The Legal Implications of Reducing Public Sector Retiree Health Benefits

by William T. Payne and Stephen M. Pincus



Most states and many local governments have promised health care benefits to their retired workers.[1] These promises may be contained in statutes or ordinances, or may have been collectively bargained. The level and duration of the retirement medical benefits to be paid vary greatly. Some governmental entities simply provide retirees access to the health plans provided to current employees without a subsidy; some require retirees to pay some or most of the cost of continuing coverage; and others provide lifetime benefits for retirees and their spouses, or benefits that last until they become eligible for Medicare.

The cost of providing retiree health care has soared with the increasing number of governmental workers reaching retirement age, retirees living longer, and medical costs outpacing general inflation. In addition, for the first time, the Governmental Accounting Standards Board (GASB) now requires – pursuant to GASB Statement No. 45 (GASB 45) – that states and localities "accrue" the costs of "other post-employment benefits" (OPEB) over an employee's career, and disclose the present value of any unfunded liability.[2] Even before the recent downturn in the stock market, it was estimated that state and local governments had OPEB liabilities totaling $1.5 trillion.[3] Among states, New Jersey has reported the highest unfunded OPEB liability at $68.8 billion ($7,946 per state resident) while, on the low end, North Dakota has reported $31 million ($48 per state resident) in unfunded liability.[4] Many municipalities have OPEB liabilities of several thousand dollars per resident, including San Francisco ($6,251) and Newton, Massachusetts ($7,758).[5]

While these obligations have been known for years, most governmental entities have not set aside funds to satisfy them, as they generally have done for pension benefits. Instead, they have treated the funding of retiree health-care as an annual "pay-as-you-go" expenditure. Now that accrual liability of state and local governmental OPEB costs is fully disclosed, credit and bond-rating agencies may decide to lower their ratings for governmental entities that are not proactive in addressing these unfunded obligations.

With GASB 45's potential impact on credit ratings and with tax revenues down due to the recession, public employers across the country have renewed their attempts to contain the cost of providing retiree health benefits. These efforts include instituting or raising monthly premiums, imposing higher deductibles, capping benefits, or eliminating retiree health-care coverage altogether. While it is clearly legal to make such changes for future hires, whether they can be made for current retirees, or current workers who have not yet retired, is often the subject of litigation by workers and retirees, who claim that their right to health-care benefits is "vested" and cannot be unilaterally changed.

The outcomes of the cases are likely to turn on careful analyses of the governing constitutional and statutory law, as interpreted by courts. This article highlights the legal landscape and the practical considerations that governmental officials and their attorneys need to evaluate when seeking to reduce retiree health benefits, and that employee and retiree groups should weigh when deciding to bring suit after such reductions.

Collectively-Bargained Benefits

For many retirees, the right to retiree health benefits is rooted in contract – specifically, the collective bargaining agreements, entered into by their unions, when they were employees. The language pertaining to retiree health benefits varies widely, as do the interpretations of this language by state courts. Many of these courts have looked to federal law for guidance, even though pertinent federal statutes do not apply to state and local government plans.[6]

The key question in cases involving retiree health benefits is whether the language of a collective bargaining agreement (CBA) provides for vested benefits. It is a well-settled principle in labor law that, in general, the terms of a CBA do not survive beyond the expiration of the contract.[7] However, a benefit can "vest" and survive the expiration of the CBA if the parties have agreed to such vesting. An example of such an agreement is one that includes language stating that retiree health benefits will be provided "until death," or "throughout retirement."

In general, courts have taken three different approaches when analyzing the language of a CBA to determine whether the parties intended to vest retiree health benefits.

Inference to Vest. Some courts find that retirement benefits constitute a form of "deferred compensation," observing that it is unlikely that the union would forgo higher wages for its members in exchange for a retirement benefit that was unilaterally terminable. These courts will infer that the parties intended that the benefits survive the expiration of the CBA, absent language to the contrary (such as a "Reservations of Rights" clause, granting the employer the right to unilaterally modify or terminate retiree health benefits).[8]

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Inference to Not Vest. Other courts find that an entitlement to retiree health benefits does not survive the expiration of the CBA in the absence of a written, unambiguous expression of an intent to make the benefits "vested." These courts find that it is "not sound policy to bind an employer to a lifetime obligation absent specific language to the contrary."[9]

No Presumption. Lastly, some courts simply utilize traditional contract principles and avoid applying a presumption for or against vesting.[10]

If the contract language is unambiguous, a court generally determines whether the benefits are vested by limiting its analysis to the governing document alone. If the language is ambiguous, courts will consider extrinsic evidence to determine the parties' intent. This evidence can take many forms, including the government's practice of continuing to provide retiree health benefits,[11] oral or written statements by the employer to retirees or prospective retirees explaining their future pension and insurance benefits, and the settlement proposals made during bargaining.[12]

In order to reduce benefits, government employers cannot simply enter into an agreement with a union to modify the health benefits provided to current retirees. In a leading case, *Allied Chem. & Alkali Workers of Am. v. Pittsburgh Plate Glass Co.*, the United States Supreme Court ruled that a union had no authority to reduce or eliminate vested retiree health benefits for member-employees who had already retired, and that retirees whose vested benefits were cut could sue their employers directly.[13] In reaching this conclusion, the Court noted that a union's primary loyalty was to the active employees, and expressed concern that, if a union simultaneously negotiated for retirees and active employees, it could "see fit to bargain for improved wages and other conditions favoring active employees at the expense of retirees' benefits."[14] Some state courts have adopted the doctrine that unions may not bind retirees who were formerly union members if the retirees' benefits have vested.[15]

Benefits Created by Legislative Act

States and local governments also provide health benefits to retirees pursuant to statute, ordinance, or written policy. In many states, these create contractual rights between the governmental entity and their employees. The Contract Clause of United States Constitution[16] protects against impairment of these contractual rights. Some state constitutions have similar protections – for example, the Illinois Constitution provides that membership in a government retirement system "shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired."[17]

An analysis regarding a possible Contract Clause violation has three elements: whether there is a contractual relationship, whether a change in law impairs that contractual relationship, and whether the impairment is substantial.[18] Whether there is a contractual relationship depends on the language of the governing legislation. For example, an employee working for the Commonwealth of Pennsylvania retired at a time when the employee handbook promised a retiree health-care plan with no retiree premium. A year after the employee's retirement, the employer eliminated the no-premium plan, resulting in a lawsuit. The court found that the language of the handbook and the employees' retirement code established that retired employees could participate in the State's health-care plan, but it did not require the State to provide retirees with the option of retaining the medical coverage they had upon retirement, and that the applicable retirement statute provided the State with flexibility in determining the extent of medical coverage provided to retirees.[19]

On the other hand, in a case from California, retired school board members brought suit against a school district, seeking a writ of mandamus directing payment of their retiree health benefits after the district reversed an earlier authorization providing for such payments. The court found that the long-time board members had a vested right to paid post-retirement health benefits because state law allowed legislative bodies, such as the school district, to provide such benefits, and the district had adopted a written policy to provide such benefits at no cost to retired school board members.[20]

If a court finds the existence of a substantial impairment, the state's action can withstand scrutiny only if it is "reasonable and necessary to serve an important public purpose."[21] Governmental entities seeking to justify the impairment of vested rights due to fiscal woes have a heavy burden. The U.S. Supreme Court has noted that a "governmental entity can always find a use for extra money, especially when taxes do not have to be raised,"[22] and the U.S. Court of Appeals for the Eighth Circuit recently found that "such concerns must be related to 'unprecedented emergencies,' such as mass foreclosures caused by the Great Depression."[23] As such, courts have almost uniformly found that governmental entities had failed to meet the burden of showing that a modification of the retirement benefit was "the only fiscal viable alternative for correcting its alleged fiscal woes."[24]

Promissory Estoppel

Generally, to prevail under estoppel principles, plaintiffs need to show that the defendant made a material misrepresentation upon which the plaintiffs reasonably relied to their detriment. Following these principles, courts deny relief under the estoppel theory in benefits cases where the plaintiffs failed to show reasonable reliance, particularly when they knew or should have known of the actual plan provision which contradicted the misrepresentation.[25] However, in a few cases, courts have held that public entities were estopped from refusing to provide lifetime benefits. For example, in *Law Enforcement Labor Serv., Inc. v. County of Mower*, the court found that the benefits were vested because the county made representations, in writing, to deputy sheriffs that they had met the eligibility criteria for retirement benefits (including payment by the county of health-care premiums), even though the CBAs did not expressly provide for such payments.[26]

When Do Benefits Vest?

State courts take different views of when retiree health benefits vest. Some courts focus on the employment relations and recognize that retirement benefits are a form of deferred compensation. More specifically, when an employee obtains

a retirement benefit through collective bargaining, the employee forgoes present wages in exchange for the future benefit. The promise of such a benefit "induces the employee to complete his or her required services before he or she receives the benefit."[27] These courts hold that the public employer cannot decrease retirement benefits once the employee begins his service [28] and, thus, governmental units may only reduce levels of retirement benefits for future hires. Other courts take the view that retirement health-care benefits vest when employees become retirement-eligible,[29] while other courts hold that such rights only vest at the time of retirement.[30]

Can Vested Benefits be Modified?

If retirees have a vested right to retiree health benefits, does the governmental body have the flexibility to modify retiree health-care plans?

The Supreme Court of Connecticut addressed this question when the City of Waterbury attempted to change retiree medical coverage from a traditional indemnity plan to a managed care plan. The court found that, although the retiree health benefits were vested, past CBAs had given the City the right to make limited modifications to the form, but not the substance, of the medical benefits plan.[31] The burden then shifted to the retirees to demonstrate that the benefits "[were] not substantially commensurate with the benefits provided under the agreements in effect at the time of the retirees' retirement, when viewing the group as a whole."[32] The court determined that, although a managed health-care plan was less flexible, a beneficiary could easily incur greater out-of-pocket costs under the old indemnity plan than under the new plan. As such, the new plan did not substantially reduce the provision of services or increase the costs to the group as a whole, and, therefore, did not materially affect the substance of the vested benefit.[33]

Bankruptcy

Municipal bankruptcies are very rare and have usually involved authorities or other limited-purpose governmental entities. In 2008, the Town of Vallejo, California filed for bankruptcy under Chapter 9 of the federal Bankruptcy Code,[34] the provision that permits municipalities to reorganize debts.[35] As part of its reorganization plan, Vallejo sought to reject current contracts with its unions that provided a variety of employee benefits, including retiree health care. The federal bankruptcy court found that, under the Supremacy Clause of the United States Constitution,[36] the federal Bankruptcy Code "trumped" any state labor laws offering protection to public sector workers. Further, in an issue of first impression, the court held that the protections added by Congress in the 1990's – imposing procedural and substantive requirements on Chapter 11 debtors before rejection of CBAs – did not apply in Chapter 9 cases. Instead, a municipality needed only to show that: the contracts burdened the state, the equities favored the rejection, the debtor had made reasonable efforts to negotiate a voluntary modification, and – despite such efforts – there was little likelihood of a prompt, satisfactory solution.[37]

If a governmental entity is permitted to reject current labor contracts in bankruptcy proceedings, it seems likely that it would also be permitted to reject expired CBAs providing for retiree health benefits. The *Vallejo* decision may, therefore, have a profound impact on financially-distressed governmental entities and their retirees. In states where the right to retiree health benefits is strongly protected, localities may find that bankruptcy offers the only mechanism for removing such obligations from their balance sheets.

Conclusion

In the wake of the implementation of GASB 45, promises of retiree health benefits made long ago are now coming home to roost. It has become apparent that many state and local governments will not be able to sustain "pay-as-you-go" funding mechanisms for retiree health benefits in the long run. Governmental employers are responding by considering pre-funding their OPEB obligations by setting up investment-earning trusts or by issuing bonds. At the same time, governmental entities are continuing their attempts to reduce plan expenses. Before any actions are taken, governmental attorneys will serve their clients well by providing a full legal analysis of any prospective actions. At the same time, attorneys for employee and retiree groups should do a similar analysis when deciding to bring suit to challenge any reductions or terminations of benefits.

Notes

1. According to one source, 92% of states and 61% of localities report providing health benefits to retirees. *At a Crossroads: The Financing and Future of Health Benefits for State and Local Government Retirees*, Center for Local Government Excellence (July 2009).
2. GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (Issued 6/04) (hereinafter "GASB 45"). A summary is available online at http://www.gasb.org/st/summary/gstsm45.html.
3. *You Dropped a Bomb on Me, GASB*, Credit Suisse, Mar. 22, 2007.
4. *At a Crossroads, supra* n. 1, at 37-52.
5. E. Keating and E. Berman, *Unfunded Public Employee Health Care Benefits and GASB No. 45*, Accounting Horizons, 251 (Sept. 2007).
6. The pertinent federal statutes are the Employee Retirement Income Security Act of 1974 (ERISA), which requires compliance with "the terms of [any] employee benefit plan," 29 U.S.C. §§ 1132(a)(1)(B) and 1132(a)(3) (West 2009), and Section 301 of the Labor Management Relations Act of 1947 (LMRA), which confers jurisdiction in suits alleging violations of labor contracts in the private sector, 29 U.S.C. § 185(a) (West 2009). *See* W. Payne and P. Ewing, *Union-Negotiated Lifetime Retiree Health Benefits: Promise or Illusion*, 9 Marquette Elder's Advisor 319 (2008). These statutes do not apply to the public sector, 29 U.S.C. § 1003(b)(1) (2002). *See* DiGuillio v. R.I. Bhd. of Corr. Officers, 819 A.2d 1271 (R.I. 2003).
7. *See* Litton Fin. Printing Div. v. NLRB, 501 U.S. 190, 207 (1991); Poole v. City of Waterbury, 831 A.2d 211, 220 (Conn. 2003).
8. *See, e.g.*, Navlet v. Port of Seattle, 194 P.3d 221, 233 (Wash. 2008); Roth v. City of Glendale, 614 N.W.2d 467, 472 (Wis. 2000).
9. Anderson v. Town of Smithfield, No. C.A. PC05-3823, 2005 WL 3481627, at *7 (R.I. Super. Dec. 20, 2005).

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drops subpoenas against 3 Seattle Times *reporters*, Seattle Tiimes, Dec. 05, 2007 ("Gov. Christine Gregoire was 'troubled' by the subpoenas and Republican gubernatorial candidate Dino Rossi called for Carr's removal from an open-government panel.").
32. Johnson v. Village of Rockton, No. 3:04-cv-50223, 2007 WL 5731932 (N.D. Ill. Dec.. 07, 2007).
33. *Id.*
34. Unspecified Author, *Soldier Sues After Police Fire Him*, Los Angeles Times, May 13, 2004 (quoting Lt. Gov. Patrick Quinn).
35. *Johnson*, 2007 WL 5731932 at 1.
36. *Id.*
37. *Id.*
38. *Id.*
39. *Soldier Sues After Police Fire Him*, *supra* note 34 (quoting Lt. Gov. Patrick Quinn).
40. Sadie Gurman, *Jury awards former Rockton cop lost wages*, Rockford Register Star, Dec. 08, 2007.
41. Johnson v. Village of Rockton, No. 3:04-cv-50223, 2007 WL 5731932 (N.D. Ill. Dec. 07, 2007) (explaining Johnson's allegations that the Village violated the Uniform Services Employment and Reemployment Rights Act, the Local Government Employees Benefit Continuation Act, the Military Leave of Absence Act, the Service Men's Employment Tenure Act, and the Public Employee Armed Services Act).
42. *Id.*
43. *Id.*
44. *Id.* ("Jurors determined that Johnson's military status was a motivating factor in his termination.").
45. Eng v. Cooley, 552 F.3d 1062 (9th Cir. 2009), *petition for cert. filed*, 78 U.S.L.W. 3001 (June 19, 2009) (No. 08-1571).
46. *Id.* at 1064.
47. Nicholas Riccardi, *D.A. Accused of Payback Prosecution*, Los Angeles Times, Feb. 28, 2003 (referring to the Belmont project as a "construction fiasco").
48. *Eng*, 552 F.3d at 1064 ("The task force was headed by Special Assistant Anthony Patchett, who emphasized from the beginning that the Task Force would deliver 'slam dunk' indictments against prominent individuals involved with the Belmont project.").
49. *Id.* ("Following an extensive seven-month investigation, the Task Force concluded that the building site was and had always been environmentally safe and that no indictments should issue.")
50. *Id.* at 1064.
51. *Id.* at 1065.
52. *Id.*
53. *Id.*
54. *Id.*
55. Nicholas Riccardi, *supra* note 47 ("Eng's attorney, Mark Geragos, says his client was set up for a sham prosecution because Eng urged Cooley to come clean with the public on Belmont more than a year ago.").
56. *Id.*
57. *Eng*, 552 F.3d at 1066.
58. *Id.*
59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.*
63. *Id.* at 1075-76.
64. *Id.*
65. Garcetti v. Ceballos, 126 S.Ct. 1951 (2006).
66. John Sanchez, *The Law of Retaliation After Burlington Northern and Garcetti*, 30 A. J. Trail Advoc. 539, 561 (2007) ("[T]he *Garcetti* Court ruled that anything public employees say in the course of performing their assigned duties is not of public concern and is therefore not protected under the First Amendment").
67. Note, Raj Chohan, *Tenth Circuit Interpretations of Garcetti: Limits on First Amendment Protections for Whistle-Blowers*, 85 Denv. U. L. Rev. 573, 579 (2008) ("The *Garcetti* Razor: … If the speech of a government employee is found to be pursuant to official duties, then the rule in *Garcetti* acts as a razor, cutting off the possibility of constitutional protection and preventing the court from proceeding to the *Connick-Pickering* test.").
68. *Garcetti*, 126 S. Ct. at 1960.
69. Raj Chohan, *supra* note 67 at 588-90.
70. Interview with Patrick O'Rourke on July 1, 2009.
71. *Id.* ML

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10. *Poole*, 831 A.2d at 223; City of Anchorage v. Gentile, 922 P.2d 248, 256 (Alaska 1996).
11. Myers v. City of Schenectady, 244 A.D.2d 845, 847 (N.Y. App. Div. 1997).
12. *City of Anchorage*, 922 P.2d at 257.
13. 404 U.S. 157, 173 (1971).
14. *Id.*
15. *See, e.g.*, Roth v. City of Glendale, 614 N.W.2d 467, 473 (Wis. 2000).
16. U.S. Const. art I, § 10.
17. Illinois Const., Art. XIII, § 5; *see* California Constitution, art. 1, § 9 ("A bill of attainder, *ex post facto* law, or law impairing the obligation of contracts may not be passed.").
18. Porter v. City of Highland Park, No. 263470, 2006 WL 1479909, *3 (Mich. Ct. App. May 30, 2006) (citing *Gen. Motors Corp. v. Romein*, 503 U.S. 181, 186 (1992)).
19. Bernstein v. Pennsylvania, 617 A.2d 55, 61 (Pa. Commw. 1992); Davis v. Wilson County, 70 S.W.3d 724, 727-28 (Tenn. 2002) (no vesting pursuant to a county resolution).
20. Thorning v. Hollister Sch. Dist., 11 Cal. App. 4th 1598, 1609 (Cal. Ct. App. 1993).
21. U.S. Trust Co. of New York v. New Jersey, 431 U.S. 1, 25 (1977); McGrath v. R. I. Retirement Bd., 88 F.3d 12, 16 (1st Cir. 1996) (citing *Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400, 411-12 (1983)).
22. *U.S. Trust Co. of New York*, 431 U.S. at 26.
23. AFSCME v. City of Benton, Ark., 513 F. 3d 874, 882 (8th Cir. 2008).
24. Calabro v. City of Omaha, 531 N.W.2d 541, 552 (Neb. 1995); Ass'n of Surrogates and Supreme Court Reporters v. New York, 940 F.2d 766, 773 (2d Cir. 1991) (noting that a payroll lag was not justified because the State could have shifted money from another governmental program or raised taxes); *cf.* Baltimore Teachers Union, Am. Fed. of Teachers Local 340 v. Mayor and City Council of Baltimore, 6 F.3d 1012, 1018-20 (4th Cir. 1993) (a one-percent pay reduction was justified due to a budgetary crisis requiring the City to balance its budget "midway through the fiscal year … [a]t the eleventh hour").