 2007; no county government increased its tax rates. As illustrated in **Exhibit 1**, more jurisdictions reduced property taxes in fiscal 2007 than in any of the four preceding fiscal years, primarily the result of the significant growth in property tax assessments in recent years that have pushed local revenues upward. Local income tax rates remained relatively constant for tax year 2007, with only one county lowering its rate. A comparison of local tax rates for fiscal 2006 and 2007 is provided in **Exhibit 2**.

Exhibit 1
Number of Counties Changing Local Tax Rates
Fiscal 2003-2007

	FY 2003		FY 2004		FY 2005		FY 2006		FY 2007	
	▲	▼	▲	▼	▲	▼	▲	▼	▲	▼
Real Property	1	5	4	1	2	6	0	13	0	17
Local Income	0	0	6	0	1	1	0	1	0	1
Recordation	2	0	5	0	1	0	1	0	0	0
Transfer	0	0	1	1	0	0	1	0	0	0
Admissions/Amusement	1	0	2	0	0	0	0	0	0	1
Lodging	0	0	1	0	5	0	5	0	0	0

Note: ▲ represents a tax rate increase. ▼ represents a tax rate decrease.

Source: Department of Legislative Services

Exhibit 2
Local Tax Rates – Fiscal 2006 and 2007

	Real Property		Local Income		Recordation		Transfer		Admissions/Amusement		Hotel/Motel	
County	**FY 2006**	**FY 2007**	**CY 2006**	**CY 2007**	**FY 2006**	**FY 2007**	**FY 2006**	**FY 2007**	**FY 2006**	**FY 2007**	**FY 2006**	**FY 2007**
Allegany	$1.0007	$0.9829	2.93%	2.93%	3.00	3.00	0.5%	0.5%	7.5%	7.5%	8.0%	8.0%
Anne Arundel	0.9310	0.9180	2.56%	2.56%	3.50	3.50	1.0%	1.0%	10.0%	10.0%	7.0%	7.0%
Baltimore City	2.3080	2.2880	3.05%	3.05%	5.00	5.00	1.5%	1.5%	10.0%	10.0%	7.5%	7.5%
Baltimore	1.1150	1.1100	2.83%	2.83%	2.50	2.50	1.5%	1.5%	10.0%	10.0%	8.0%	8.0%
Calvert	0.8920	0.8920	2.80%	2.80%	5.00	5.00	0.0%	0.0%	10.0%	1.0%	5.0%	5.0%
Caroline	0.9100	0.8700	2.63%	2.63%	5.00	5.00	0.5%	0.5%	0.0%	0.0%	5.0%	5.0%
Carroll	1.0480	1.0480	3.05%	3.05%	5.00	5.00	0.0%	0.0%	10.0%	10.0%	5.0%	5.0%
Cecil	0.9800	0.9600	2.80%	2.80%	4.10	4.10	0.0%	0.0%	6.0%	6.0%	5.0%	5.0%
Charles	1.0260	1.0260	2.90%	2.90%	5.00	5.00	0.0%	0.0%	10.0%	10.0%	5.0%	5.0%
Dorchester	0.9200	0.8960	2.62%	2.62%	5.00	5.00	0.75%	0.75%	0.5%	0.5%	5.0%	5.0%
Frederick	1.1350	1.0640	2.96%	2.96%	5.00	5.00	0.0%	0.0%	5.0%	5.0%	3.0%	3.0%
Garrett	1.0000	1.0000	2.65%	2.65%	3.50	3.50	1.0%	1.0%	4.5%	4.5%	5.0%	5.0%
Harford	1.0820	1.0820	3.06%	3.06%	3.30	3.30	1.0%	1.0%	5.0%	5.0%	0.0%	0.0%
Howard	1.1695	1.1395	3.20%	3.20%	2.50	2.50	1.0%	1.0%	7.5%	7.5%	5.0%	5.0%
Kent	0.9920	0.9720	2.85%	2.85%	3.30	3.30	0.5%	0.5%	4.5%	4.5%	5.0%	5.0%
Montgomery	0.9670	0.9160	3.20%	3.20%	3.45	3.45	1.0%	1.0%	7.0%	7.0%	7.0%	7.0%
Prince George's	1.3190	1.3190	3.20%	3.10%	2.20	2.20	1.4%	1.4%	10.0%	10.0%	5.0%	5.0%
Queen Anne's	0.8700	0.8000	2.85%	2.85%	3.30	3.30	0.5%	0.5%	5.0%	5.0%	5.0%	5.0%
St. Mary's	0.8720	0.8570	3.00%	3.00%	4.00	4.00	1.0%	1.0%	2.0%	2.0%	5.0%	5.0%
Somerset	0.9900	0.9400	3.15%	3.15%	3.30	3.30	0.0%	0.0%	4.0%	4.0%	5.0%	5.0%
Talbot	0.5200	0.5000	2.25%	2.25%	3.30	3.30	1.0%	1.0%	5.0%	5.0%	4.0%	4.0%
Washington	0.9480	0.9480	2.80%	2.80%	3.80	3.80	0.5%	0.5%	5.0%	5.0%	6.0%	6.0%
Wicomico	0.9930	0.9420	3.10%	3.10%	3.50	3.50	0.0%	0.0%	6.0%	6.0%	6.0%	6.0%
Worcester	0.7300	0.7000	1.25%	1.25%	3.30	3.30	0.5%	0.5%	3.0%	3.0%	4.0%	4.0%

Notes: The real property tax rates shown for Charles, Frederick, Howard, Montgomery, and Prince George's counties include special tax rates. Real property tax is per $100 of assessed value. Income tax is a percentage of taxable income. Recordation tax is per $500 of transaction.

Source: Department of Legislative Services

Property Tax Rates

For fiscal 2007, 17 counties decreased their real property tax rates, while no county increased its real property tax rate. The only counties that left their real property tax rate unchanged were Calvert, Carroll, Charles, Garrett, Harford, Prince George's, and Washington. Real property tax rates range from $0.50 per $100 of assessed value in Talbot County to $2.288 per $100 of assessed value in Baltimore City.

Local Income Tax Rates

Prince George's County was the only jurisdiction to alter its local income tax rate for calendar 2007, decreasing it from 3.20 to 3.10 percent. Local income tax rates range from 1.25 percent in Worcester County to 3.20 percent in Howard and Montgomery counties.

Recordation Tax Rates

No county changed its recordation tax rate for fiscal 2007. The range for recordation tax rates is $2.20 per $500 of transaction in Prince George's County to $5.00 per $500 of transaction in seven jurisdictions – Baltimore City and Calvert, Caroline, Carroll, Charles, Dorchester, and Frederick counties.

Transfer Tax Rates

No county changed its transfer tax rate for fiscal 2007. Local transfer tax rates range from 0.5 percent in six jurisdictions (Allegany, Caroline, Kent, Queen Anne's, Washington, and Worcester counties) to 1.5 percent in Baltimore City and Baltimore County. Seven counties (Calvert, Carroll, Cecil, Charles, Frederick, Somerset, and Wicomico) do not impose a transfer tax on property transfers.

Admissions and Amusement Tax Rates

One county changed its admissions and amusement tax rate for fiscal 2007 – Calvert County lowered it from 10.0 to 1.0 percent. Admissions and amusement tax rates range from 0.5 percent in Dorchester County to 10.0 percent in six jurisdictions – Baltimore City and Anne Arundel, Baltimore, Carroll, Charles, and Prince George's counties. Caroline County is the only jurisdiction that does not impose an admissions and amusement tax rate.

Hotel and Motel Tax Rates

No county changed its hotel and motel tax rate for fiscal 2007. Hotel and motel tax rates range from 3.0 percent in Frederick County to 8.0 percent in Allegany and Baltimore counties. Harford County is the only jurisdiction that does not impose a hotel and motel tax.

Tax Limitation Measures

Five charter counties (Anne Arundel, Montgomery, Prince George's, Talbot, and Wicomico) have amended their charters to limit property tax rates or revenues. In Anne Arundel County, the total annual increase in property tax revenues is limited to the lesser of 4.5 percent or the increase in the consumer price index. In Montgomery County, the growth in property tax revenues is limited to the increase in the consumer price index; however, this limitation does not apply to new construction. In addition, the limitation can be overridden by an affirmative vote of seven of the nine county council members. In Prince George's County, the general property tax rate is capped at $0.96 per $100 of assessed value. Special taxing districts, such as the Maryland-National Capital Park and Planning Commission, are not included under the tax cap. In Talbot and Wicomico counties, the total annual increase in property tax revenues is limited to the lesser of 2 percent or the increase in the consumer price index.

County Salary Actions

An analysis of local government salary actions for county employees and teachers indicates that all Maryland jurisdictions are providing salary enhancements during improved economic times. **Exhibit 3** shows local salary action for fiscal 2007. All 23 counties and Baltimore City provided their employees with a cost-of-living adjustment (COLA), while 21 counties provided step increases. Additionally, all 24 boards of education provided COLAs and step increases for their teachers. A majority of county governments and local boards of education provided at least a 4 percent COLA (including any market adjustments) to their employees in fiscal 2007. For comparison purposes, the State provided its employees with a 2.15 percent average COLA.

Exhibit 3
Local Government Salary Actions in Fiscal 2007

	County Government Generally		Board of Education Teachers	
County	**COLA**	**Step**	**COLA**	**Step**
Allegany[1]	3.00%	Yes	7.50%	Yes
Anne Arundel[2]	3.00%	Yes	6.00%	Yes
Baltimore City[3]	Varies	Yes	5.00%	Yes
Baltimore[4]	3.00%	Yes	5.00%	Yes
Calvert	4.00%	Yes	3.70%	Yes
Caroline[5]	7.00%	Yes	4.00%	Yes
Carroll	2.00%	Yes	3.00%	Yes
Cecil	4.00%	Yes	4.65%	Yes
Charles[6]	4.50%	Yes	5.00%	Yes
Dorchester[7]	2.50%	Yes	3.50%	Yes
Frederick	2.00%	Yes	4.50%	Yes
Garrett[8]	3.00%	Yes	7.50%	Yes
Harford[9]	3.00%	Yes	3.00%	Yes
Howard	3.00%	Yes	3.50%	Yes
Kent	4.00%	No	4.00%	Yes
Montgomery[10]	4.00%	Yes	4.00%	Yes
Prince George's[11]	2.50%	Yes	5.00%	Yes
Queen Anne's	3.25%	Yes	3.25%	Yes
St. Mary's	4.00%	Yes	3.00%	Yes
Somerset[12]	1.50%	Yes	4.00%	Yes
Talbot	5.00%	Yes	4.00%	Yes
Washington[13]	4.50%	No	4.00%	Yes
Wicomico	8.00%	No	6.00%	Yes
Worcester	4.00%	Yes	4.00%	Yes
Number Granting	24	21	24	24

Comments

[1] In Allegany County, board of education bargaining units, other than teachers, received a 5% cost-of-living adjustment (COLA).

[2] In Anne Arundel County, labor, maintenance, and clerical workers received a COLA of 2%. County school administrators received a 6% COLA; however, board of education employees represented by AFSCME received a 3% COLA, and board of education secretaries, teacher assistants, and technicians did not receive a COLA in fiscal 2007.

[3] In Baltimore City, effective January 1, 2007, firefighters and police officers will receive a 3% COLA, and managerial and professional employees will receive a 2% COLA. Employees represented by the City Union of Baltimore received a 3% COLA (effective July 1, 2006) as well as an adjustment of $0.17 per hour (effective January 1, 2007). Employees represented by AFSCME received a 4% COLA (3% effective July 1, 2006 and 1% effective January 1, 2007).

[4] In Baltimore County, police officers and firefighters received a 4% COLA. Board of education bargaining units, other than teachers, received a 3% COLA.

[5] In Caroline County, sworn police officers and public safety employees received a 3% COLA.

[6] In addition to the COLA, Charles County employees received a 5% market adjustment to their salary.

[7] In Dorchester County, school administrators received a 4% COLA and school board support staff received a 2% COLA or $500.

[8] Garrett County roads employees received an adjustment of $0.50 per hour.

[9] Harford County teachers received a 4% market adjustment to their salaries in addition to the 3% COLA.

[10] Of the 4% COLA for Montgomery County employees, 3% was effective July 9, 2006 and 1% will be effective January 1, 2007. Firefighters (IAFF) and Fire Management employees received a 5% COLA (4% effective July 9, 2006 and 1% effective January 7, 2007).

[11] In Prince George's County, correctional officers, police officers (FOP), sheriff's officials and deputies, and fire officials and fire fighters received a 3% COLA.

[12] In addition to the 1.5% COLA in Somerset County, county employees also received a 4% salary adjustment reflecting implementation of Phase III (final) of the county's special salary scale adjustment plan. Somerset County school administrators received a 5% COLA and board of education classified employees received a 1% COLA.

[13] In Washington County, school administrators received a 6% COLA but did not receive merit/step increases. Other board of education classified employees (excluding teachers) did not receive a COLA, but did receive merit/step increases.

Source: Department of Legislative Services

Local Government

Property Taxation in Maryland

Property assessments in Maryland are projected to cool down over the next couple of years after reaching record levels. However, due to the State's triennial assessment process, local governments should continue to realize sizeable growth in local property tax revenues for the near future.

Importance of the Property Tax

Local governments collected $5.1 billion in property taxes in fiscal 2005. The property tax is one of the three major revenue sources for county governments, accounting for 25 percent of total revenues. It is the second largest revenue source for municipal governments, accounting for 31 percent of total revenues. As a relatively stable and predictable revenue source for local governments, and due to the sizeable growth in property assessments in recent years, local property tax collections should remain strong for the near future.

State Role in Property Assessments

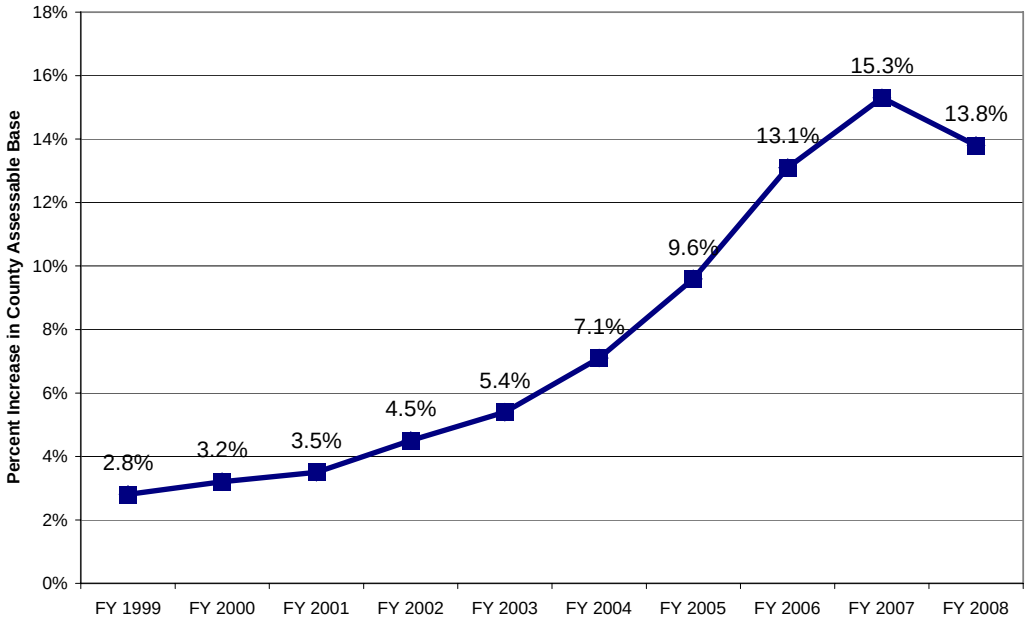
A well-defined statutory relationship exists between the State and local governments in the administration of the Maryland property tax system. While property tax revenues are a relatively minor State revenue source, the State has assumed responsibility for the valuation and assessment of property. Local governments, on the other hand, levy and collect property taxes. The State takeover of the valuation and assessment function was implemented to provide uniform and equitable assessments of property throughout the State.

Real property is valued and assessed once every three years with assessors physically inspecting each property. No adjustments are made in the interim, except in certain cases. Any increase in property values is phased in over a three-year period; however, any decrease is recognized immediately for assessment purposes. Because only one-third of the properties in each county are reassessed in a given year, local governments can rely on prior years' growth in the other two-thirds of the base to reduce the full impact of any one-year decline or slow down in assessable base. Conversely, when market values are rising, assessed values lag behind the current market, resulting in a slower annual growth in the assessable base than the market may indicate. The triennial process and its three-year phase-in schedule provide some cushion for taxpayers during periods of dramatically increasing property values and for local governments during a downturn in the housing market.

Property Assessments

Property assessments in Maryland are projected to cool down over the next couple of years after reaching record levels. Over the last six years, the real estate market in Maryland has soared, contributing to record increases in property assessments. The average three-year increase in the full cash value of property undergoing reassessment has climbed from 10 percent in 2001 to 60 percent in 2006, the largest increase in Maryland since the beginning of the triennial reassessments in 1980. The increase in 2007 is projected to be lower than the prior year's growth rate but still should remain relatively strong. Under the State's triennial assessment process, the assessable base used for local tax purposes in fiscal 2008 will include properties reassessed in 2004, 2005, and 2006. Two of the three years realized record assessment increases. **Exhibit 1** shows the growth in county assessable base that is used for property tax purposes.

Exhibit 1
Assessable Base Growth Expected to Slow Down
Fiscal 1999-2008



Source: Department of Legislative Services

Property Tax Relief Measures

The constant increase in property assessments throughout Maryland has led the State, and in some instances the voters, to take action to curtail the rise in property taxes. Three primary approaches are used in Maryland to provide property tax relief to homeowners: (1) the homestead property tax credit program that limits annual assessment increases to all homeowners regardless of income; (2) the homeowners' (circuit breaker) tax credit program and the renters' tax credit program that provide credits for certain individuals who qualify based on a sliding scale of property tax liability and income; and (3) property tax limitation measures that either limit the property tax rate that can be imposed by the county council or the property tax revenue that can be collected. All three approaches have significantly impacted either State or local revenues, and members of the General Assembly have repeatedly introduced legislation addressing these property tax relief measures.

The homestead property tax credit program has provided significant local property tax relief in recent years by moderating the growth in property assessments. The State requires the cap on assessment increases to be set at 10 percent for State property tax purposes; however, local governments have the authority to lower the rate. Unlike other statewide mandated tax credit programs, the costs of the homestead property tax credit program are incurred fully by the local governments.

In fiscal 2007, 15 of the 24 local jurisdictions have assessment caps below 10 percent. In addition, 65 of the State's 156 municipal corporations have also lowered assessment caps below 10 percent. The foregone revenue for county governments due to the assessment caps is estimated at $622.4 million in fiscal 2007 and $902.2 million in fiscal 2008.

The extent to which the program may actually restrict the ability of a local government to raise property tax revenues depends on the locality's need for revenues from the property tax and other legal and practical limitations. For example, a county impacted by a charter-imposed property tax limitation measure would presumably reduce tax rates to offset the impact of rising assessments in the absence of the homestead credit.

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Local Government

2007 Legislative Agenda – Maryland Municipal League

The Maryland Municipal League has identified several initiatives for its 2007 legislative agenda: (1) increased State aid for police protection; (2) local government authorization to purchase street lights; and (3) municipal opt-out electrical aggregation.

Increased State Aid for Police Protection

The Maryland Municipal League (MML) supports legislation to increase the municipal sworn officer allocation used in the calculation of the police aid formula. Counties and qualifying municipalities receive State funding for police protection through a program commonly known as the police aid formula. In fiscal 2008, State funding for police aid is projected to total $66.2 million, with municipalities projected to receive 18.5 percent or $12.2 million. One component of the police aid formula is based on the number of municipal sworn officers: each qualifying municipality receives $1,800 for every sworn police officer employed on a full-time basis. This allocation was last changed in 1999, when it increased from $1,200 to $1,800. House Bill 1020 of 2006 would have increased the municipal sworn officer allocation from $1,800 to $2,000 per full-time sworn police officer but was not adopted.

Local Government Authorization to Purchase Street Lights

MML supports legislation that • requires utilities to give local governments the option of purchasing, at fully depreciated fair market cost, the streetlights located on wooden poles within its jurisdiction; and • exempts municipalities that maintain streetlights, along with municipal maintenance contractors, from current restrictions allowing only electricity providers to come within 10 feet of overhead power lines. Similar legislation was introduced at the 2006 session (Senate Bill 296 and House Bill 1657) but was not approved.

According to MML, maintenance services are competitive for metered streetlights on metal poles without overhead high voltage lines attached, thus allowing a municipality to save money on maintenance costs, select from a wide array of choices for lamp and luminaire, and facilitate potentially faster response to reports of streetlight outages. MML further advises that because of distance restrictions regarding high voltage lines, this option is not currently available in the case of streetlights on wooden poles with overhead high voltage lines attached.

A high voltage line has more than 750 volts and is installed above ground. Generally, until determined otherwise by the owner or operator of the line, an installed above ground electric line is presumed to be high voltage and energized. Among other things, whenever a person erecting,

operating, storing, transporting, or otherwise handling any object, including equipment, machinery, material, tools, or other apparatus, comes within 10 feet of a high voltage line, the person responsible for performing the activity must:

- promptly notify the owner or operator of the high voltage line of the activity to be performed;
- make any appropriate arrangements with the owner or operator of the high voltage line to carry out any required safety measures; and
- with any necessary cooperation from and subject to any necessary agreement with the owner or operator of the high voltage line, ensure that the line has been effectively guarded against accidental contact.

The provisions of law regarding high voltage lines generally do not apply to • maintenance or repair of an electric power plant or system owned by a private company or corporation for its own use; or • construction, maintenance, or operation of a high voltage line and its support structures and associated equipment by a regulated public utility or its agents or contractors.

Electric Industry – Local Aggregation

MML seeks approval of legislation that allows a municipality to serve as an aggregator for its residents and link with other municipalities with the aim of providing residential electricity customers a better electricity rate. Under current law, counties and municipalities may not act as aggregators for electricity services unless the Public Service Commission determines there is insufficient competition within their boundaries. Legislation was introduced at the 2006 session (Senate Bill 1092 and House Bill 1731) that would have authorized a county or municipality or groups thereof to act as an aggregator for the purpose of purchasing electricity on behalf of customers under specified conditions. Neither of the bills was approved.

Local Government

2007 Legislative Agenda – Maryland Association of Counties

Maintaining full funding of State aid programs and increasing State support for public school construction remain important issues for the Maryland Association of Counties.

Each year, the Maryland Association of Counties (MACo) selects up to four issues as its legislative initiatives for the upcoming session. Since 2006 is an election year for nearly all counties, MACo has decided to defer adoption of its formal legislative slate until the newly elected officials take office. However, even without a formally adopted slate of initiatives, certain major, ongoing issues will continue to be at the forefront of county concerns, including protecting State assistance and increased State funding for public school construction.

Protecting State Assistance

State aid is the largest revenue source for most county governments in Maryland, accounting for 26.5 percent of total county revenues. In five counties (Anne Arundel, Baltimore, Queen Anne's, Talbot, and Worcester), State aid is the second largest revenue source after property taxes. In Howard and Montgomery counties, State aid is the third largest revenue source after both property and income taxes. Due to State aid's significance to county operating budgets, MACo supports plans to fully fund State aid programs and reinstate State aid where it has been abridged in prior years.

Year-over-year decreases in general fund revenues in fiscal 2002 and 2003 created a significant imbalance between available revenues and spending requirements. This structural problem was exacerbated by the enactment of the Bridge to Excellence in Public Schools Act (Chapter 288 of 2002), also known as the "Thornton Legislation," which required a significant funding enhancement for public schools without the establishment of a new revenue source. Since fiscal 2003, the State budget has funded most of the education aid increases required by the legislation. However, between fiscal 2004 and 2006, around $505.7 million in State aid to local governments was either reduced or transferred to the State's general fund to close projected budgetary shortfalls. Most of these funds were earmarked for counties and municipalities, with two State aid programs, local highway user revenues and Program Open Space, accounting for over 70 percent of the total reductions. With the exception of the police aid formula, none of the reductions to mandated State aid programs were made permanent by changing the underlying statute governing the program.

Beginning in fiscal 2007, local highway and land preservation grants were restored to statutory funding levels. In fiscal 2008, county and municipal governments are projected to receive almost $1 billion in State aid, a $266.9 million increase over fiscal 2002, the year prior to

the State's fiscal crisis. In total, State aid to local governments (including State funding for public schools, libraries, community colleges, and local health departments) has increased by $2.8 billion since fiscal 2002.

School Construction and Renovation Funding

The Task Force to Study Public School Facilities, established in 2002 by the Bridge to Excellence in Public Schools Act, undertook an assessment of the current conditions of the State's existing public schools that indicated $3.9 billion is needed to bring existing public schools up to standards. In 2004, the General Assembly approved legislation specifying that $2 billion in State funding be provided for public school construction projects by fiscal 2013. The goal envisions $1.85 billion in local government spending during the same period.

To meet this funding level, approximately $250 million in State funds will be needed annually. After relatively low funding in fiscal 2004 and 2005, the level of funding in fiscal 2006 and 2007 has met or exceeded the goal established in the 2004 legislation. The State authorized a total of $975.3 million for school construction projects from fiscal 2003 to 2007. The fiscal 2007 total of $322.7 million is the highest funding level since the public school construction program began in 1971. MACo requests that the State continue to make State funding for public school construction a high priority for the Administration and the General Assembly.

Local Government

Development Charges and Adequate Public Facilities Ordinances

Local governments throughout the nation are increasingly turning to development charges to finance the expansion or construction of new public facilities required by residential development. Currently, 16 counties in Maryland impose either a development impact fee or excise tax, and 13 counties have adopted adequate public facilities ordinances.

Reasons for Local Impact Fees and Excise Taxes

Development impact fees and excise taxes, commonly referred to as development charges, enable local governments to collect revenue from builders for public facilities required by new development. As a result of development charges, local governments are able to shift the costs of new public facilities from existing taxpayers to individuals responsible for the development. In many situations, the use of development charges could eliminate the need for countywide tax increases. Another benefit is that local officials can collect the needed revenue for the expansion or construction of new public facilities prior to the construction of new development. In this manner, payment of an impact fee or excise tax generally is required prior to the issuance of a building permit or approval of a subdivision plat.

Local governments in Maryland must obtain explicit authority from the General Assembly before imposing a development impact fee or excise tax. One exception to this restriction applies to code home rule counties, which have already received authority from the General Assembly to impose such charges. Sixteen counties currently impose either a development impact fee or excise tax which generated approximately $134.6 million in fiscal 2006. The primary services funded by these charges include public school construction, transportation, public safety, parks and recreation, and water/sewer utilities. **Exhibit 1** shows the counties that impose either a development impact fee or excise tax and the revenues generated by such charges.

Differences Between Impact Fees and Excise Taxes

A development impact fee involves a complex process that requires a jurisdiction to justify the fee amount in relation to the potential impact that the new development would have on the jurisdiction. Before imposing an impact fee, a jurisdiction must conduct a study that measures the impact that the new development will have on various public services. In addition, there must be a nexus between the impact of the new development and the fee amount, and there must be a geographic nexus between where the fee is collected and where the funds are spent. A jurisdiction cannot collect the impact fee in one part of the county and spend the funds elsewhere.

Exhibit 1

Maryland Counties with Development Impact Fees or Excise Taxes

County	Type	FY 2007 Rate Per Dwelling[1]	FY 2006 Revenues
Anne Arundel	Impact Fee	$4,781	$11,127,876
Calvert	Excise Tax	12,950	5,302,300
Caroline[2]	Excise Tax	5,000	966,402
Carroll	Impact Fee	6,836	3,436,236
Charles	Excise Tax	10,859	8,649,532
Dorchester[3]	Excise Tax	3,671	1,265,851
Frederick[4]	Both	11,595	15,064,080
Harford	Impact Fee	7,442	3,400,200
Howard[5]	Excise Tax	See note	13,605,188
Montgomery[6]	Excise Tax	14,283	13,212,000
Prince George's[7]	Excise Tax	19,361	43,102,486
Queen Anne's	Impact Fee	6,606	2,474,740
St. Mary's	Impact Fee	4,500	3,789,525
Talbot[8]	Impact Fee	5,347	1,378,430
Washington	Excise Tax	13,000	7,745,961
Wicomico[9]	Impact Fee	5,231	96,000
Total			**$134,616,807**

[1] Rates listed are generally those applicable to single-family detached dwellings.
[2] A $750 development excise tax for agricultural land preservation is also imposed on single-family residential lots created by subdivision in a "rural district."
[3] A slightly higher rate applies outside of the Cambridge and Hurlock areas.
[4] Roads tax ranges from $0.10/sq.ft to $0.25/sq.ft.
[5] Roads tax is $0.80/sq.ft. School surcharge is $1.07/sq.ft.
[6] Excise tax represents $5,819 for transportation and $8,464 for schools. The school excise tax is increased by $1 for each square foot between 4,500 and 8,500 gross square feet. Different transportation rates apply in the Metro Station and Clarksburg areas.
[7] Excise tax represents $13,151 for school facilities and $6,210 for public safety. A lower school facilities rate ($7,671) applies inside the beltway and a lower public safety rate ($2,070) applies inside the "developed tier" as defined in the 2002 Prince George's County Approved General Plan.
[8] A lower rate ($4,620) applies to "in-town" development.
[9] Approximate revenue figure. Impact fee was in effect for less than one month at the end of fiscal 2006.

Source: Department of Legislative Services

By contrast, a development excise tax is a more straightforward approach in financing capital projects resulting from new development. A jurisdiction can set the tax amount at any reasonable level, and there does not have to be a geographic nexus between where the fee is collected and where it is spent. The excise tax can be imposed on activities and in amounts authorized by the General Assembly.

Adequate Public Facilities Ordinances

In addition to development charges, county and municipal governments with planning and zoning authority may adopt an adequate public facilities ordinance (APFO). An APFO establishes capacity standards for public schools; roadways; water/sewer utilities; police, fire, and rescue services; storm drainage; and utilities. If new development is projected to exceed capacity standards in an area, the developer may be required to make contributions for capital improvements, such as building additional classrooms for a public school or constructing new roadways, as a condition of moving the development forward. Another option would be for the county or municipality to delay the development until the respective government provides the capital improvements. APFOs have been adopted in 13 counties, with several municipalities adopting their own ordinances. **Exhibit 2** lists the counties that have adopted APFOs.

Exhibit 2
Counties with Adequate Public Facilities Ordinances

Anne Arundel	Carroll	Harford	Prince George's	Washington
Baltimore	Charles	Howard	Queen Anne's	
Calvert	Frederick	Montgomery	St. Mary's	

Source: Maryland Department of Planning, Maryland Association of Counties

Senate Bill 1024 and House Bill 1683 of 2006 (neither of which passed) would have required a municipality to be governed by the county APFO until the municipality adopts an ordinance that meets minimum specified standards and requirements. Specified standards and requirements included provisions for the impact of any development or growth within the municipality that affects public schools, libraries, and roadways located in the county. This legislation addressed the concerns that county governments had with developers circumventing county APFO requirements by locating proposed developments in municipalities without or with less stringent APFO requirements.

Local Government

Eminent Domain – Developments Since the *Kelo* Decision

The Maryland General Assembly and other state legislatures, the U.S. Congress, state courts, and the electorate continue to grapple with issues related to eminent domain as a result of the 2005 U.S. Supreme Court decision in *Kelo v. City of New London, Connecticut*.

Background

The heated reaction to the U.S. Supreme Court's ruling last year in the case of *Kelo v. City of New London, Connecticut* continued throughout 2006. In the June 2005 case, the court ruled that the city of New London was authorized to exercise its power of eminent domain under a state law to require several homeowners to vacate their properties to make way for a privately owned mixed use development. The court maintained that, even though all the property at issue was not planned to be used by the general public, the city's development plan for the area, which was designed to bring comprehensive and appreciable economic benefits including new jobs and increased tax revenue, had sufficient "public purpose" so as not to constitute a violation of the Takings Clause under the Fifth Amendment to the U. S. Constitution.

Despite finding in favor of the city in the case, the court emphasized that "nothing in our opinion precludes any State from placing further restrictions on its exercise of the takings power." Many state legislatures that met soon after the ruling, as well as the U. S. Congress, considered several legislative proposals in direct response to the decision. Most state legislatures meeting this year continued the contentious debate resulting in outcomes that, with some exceptions, generally provide more protection for property owners' rights.

In Maryland, the 2006 General Assembly passed none of the more than 40 different bills relating to eminent domain that were introduced. These measures included constitutional amendments and recommendations by a legislative-created task force on business owner compensation in condemnation proceedings that was established prior to the publication of the *Kelo* decision.

Actions by Other State Legislatures

According to the National Conference of State Legislatures (NCSL), eminent domain legislation in response to the *Kelo* decision was considered in each of the 44 states that went into session in 2006. From January 2006 to date, legislatures have passed eminent domain bills in 28 of those states: in 24 states, the legislation was enacted; in 2 states, the measures passed were

constitutional amendments that went on the November ballot for voter approval; and in 2 states, the legislation was vetoed by the Governor.

NCSL has identified the following seven categories of state legislation that deal with eminent domain:

- prohibiting eminent domain for economic development purposes, to generate tax revenue, or to transfer private property to another private entity;
- defining what constitutes "public use," generally the possession, occupation, or enjoyment of the property by the public at large, public agencies, or public utilities;
- restricting eminent domain to blighted properties and redefining what constitutes blight to emphasize detriment to public health or safety;
- requiring greater public notice, more public hearings, negotiation in good faith with landowners, and approval by elected governing bodies;
- requiring compensation greater than fair market value where property condemned is the principal residence;
- placing a moratorium on eminent domain for economic development; and
- establishing legislative study committees or stakeholder task forces to study and report back to the legislature with findings.

Ohio High Court Ruling

The Ohio Supreme Court, considering the first challenge of property rights laws to reach a state high court since the *Kelo* decision, ruled unanimously in July that a Cincinnati area municipality could not take private property by the power of eminent domain for a $125 million privately developed project of offices, shops, and restaurants. The court found that economic development alone is not a sufficient reason under the state constitution to justify taking private residences. Citing the need to apply a heightened scrutiny standard in cases involving private property rights, the court also ruled that targeting property because it is in a "deteriorating area" is unconstitutional because that term is too vague. Several property rights advocates now maintain that this case will carry enormous precedential weight as many state supreme courts have not considered these issues in decades.

State Ballot Questions and "*Kelo* Plus"

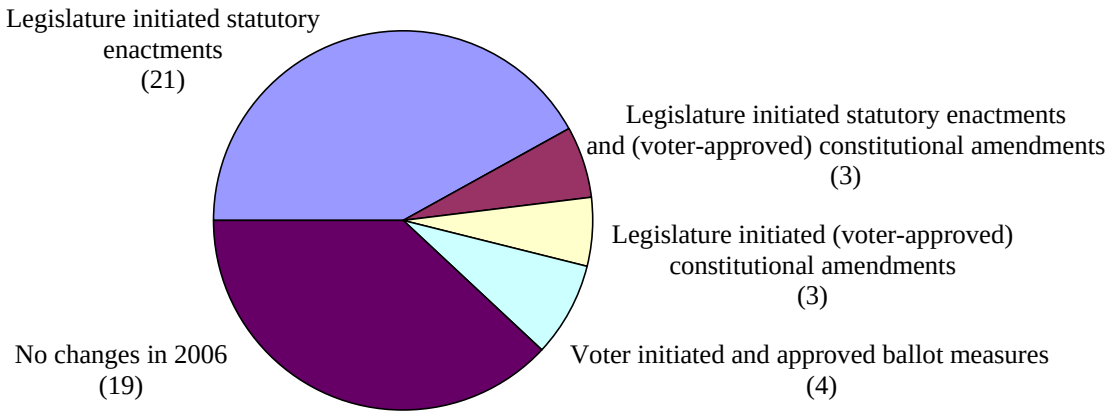
According to NCSL, 13 states had ballot questions this year dealing with property owners' rights. Seven of these ballot questions were citizen initiated while six were referred by state legislatures.

Nine of the 13 states had ballot questions concerning eminent domain in direct response to the *Kelo* decision. All these proposals basically prohibit the use of eminent domain for economic development; taking property for a public use, *e.g.*, highways or schools, is still allowed under these measures. One of these ballot questions (Louisiana) was passed in the September primary election while the ballot questions in the other eight states (Florida, Georgia, Michigan, Nevada, New Hampshire, North Dakota, Oregon, and South Carolina) passed in the November general election.

Three other states (Arizona, California, and Idaho) had November ballot questions that combined the issue of eminent domain with the issue of regulatory takings, so-called "*Kelo* Plus" measures. These initiatives, in addition to prohibiting the use of eminent domain for economic development purposes, require the government to pay for any reduction in property value caused by a government regulation or zoning restriction, not just the physical taking of the property. This combined question passed only in one state (Arizona). Interestingly, Nevada's eminent domain initiative was originally proposed as a combined eminent domain/regulatory takings question, but the state supreme court found that the combined question violated the state's single subject rule for initiatives. Rather than blocking the question from the ballot, the court removed the regulatory takings portion of the question and left only the eminent domain portion on the ballot. There is some speculation that the "*Kelo* Plus" measure that passed in Arizona may face a similar objection.

One state (Washington) had a November ballot question that dealt only with regulatory takings; that proposal failed along with most of the "*Kelo* Plus" measures. Some observers have suggested that regulatory takings protection advocates have been trying to take advantage of the post-*Kelo* momentum but have failed to acknowledge that this issue might be seen as distinct from and more controversial than actual takings by eminent domain. **Exhibit 1** provides an overview of actual and proposed 2006 state law changes to eminent domain laws.

Exhibit 1
Eminent Domain: 2006 State Law Changes



Legislature initiated statutory enactments	Alabama, Alaska, Colorado, Idaho[1], Illinois, Indiana, Iowa[2], Kansas, Kentucky, Maine, Minnesota, Missouri, Nebraska, North Carolina, Pennsylvania, South Dakota, Tennessee, Utah, Vermont, West Virginia, Wisconsin
Legislature initiated statutory enactments and (voter-approved) constitutional amendments	Florida, Georgia, New Hampshire
Legislature initiated (voter-approved) constitutional amendments	Louisiana, Michigan, South Carolina
Voter initiated and approved ballot measures (statutory change or constitutional amendment)	Arizona[3], Nevada (state law requires approval again in 2008 before taking effect), North Dakota, Oregon
No changes in 2006	Arkansas, California[1], Connecticut, Delaware, Hawaii, Maryland, Massachusetts, Mississippi, Montana, New Jersey, New Mexico[3], New York, Ohio, Oklahoma, Rhode Island, Texas, Virginia, Washington[1], Wyoming

[1] Voter initiated ballot measures were unsuccessful.
[2] Legislature overrode the governor's veto.
[3] Legislature passed measures that were vetoed by the governor.

Source: National Conference of State Legislatures

U. S. Congress

Public Law 109-115, which passed Congress in November 2005, made appropriations for fiscal 2006 for the Department of Transportation, Treasury, and Housing and Urban Development, and other agencies. Among other things, the law prevents the use of federal funds to support federal, state, or local projects that seek to use the power of eminent domain, unless that power is used for a public use. The law specifically provides that economic development that primarily benefits private entities does not constitute a public use. In addition, the law requires the U.S. Government Accountability Office to submit within one year a report to the Congress on the nationwide use of eminent domain; publication of this report is pending. H.R. 5576, the appropriations bills for fiscal 2007 for the same agencies, includes the same restrictions as the 2006 law but the measure is still being debated in the Senate.

Another measure, H.R. 4128, offers a very sweeping proposal. Basically, the bill denies for two fiscal years federal economic development funds to state and local governments that use eminent domain for private economic development. The bill also directly prohibits the federal government from using eminent domain for private development. The House passed the bill in November 2005, and it has been referred to the Senate. Senate Bill 3873, which is identical to H.R. 4128, was introduced in September 2006 but has not yet been assigned to committee. It is unclear if the 109th Congress will pass any legislation in the area of property owners' rights before the end of its lame duck session.

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Local Government

WSSC Minority Business Enterprise Procurement Program

In the aftermath of the General Assembly not extending the Minority Business Enterprise Procurement Program operated by the Washington Suburban Sanitary Commission (WSSC) during the 2006 session, the Attorney General advises WSSC that it may not implement a "Stop Gap MBE Program" because the program does not comply with constitutional standards enunciated by the U.S. Supreme Court and because it lacks explicit authority to do so from the General Assembly.

Background

Established as a bicounty commission in 1918, WSSC is responsible for managing water and sewage services for Montgomery and Prince George's counties. In 1979, the General Assembly authorized WSSC to implement a minority business enterprise (MBE) procurement program to encourage greater minority business participation in its construction contracts, and in 1992, the General Assembly expanded the program to include contracts for goods and services. The enabling legislation included provisions requiring the termination of the program and requiring periodic disparity studies to analyze the program's effectiveness. Since 1992, WSSC has conducted several studies, and the General Assembly has extended the MBE program's termination date several times. In 2005, the General Assembly extended the MBE program from July 1, 2005, until July 1, 2006, while waiting on the results of the WSSC 2005 Disparity Study. The study was completed in June 2005, but the General Assembly did not act on proposed legislation to extend the MBE program during the 2006 session.

WSSC responded to the General Assembly's failure to extend the MBE program by proposing the implementation of a "Stop Gap MBE Program" that in effect would extend the MBE program without legislative authority. Before implementation, WSSC asked for the Attorney General's opinion on the legality of the program and was advised that it could not implement the "Stop Gap MBE Program" or any other program based on race and gender conscious policies without explicit authority from the General Assembly. Consequently, the MBE program terminated on July 1, 2006.

Attorney General Opinion

The Attorney General opinion was based in part on the U.S. Supreme Court decision in 1989 in *City of Richmond v. J. A. Croson Co.* In that case, the court held that state or local MBE programs using race-based classifications are subject to strict scrutiny under the equal protection clause of the Fourteenth Amendment to the U.S. Constitution and may only be upheld by the courts if they are narrowly tailored to achieve a compelling purpose. The Attorney General

concluded that the proposed "Stop Gap MBE Program" does not comply with constitutional standards because it is a continuation of the MBE program that the WSSC 2005 Disparity Study recommended undergo substantial changes.

The Attorney General also concluded that WSSC could not implement any other program based on race or gender conscious policies because:

- a prior expansion of the MBE program carried out without legislative authority in the late 1980s was struck down by a U.S. Federal Court in *Concrete General, Inc. v. WSSC* on the grounds that WSSC lacked statutory authority to expand the program; and

- the General Assembly demonstrated its intent to terminate the MBE program by failing to pass legislation extending the termination date despite having done so in the past and having been advised that legislation was essential to the continuation of the program.

WSSC 2005 Disparity Study

The WSSC 2005 Disparity Study focused on the contracting divisions of the MBE program from 1999 through 2004. The disparity study found that utilization of MBEs for:

- goods and services exceeded the percentage availability of MBE contractors in the division and recommended that the MBE program for goods and services contracts be replaced with a small business program;

- professional services contracts did not meet the percentage availability of MBE contractors in the division and recommended the continuation of the MBE program for professional services contracts;

- subconsultant architectural and engineering contracts exceeded the percentage availability of MBE contractors in the division and recommended the phasing out of the MBE program for subconsultant architectural and engineering contracts;

- prime architectural and engineering contracts did not meet the percentage availability of MBE contractors in the division and recommended the continuation of the MBE program for prime architectural and engineering contracts; and

- construction contracts did not meet the percentage availability of MBE contractors in the division and recommended that WSSC improve and expand its small business program in construction and continue a voluntary goals program for construction contracts.

MBE Contracting Goals and Fiscal Results

Although it is not required by statute to establish MBE contracting goals, WSSC has established MBE contracting goals for each of its contracting divisions; the construction division goal is voluntary. The goals are:

- Architectural and Engineering: 24%
- Procurement: 28%
- Professional Services: 20%
- Construction (voluntary): 20%

In fiscal 2006, 28 percent of all WSSC contracting, or $45 million, was awarded to MBEs. WSSC exceeded all of its goals except for its goal for professional services.

Implications for the 2007 Session

The Attorney General recommended that the General Assembly consider legislation to reauthorize the MBE program during the 2007 session, taking into account the constitutional implications of the WSSC 2005 Disparity Study results and the 2006 MBE fiscal results.