

Message from Ann M. Smith Re: CA Supreme Court's Recent Determination Related to a Detrimental Change in Health Benefit Costs for Orange County's Retirees:

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Dear All:

You may have read or heard recently that the California Supreme Court has made a determination related to retiree health benefits for Orange County retirees. As a result, you may have new questions or concerns – or even some confusion – over what this determination means about the agreement MEA reached with the City related to active employees' retiree health benefits. Here is a brief overview of the issues in an attempt to put this into perspective for you:

1. **WHY ORANGE COUNTY RETIREES SUED ON 11/5/07.** The case began when the Retired Employees Association of Orange County (REAOC) filed suit in a federal district court to challenge Orange County's decision to stop pooling active and retired employees for purposes of health insurance coverage and premium costs. The County had pooled active and retired employees into a single unified pool without interruption from 1985 through 2007. Retired employees, as a group, are on average older and more expensive to insure than active employees; if pooled separately, retirees normally would pay higher premiums. The single unified pool thus had the effect of subsidizing health insurance for retirees in that it lowered retiree premiums below their actual costs, while raising active employee premiums above their actual costs. The County paid a large portion of the premiums for active employees, but retired employees paid the majority of their own premiums. Due to budgetary concerns, the County passed a resolution in 2007 splitting the pool of active and retired employees, effective January 1, 2008. This meant that retirees would pay more for their health insurance premiums.

(2) APPEAL TO NINTH CIRCUIT AFTER COUNTY WINS IN TRIAL COURT. The federal district court ruled against REAOC -- denying its attempt to get an injunction on behalf of approximately 4,600 retired County employees. The County's action to split the pool of active and retired employees went forward as planned and retirees were forced to pay the higher health insurance premiums. REAOC had unsuccessfully argued that, even though the MOUs and the Board of Supervisors' resolutions adopting those MOUs were silent on the duration of this unified pool, an *implied* right to a continuation of the single unified pool had been created for those who had retired before January 1, 2008. REAOC appealed to the Ninth Circuit Court of Appeals. In turn, the Ninth Circuit noted that whether an implied contract had arisen under these circumstances was a matter of state law, not federal law – and so the Ninth Circuit asked the California Supreme Court to answer this certified question: “Whether California law prohibits a county and its employees from agreeing, by means of an implied contract, to confer vested rights to health benefits on retired county employees?”

(3) LIMITED ISSUE BEFORE THE COURT. In answering the certified question for the Ninth Circuit, the California Supreme Court underscored several points which REAOC had conceded and which influenced its determination:

1. REAOC contended that a retiree's right to the benefits of a single unified pool *vested at the time of retirement* and, as the Court emphasized, had "explicitly disavowed any claim that the benefits vested when the employee began his or her service."

- a. REAOC contended that an implied right to a continuation of the single unified pool had been created for those *who had already retired* before the County implemented its decision to split the pool of active and retired employees.

(4) THE SUPREME COURT'S DETERMINATION LEAVES THE RESULT OPEN AND UNKNOWN FOUR YEARS LATER. The California Supreme Court concluded that, "under California law, a vested right to health benefits for *retired* county employees can be implied under certain circumstances from a county ordinance or resolution. Whether those circumstances exist in this case is beyond the scope of the question posed to us by the Ninth Circuit." The California Supreme Court emphasized that it was *not* deciding whether such a contractual right for the continuation of a single unified pool for purposes of setting health insurance premiums for retired Orange County employees can be implied or not from the Board of Supervisor's prior resolutions approving memoranda of understanding. Thus, the County's decision which led to increased health insurance premiums for Orange County retirees effective January 1, **2008**, remains in effect as the case heads back to the Ninth Circuit four years later.

At this point it remains to be seen how the Ninth Circuit will ultimately decide the issue of whether the single unified pool for active and retired employees could lawfully be changed to the detriment of those employees *who had already retired before the effective date of Orange County's decision to split the pool with the consequence that retirees were forced to pay more for their health insurance premiums.*

However, the California Supreme Court did offer some additional comments which may influence how the Ninth Circuit resolves the dispute. As to the ever-increasing unfunded liabilities associated with retiree health benefits, the Court said that the "certified question" before it was "one of law, not policy." But the Court cautioned: "A court charged with deciding whether private contractual rights should be implied from legislation, however, should proceed cautiously both in identifying a contract within the language of a . . . statute and in defining the contours of any contractual obligation. (citing a United States Supreme Court case). The requirement of a 'clear showing' that legislation was intended to create the asserted contractual obligation (citing a federal 1st Circuit case) should ensure that neither the governing body nor the public will be blindsided by unexpected obligations."

(5) HOW DOES THIS DETERMINATION AFFECT CITY RETIREES. The California Supreme Court's determination reinforces the view we have previously expressed that the City of San Diego's *retirees* have an ironclad, vested right to receive the retiree health benefits in effect at the time of their retirement. The City of San Diego agrees and has acknowledged this obligation.

(6) HOW DOES THIS DETERMINATION AFFECT ACTIVE EMPLOYEES & MEA'S NEW RETIREE HEALTH AGREEMENT. This decision has no effect on the difficult debate which has raged over the legal character of retiree health benefits for **active employees** – with the City arguing that it is at liberty to terminate all retiree health benefits for employees *during their employment* and MEA arguing that these benefits, like employees' pensions, are vested. In fact, as you know, it was precisely because of this continuing, unresolved debate that MEA reached agreement earlier this year over retiree health benefits which involves compromise. This agreement also

came in the context of a set-back in the overall debate when POA litigated and lost the argument that retiree health benefits are vested – resulting in a published decision by the Ninth Circuit Court of Appeals. Even though this case directly related only to the City’s sworn police officers -- and resulted from the malpractice of the attorneys who litigated the matter for the POA and failed to present the detailed factual and legal history associated with City’s retiree health benefits -- it does establish “bad law” on this issue. [In fact, in making the determination explained above, the California Supreme Court cited this Ninth Circuit POA case (*San Diego Police v. San Diego Retirement System* (9th Cir. 2009) 568 F.3d 725) with approval to the extent that it had criticized an earlier state court decision for failing to focus explicitly on “the legislative’s body intent to create vested rights” and the plaintiffs’ “heavy burden” to demonstrate that intent.]

(7) BOTTOM LINE: This determination by the California Supreme Court in the case brought by Orange County RETIREES does not undermine or change the rationale for the Agreement reached between the City and MEA over retiree health benefits nor does it change the balance of the competing factors which MEA’s elected Negotiating Team carefully considered when making the decision to recommend this Agreement to you for ratification.

Best regards to all . . . and a Happy Holiday season to you and yours, Ann M. Smith