THE PUBLIC SECTOR

California Supreme Court finds public employee benefits may 'vest' by implication

by Jonathan Holtzman

On November 21, the California Supreme Court decided *Retired Employees Association of Orange County, Inc. v. County of Orange* — one of the most important public-sector employment cases in recent years. In its decision, the court found that "under certain limited circumstances," a vested right to retiree health benefits may be implied into formal legislation adopted by a public agency's governing body.

While this decision may seem a little dry, it's important because retiree health benefits in the public sector are largely unfunded, often come with a multimillion-dollar price tag, and have the potential for bankrupting many cities and counties. For example, San Francisco's liability for postemployment medical benefits is estimated at $4.5 billion. Should such a decision be made by "implication" — *i.e.,* without express authorization and without the public's knowledge?

The ruling is also critically important because it continues a trend toward finding contractual obligations in public employment, contrary to nearly a century of case law suggesting that public employment is created and regulated "by statute," not by contract. If obligations the size of retiree health care can be implied for the life of a retiree, does this opinion open the door to other private-sector lawsuits, such as generic wrongful discharge actions, which courts so far have held may not be filed against public employers?

Background

In 1966, Orange County began offering group medical insurance to retired county employees. Initially, the county calculated insurance premiums separately for active and retired employees. However, starting in 1985, it began combining active and retired employees into a single "pool" for purposes of calculating their health insurance premiums. This "pooling arrangement" had the effect of lowering retiree premiums below their actual costs while raising active employee premiums above their actual costs.

In 2007, because of budgetary concerns, the county passed a resolution splitting the pool of active and retired employees effective January 1, 2008. In response, the Retired Employees Association of Orange County, Inc. (REAOC), filed a lawsuit against the county in federal district court. In its complaint, REAOC asserted that the county's past practice of pooling active and retired employees — along with its representations to employees regarding a unified pool — created an implied contract that the pooling arrangement wouldn't be modified for employees who retired before January 1, 2008.

The federal district court dismissed the case without a trial. In its decision, the court held that the lack of explicit vesting or durational language in any board-approved resolution, ordinance, or other legislative enactment precluded REAOC's argument for vesting, explaining: "The law is clear: California courts have refused to find public entities contractually obligated to provide specified retirement benefits like those [REAOC] seeks in the absence of explicit legislative or statutory authority."

REAOC appealed the district court's decision to the Ninth U.S. Circuit Court of Appeals (the federal appellate court that covers California and other western states). Finding that REAOC's appeal turned on whether the county had in fact entered into an "enforceable contract" to continue the pooling arrangement for retired employees — a state-law question — the Ninth Circuit asked the California Supreme Court "whether, as a matter of California law, a California county and its employees can form an implied contract that confers vested rights to health benefits on retired county employees."

In a unanimous decision, the California Supreme Court answered the Ninth Circuit's question in the affirmative, finding 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."

The change

One of the seminal differences between private- and public-sector employment has long been the view that public-sector employment is a creature of law, while private-sector employment is a creature of contract. The idea behind that principle, which predates the collective bargaining era in the public sector, is that the rights of government employees are determined by laws passed by a legislative body — a board of supervisors, city council, commission, or legislature. Hence, for example, to this day one can't sue a public employer for "wrongful discharge" in breach of contract.

But over time, this once-sharp distinction has become blurred, primarily because of collective bargaining but also because of various court decisions. Most public employees are covered by collective bargaining agreements. Clearly, the agreements are contracts and generally are enforceable through arbitration. Anyone who has ever gone to arbitration knows that arbitrators frequently "imply" terms into collective bargaining agreements.

With respect to court decisions, as early as 1969, the California Supreme Court held in *Youngman v. Nevada Irrigation District* that "[g]overnmental subdivisions may be bound by an implied contract if there is no statutory prohibition against such arrangements."

In the Orange County case, the supreme court directly took on the long-standing maxim that "public employment is governed by statute, not contract." The court explained that this "often-quoted" principle was designed to address *conflicts* between a public employee's claim and a governing statute or ordinance. The court found no such conflict in this case. It also held that this principle "has limited force where, as here, the parties are legally authorized to enter (and have in fact entered) into bilateral contracts to govern the employment relationship."

The shock waves from this conclusion are potentially enormous. Does this mean public employers can be sued for contract-based wrongful discharge? If so, who has the power to bind a public agency? The primary reason for the old rule was simple: A democratic government shouldn't be bound by the actions of its employees; it should be bound only by agreements expressly approved by the politically elected body. Otherwise, what's the point of laws requiring that government decisions be made in public?

The hope

In fairness to the court, it did attempt to place some limits on this expansive doctrine of government by implication. After recounting prior decisions addressing the extent to which public employers may be bound by implied contractual terms, the court stated, "From these cases, we conclude generally that legislation in California may be said to create contractual rights when the statutory language or circumstances accompanying its passage 'clearly . . . evince a legislative intent to create private rights of a contractual nature enforceable against the [governmental body].'" The court cautioned, however, that "[a]lthough the intent to make a contract must be clear, our case law does not inexorably require that the intent be express." *Retired Employees Assn. of Orange County, Inc. v. County of Orange* (California Supreme Court, 11/12/11).

The aftermath

Prior to the *Orange County* ruling, the prevailing view among labor-law practitioners was that public employees couldn't have a vested right to retiree health benefits unless express language in a statute, resolution, or other formal legislative enactment guaranteed that the benefits were vested or otherwise would continue unchanged in perpetuity. Indeed, a number of practitioners believed that because of the ever-changing nature of medical benefits, retiree health benefits could never become truly "vested." Retiree associations and unions will now argue that a vested right may be implied by the circumstances surrounding or stemming from legislation conferring retiree health benefits, even in the absence of explicit vesting language.

There is some solace in the supreme court's ruling that "vested" rights won't be implied in the absence of clear legislative intent. However, that's likely to lead to extended legal battles over what the legislature intended. Does a retiree's understanding of what the law was "meant" to accomplish create an issue of fact that prevents the case from being resolved before trial? An individual retiree's, employee's, or even legislator's understanding should be irrelevant to what the legislative body intended. We'll see if courts agree.

This whole problem could have been avoided — and undoubtedly will be avoided in the future — simply by stating in the operative legislation or agreement that the benefits in question are "not vested." Hindsight is 20/20. Interestingly, however, the state legislation covering Orange County's retirement system states that any *county* subsidy for retiree health isn't vested. The court went out of its way to find the "pooling" arrangement was not a county subsidy.

Finally, some argue this decision signals that the courts will continue to stand behind earlier vesting rulings as various challenges to vesting work their way through the courts. Others argue that the Ninth Circuit simply asked the supreme court to summarize existing California case law, and that's what it tried to do.

One thing is clear: Many of the supreme court's earlier decisions regarding vesting are dated, sparsely reasoned, and inconsistent with decisions in other states and involving the federal government. If they aren't revisited thoughtfully, there is a very real threat that in the long run, cities and counties will be relieved of these obligations through bankruptcy. And that's in no one's interest.

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