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May 4, 2016

The Honorable Lawrence J. Hogan, Jr.
Governor of Maryland
State House
100 State Circle
Annapolis, Maryland 21401

RE: *Senate Bill 907, "Transportation – Harry W. Nice Memorial Potomac River Bridge – Replacement"*

Dear Governor Hogan:

We have reviewed and hereby approve for constitutionality and legal sufficiency Senate Bill 907, "Transportation – Harry W. Nice Memorial Potomac River Bridge – Replacement." Because the bill limits the discretion of the Maryland Transportation Authority ("Authority") under a certain provision of its trust agreement with bondholders, we have considered whether the bill violates the Contract Clause of Article I, § 10 of the United States Constitution. It is our view that a court likely would conclude that the bill does not violate the Contract Clause because it does not cause a substantial impairment of the trust agreement.

Senate Bill 907

Senate Bill 907 requires the State and the Maryland Transportation Authority to finance a multilane replacement bridge for the Harry W. Nice Memorial Potomac River Bridge. The replacement bridge must have at least two lanes in each direction and be constructed and commence operation on or before December 31, 2030. For the purpose of "assist[ing] the State in financing the design and construction of the replacement bridge," the bill establishes a Harry W. Nice Memorial Potomac River Bridge Replacement Fund ("Bridge Fund") and requires the Authority, for fiscal years 2018 through 2027, to deposit \$75,000,000 into the Bridge Fund each year from the rentals, rates, fees, tolls, and other charges and revenues derived from the Authority's transportation facilities. The bill provides that the annual \$75,000,000 deposit shall be made as follows:

The money ... shall be deposited from the balance of funds that are deposited in the Authority's general account after the Authority has, as required under its trust agreement and any supplemental trust agreements, paid or set aside amounts to fund or meet current expenses, debt service obligations on bonds issued by the Authority, maintenance and operation reserve requirements, and other reserve and junior obligations requirements.

The bill further provides that the Annual deposit to the Bridge Fund must be made before the Authority may use the balance of funds in its General Account for any other purpose.

The Authority may deposit into the Bridge Fund an amount less than \$75,000,000 in any fiscal year if it determines there is an "emergency circumstance" that requires a reduction of the annual deposit in order for the Authority to (1) remain in compliance with its trust agreement and any supplemental trust agreements or (2) ensure that an unforeseen circumstance does not adversely affect the continuity of operations at any of the Authority's transportation facilities projects. The bill defines the term "emergency circumstance" to mean "[a]n unforeseen event or occurrence that requires the Authority to expend at least \$25,000,000 in a given fiscal year to address an unforeseen need that was not included in the Authority's most recent financial forecast"

Maryland Transportation Authority's Trust Agreement

Pursuant to § 4-311 of the Transportation Article ("TR"), the Authority has entered into a trust agreement to provide security for the payment of its revenue bonds and to furnish its bondholders with certain protections. *Second Amended and Restated Trust Agreement by and between Maryland Transportation Authority and the Bank of New York, as Trustee*, dated as of September 1, 2007, as amended and supplemented from time to time ("Trust Agreement"). Among the protections for bondholders are those set forth in Section 4 of the Trust Agreement. Section 4.05 establishes an Operating Account into which all revenues collected by the Authority must be deposited and provides that all funds in the Operating Account are subject to a lien for the benefit of bondholders:

The moneys in the Operating Account shall be held by the Authority in trust and applied as hereinafter provided and, pending such application, such moneys shall be subject to a lien and charge in favor of the owners of the outstanding Bonds and Parity Indebtedness.

Section 4.06 governs the disbursement of funds from the Operating Account. That section requires the Authority to withdraw the funds from the Operating Account monthly, except for a portion that may be held back to fund Current Expenses,¹ and to set aside those funds for the credit of various accounts and subaccounts. In providing for the disbursement of funds from the Operating Account, the Trust Agreement establishes a priority of payments. The funds must first be used to pay the debt service on the Authority's bonds by transferring a certain amount, as specified in the Trust Agreement, to the credit of a Bond Service Subaccount. From the balance of funds remaining, the Authority must deposit into the Maintenance and Operations Reserve Account² the amount set forth in the Annual Budget. Next, the Authority must deposit a certain amount to the credit of the Reserve Subaccount to maintain a specified balance in that account and then to the credit of the Junior Obligations Account. If there is any remaining balance after making these disbursements, the balance of the Operating Account, less the amount retained for Current Expenses, must be credited to the General Account.

Section 4.11 of the Trust Agreement, which governs the use of funds in the General Account, provides that the funds may be used only for the following four purposes:

The Authority shall from time to time (a) transfer or deposit to the credit of any account or subaccount created under the provisions of this Trust Agreement any moneys held for the credit of the General Account or (b) deposit any such moneys in the Transportation Authority Fund, *a special fund created and designated by the Enabling Legislation, or any other fund permitted by law*, upon the receipt of a certified copy of a resolution duly adopted by the Authority directing such transfer or payment or (c) apply such moneys for any purpose related to

¹ "Current Expenses" generally include the Authority's "reasonable and necessary" current expenses of maintenance, repair and operation of the Authority's transportation facilities projects. Trust Agreement, Section 1.01(25).

² Per Section 4.08 (a) of the Trust Agreement, the funds deposited into the Maintenance and Operations Reserve Account are used "...for the purpose of paying the cost of (i) unusual or extraordinary maintenance or repairs, maintenance or repairs not recurring annually, and renewals and replacements, including major items of equipment; (ii) repairs or replacements resulting from an emergency caused by some extraordinary occurrence...; (iii) engineering expenses incurred under the provisions of this Section; and (iv) extraordinary premiums on purchased insurance carried, or payments to be set aside in reserve for self-insurance maintained..." As such, the funds in the Maintenance and Operations Reserve Account are not used to pay for routine, ordinary maintenance and repairs.

any General Account Project or Projects³ or (d) apply such moneys for the payment of any amount payable by the Authority upon the termination of a Qualified Swap or other fees, expenses, indemnification or other obligations to a counterparty to a Qualified Swap, which payments shall not be paid from any fund or account established under this Trust Agreement other than the General Account.

The Bridge Fund established by Senate Bill 907 is “a special fund created by the Enabling Legislation.” Alternatively, it qualifies as “any other fund permitted by law.” Thus, the Authority is in compliance with the Trust Agreement when it transfers money from the General Account to the Bridge Fund. However, the bill’s *requirement* that the Authority annually transfer \$75,000,000 from the General Account to the Bridge Fund limits the Authority’s discretion to determine how to use the funds in the General Account.

Specifically, the bill requires the Authority to make the annual distribution to the Bridge Fund before it may use funds in the General Account for any other purpose, which could limit the Authority’s ability to use General Account funds to address unanticipated expenditures related to the operation and maintenance of its transportation facilities. Pursuant to Section 6.02 of the Trust Agreement, the Authority covenants that it will maintain and operate its transportation facilities projects in a reasonable, efficient, and economical manner.⁴ The effect

³ Pursuant to this provision, the Authority has utilized funds in the General Account to fund its capital program, which has included operation and maintenance costs related to its facilities. The term “General Account Project” is defined in Section 1.01(44) of the Trust Agreement to include the Thomas J. Hatem Memorial Bridge and the Intercounty Connector and any other Project designated by Authority Resolution to be a General Account Project. Additionally, “Project” is defined in Section 1.01(76) of the Trust Agreement as “any transportation facilities project that the Authority is authorized to construct or acquire under the provisions of the Enabling Legislation, as amended, and that the Authority determines by resolution filed with the Trustee to include in the Transportation Facilities Projects or General Account Projects....” Therefore, the Authority has had flexibility and control over its ability to use the funds in the General Account to pay necessary facility and project costs that are not covered by the disbursements the Authority is required to make before depositing funds into the General Account.

⁴ Section 6.02 of the Trust Agreement provides as follows:

The Authority covenants that it will establish and enforce reasonable rules and regulations governing the use of the Transportation Facilities Projects and the operation thereof, that all conditions of employment and all compensation, salaries, fees and wages paid by

of such a limitation, however, is mitigated by the provision in the bill that allows the Authority to reduce the annual distribution to the Bridge Fund in the event of an “emergency circumstance,” which is defined as an unforeseen event or occurrence that requires the expenditure of at least \$25,000,000 in a year to address an unforeseen need not included in the Authority’s financial forecast.⁵ Thus, the Authority retains a certain degree of flexibility, in the event of unanticipated expenses, to use funds that would otherwise be transferred to the Bridge Fund to supplement funding for operations and maintenance in order to comply with the covenant in Section 6.02. Notwithstanding this flexibility, the bill does limit the Authority’s discretion to use funds in the General Account. The question is whether this limitation constitutes an impairment of contract in violation of the Contract Clause of the United States Constitution.

Impairment of Contract

The Contract Clause of Article I, § 10 of the United States Constitution provides that “[n]o State shall ... pass any ... Law impairing the Obligation of Contracts” Though phrased in absolute terms, this constitutional provision does not prohibit all laws that impair a private or government contract. *See Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 240 (1978) (although “the Contract Clause appears unambiguously absolute ...,” it “is not ... the Draconian provision that its words might seem to imply”). Rather, the Court has applied the following three-part test: first, a court must determine whether the state law has impaired a contract; second, a court must determine whether the contract was “substantially impaired”; and third, if the law is a substantial impairment of a contract, a court must determine “whether the impairment is nonetheless permissible as a legitimate exercise of the state’s sovereign powers.” *Baltimore Teachers Union v. Mayor and City Council of Baltimore*, 6 F.3d 1012,

it in connection with the maintenance, repair and operation of the Transportation Facilities Projects will be reasonable, that no more persons will be employed by it than are reasonably necessary, that it will take reasonable steps to assure that all persons employed by it will be qualified for their respective positions, that it will maintain and operate the Transportation Facilities Projects in an efficient and economical manner, that, from the Revenues, it will at all times maintain the same in good repair and in sound operating condition and make all necessary repairs, renewals and replacements and that it will observe and perform all of the terms and conditions contained in the Enabling Legislation.

⁵ TR § 4-210 requires the Authority to annually adopt a 6-year financial forecast for the Authority’s operations.

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1015 (4th Cir. 1993) (citing *United States Trust Co. v. New Jersey*, 431 U.S. 1, 17 (1977) and *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978)).

It is our view that a court likely would conclude that the bill's restriction on the use of funds in the General Account does not violate the Contract Clause because the restriction does not constitute a "substantial impairment" of the Trust Agreement. Though the Supreme Court has not articulated specific criteria for determining whether or not an impairment is substantial, the Court has provided some general guidance, and it is clear that not all impairments of contract amount to a Contract Clause violation.

"Total destruction of contractual expectations is not necessary for a finding of substantial impairment." It is established, however, that a finding of "technical impairment" is insufficient, i.e., such a finding is merely "a preliminary step in resolving the more difficult question of whether that impairment is permitted under the Constitution." In determining whether an impairment is substantial and so not "permitted under the Constitution," of greatest concern appears to be the contracting parties' actual reliance on the abridged contractual term. Specifically, the Supreme Court has examined contracts to determine whether the abridged right is one that was "reasonably relied" on by the complaining party ... or one that "substantially induced" that party "to enter into the contract." When assessing whether there has been the requisite reliance, the Court has looked to objective evidence of reliance.

City of Charleston v. Pub. Serv. Comm'n of W. Virginia, 57 F.3d 385, 392 (4th Cir. 1995). For the purpose of assessing a party's expectations and its reasonable reliance on an abridged right, the Supreme Court has considered the pervasiveness of past regulation of a particular industry, *National R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co.*, 470 U.S. 451, 469 (1985) ("pervasiveness of ... prior regulation ... suggests that absent some affirmative indication to the contrary" there was "no legitimate expectation the regulation would cease ..."); whether a covenant "was abolished or 'merely modified,'" *City of Charleston*, 57 F.3d at 393 (quoting *United States Trust*, 431 U.S. at 19); and whether the abridged right was "the central undertaking" or "primary consideration" of the contracting parties, *City of El Paso v. Simmons*, 379 U.S. 497, 514 (1965).

Senate Bill 907 preserves the priority of payments required by Section 4.06 of the Trust Agreement, i.e., that revenues must first be used for debt service, maintenance and operations, reserve deposits and payment of junior obligations. Moreover, the bill does not authorize the Authority to use General Account funds in a way that is inconsistent with the Trust Agreement,

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as Section 4.11 allows the Authority to deposit such funds in a “special fund created and designated by the Enabling Legislation” or “any other fund permitted by law.” Although the bill limits the Authority’s discretion to use funds in the General Account, as it requires the Authority to make the deposit to the Bridge Fund before funds in the General Account may be used for any other purpose permitted by the Trust Agreement, such a restriction is likely to be viewed by bondholders as an immaterial modification of the Trust Agreement because it does not impact the security of bondholders in any meaningful way. In fact, as previously noted, the bill allows the Authority to reduce the amount of the distribution to the Bridge Fund under specified circumstances in order to remain in compliance with the Trust Agreement or to ensure that the continuity of operations at the Authority’s transportation facilities projects are not adversely affected.

In light of the above, we believe the contractual right abridged – the Authority’s absolute discretion to use funds in the General Account for any of the purposes listed in Section 4.11 – is not one that is “essential to the underlying contract.” *City of Charleston*, 57 F.3d at 394. Accordingly, we believe a court likely would conclude that bondholders were not substantially induced to enter into the contract by reason of the Authority’s broad discretion to use funds in the General Account, that any impairment of the Trust Agreement caused by Senate Bill 907, therefore, is not substantial, and that the bill does not violate the Contract Clause.⁶

Sincerely,



Brian E. Frosh
Attorney General

BEF/DS/kk

cc: The Honorable John C. Wobensmith
Joseph M. Getty
Warren Deschenaux

⁶ This advice does not address what impact this legislation may have in regards to the bond market and the bond rating agencies.