SUPREME COURT OF THE STATE OF CALIFORNIA
No. S184059

RETIRED EMPLOYEES ASSOCIATION OF ORANGE COUNTY,
Petitioner,

vs.

COUNTY OF ORANGE,
Respondent.

After Order Of This Court Accepting Certification Of Question From The United States Court of Appeals For The Ninth Circuit

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PETITIONER'S REPLY BRIEF ON THE MERITS

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INTRODUCTION

The County states its fundamental legal position on page 3 of its Brief: "Under California law, there can be no vested right to a benefit that was never approved explicitly by the [County Board of Supervisors]." The failings in the County's argument can be highlighted simply by breaking down this sentence.

First, California law provides that promised compensation, including deferred compensation like retiree health benefits, is earned when an employee provides his or her labor in exchange for those promised benefits. (See, e.g., *Olson v. Cory* (1980) 27 Cal.3d 532, 538; *Suastez v. Plastic Dress-Up Co.* (1982) 31 Cal.3d 774, 780.) Thus, unless those benefits are subsequently bargained away, they are "vested." As to the retirees in this case, there is no dispute that they provided their labor, and did not bargain away their rights to the benefit at issue here – the Retiree Premium Subsidy. Thus, assuming the Retiree Premium Subsidy was promised compensation, the retirees have a "vested right" to it.

Second, the record shows that the Retiree Premium Subsidy *was* explicitly approved by the Board over and over for 23 years when the Board repeatedly approved the pooled rate structure, and repeatedly approved MOUs providing for retiree health care, all with the knowledge – publicly

discussed – of the cost of providing the Retiree Premium Subsidy to current and future retirees.

Finally, the record is clear that the County promised this benefit for the purpose of recruiting and retaining employees, used this benefit as a bargaining chip during collective bargaining, and understood that the benefit could not be taken away from current employees without collective bargaining because the benefit was a term of the parties' MOUs.

From any perspective – the law regarding earned compensation, the law regarding interpretation of collective bargaining agreement, or perhaps most importantly, fundamental fairness to individuals who have fulfilled their end of an employment bargain – the answer to the Ninth Circuit's question is evident: a California county and its employees *can* form an implied contract that confers vested rights to health benefits on retired county employees.

Before turning to its argument, REAOC must address a critical factual misrepresentation that the County made in the trial court, repeated in the Ninth Circuit and has again repeated before this Court. The County continues to assert that "[a] staggering $400 million unfunded liability is at stake" in this litigation. (Resp. Brief ["RB"] at 1.) The County *knows* this to be grossly inaccurate.

The County gets its $400 million number from an actuarial report that estimated the total cost of providing the Retiree Premium Subsidy over the following 30 years to be approximately $400 million. (RB at 11.) But it is undisputed that the $400 million estimate included the 30-year projected costs for *both* current retirees *and* every employee who would retire during that 30-year period. (Opening Brief ["OB"] at 31.) The County itself broke down the costs of providing the benefit to each group: approximately $120 million for current retirees and $280 million for future retirees. (*See* OB at 31.) This litigation seeks recovery *only* on behalf of the former group, that is, people who were retired as of January 1, 2008, the date the County's new "split pool" retiree premiums went into effect.

But the County's misrepresentation is worse than this 330% exaggeration. Throughout the history of providing the Retiree Premium Subsidy, the State and Federal governments funded 80% of its cost through program reimbursements. (OB at 31.) Thus, the County's *actual* cost of providing this benefit over a 30-year period would be approximately $24 million (20% of $120 million), or $800,000 per year. (*Id.*) In sum, the County's $400 million number is *sixteen times* greater than it should be.

REAOC made this showing in the trial court, before the Ninth Circuit and now again before this Court. The County has never even *attempted* to respond, but instead simply repeats the misrepresentation.

ARGUMENT

I. REAOC CONCLUSIVELY ESTABLISHED THAT PUBLIC EMPLOYMENT AGREEMENTS MUST BE CONSTRUED TO INCLUDE IMPLIED-IN-FACT TERMS BASED ON THE PARTIES' PAST PRACTICES AND COURSE OF DEALING AND MUST BE INTERPRETED IN LIGHT OF EXTRINSIC "PAROL" EVIDENCE.

In Section I of its Opening Brief, REAOC explained in detail several well-settled tenets of contract interpretation that govern this case, namely:

(1) California law requires that contracts be construed to include express terms as well as terms implied from the parties' course of dealing (Civil Code § 1619 ["[a] contract is either express or implied," and there is "no difference in legal effect" between implied and express promises]; Civil Code § 1655 [contracts must be read to include implied terms, where the express terms are silent, if such implicit terms "are necessary to make a contract reasonable or conformable to usage"]; *Walker v. Occidental Life Ins. Co.* (1967) 67 Cal.2d 518, 523.);

(2) Under California's parol evidence doctrine, "[e]xtrinsic evidence is admissible to explain the meaning of a contract if the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible" (*DVD Copy Control Association v. Kaleidescape, Inc.* (2009) 176 Cal.App.4th 697,712-13, *quoting Pacific Gas & E. Co. v. G.W. Thomas Drayage etc. Co.* (1968) 69 Cal.2d 33, 37); and

(3) One type of extrinsic evidence courts look to is "the acts of the parties that show what they believed the contract to mean" (*DVD Copy*, 176 Cal.App. 4th at 712-13, *quoting* 1 Witkin, Summary of Cal. Law (10th ed. 2005) Contracts, § 749, p. 838) Thus, "the construction given [a contract] by the acts and conduct of the parties with knowledge of its terms, *and before any controversy has arisen as to its meaning*, is admissible on the issue of the parties' intent." (*Id.* [emphasis added].)[1]

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[1] This rule is not limited to the joint conduct of the parties. Rather,

> [t]he practical interpretation of the contract by one party, evidenced by his words or acts, can be used against him on behalf of the other party . . . In the litigation that has ensued, *one who is maintaining the same interpretation that is*

The County offers no authority to undermine the application of these fundamental principles to this case.

This Court's precedents make clear that the application of these well-settled tenets of contract interpretation is especially appropriate in the context of employment contracts. (*See Scott v. Pacific Gas & Electric* (1995) 11 Cal.4th 454, 463; *Guz v. Bechtel National, Inc.* (2000) 24 Cal.4th 317, 344; OB at 39-40.) Moreover, these rules of construction apply equally to both private and public contracts. (Civil Code § 1635 ["All contracts, whether public or private, are to be interpreted by the same rules, except as otherwise provided in this Code."][2]; OB at 39-40.)

Indeed, as explained in greater detail in REAOC's Opening Brief, this Court long ago applied the implied-in-fact contract doctrine to interpret a public sector employment agreement. (*Youngman v. Nevada Irrigation*

> *evidenced by the other party's earlier words, and acts, can introduce them to support his contention.*

(*Id.* [emphasis added]; *see also* Cal. Code Civ. Proc. § 1856 [even where a writing is deemed an integration, the express terms "may be explained or supplemented by course of dealing or usage of trade or by course of performance"] [emphasis added].)

[2] *See also M. F. Kemper Const. Co. v. City of Los Angeles* (1951) 37 Cal.2d 696, 704-05 ("The California cases uniformly refuse to apply special rules of law simply because a governmental body is a party to a contract.").

District (1970) 70 Cal.2d 240, 246-47; OB at 33-35.) *Youngman* has been repeatedly cited in judicial opinions and other authorities, both for the general proposition that implied obligations arise from past practices between contracting parties, and for the specific proposition that public and private employers may be held to implied obligations arising from their course of dealing with their employees. (*See Caterpillar, Inc. v. Williams* (1987) 482 U.S. 386, 395 n.9 [under California law conduct can give rise to implied-in-fact contracts in employment relationships]; authorities cited in OB at 34-35.)

Further, in *Glendale City Employees Association v. City of Glendale* (1975) 15 Cal.3d 328, in the specific context of interpreting a *public sector* collective bargaining agreement (MOU), this Court expressly endorsed both the liberal parol evidence doctrine established in *Pacific Gas & Electric*, *supra*, and the notion that the express provisions of collective bargaining agreements must be assumed to be incomplete and in need of filling in through extrinsic evidence, such as course of dealing. (*Id.* at 335-39 & nn. 15-16.)

The Courts of Appeal and the Public Employee Relations Board ("PERB") have repeatedly acknowledged that MOUs contain implied terms that arise from the unwritten practices and courses of dealing between public

employers and employees. (*See Sacramento County Attorneys Association v. County of Sacramento* (2009) PERB Decision No. 2043-M]; *International Association of Firefighters Union v. City of Vernon* (1976) 56 Cal.App.3d 959, 972.

Finally, the County itself acknowledges that the rules of contract interpretation set forth in the Civil Code and Code of Civil Procedure apply to the interpretation of MOUs. (RB at 37, *citing Andersen v. Workers' Comp. Appeals Board* (2007) 149 Cal.App.4th 1369, 1377 [applying Civil Code and Civil Procedure Code "contract interpretation" rules to interpret MOU].)

II. THE COUNTY'S ARGUMENTS DO NOT UNDERMINE THE FACT THAT THESE FUNDAMENTAL PRINCIPLES OF CONTRACT INTERPRETATION APPLY IN THIS CASE.

In its Brief the County attempts to escape the substantial authority that supports REAOC's position. For the reasons set forth below, not one of its arguments is persuasive.

A. The County Misstates The Factual Record In An Attempt To Evade The Application Of Established Tenets Of MOU Interpretation.

1. The County Waived Its "Integration-Merger" Argument And It Is Unavailing In Any Event.

The County contends that REAOC's implied-in-fact contract claims fail because the relevant MOUs contained "integration clauses." (RB at

37-38.) But, the County failed to raise any argument regarding an "integration clause" in the district court. As such, under Ninth Circuit precedent, the County waived that argument. (*In re America West Airlines* (9th Cir. 2000) 217 F.3d 1161, 1165 ["Absent exceptional circumstances, we generally will not consider arguments raised for the first time on appeal. . . ."].)

Moreover, there is no such integration clause in any MOU. An integration is a writing that is intended "as a complete and exclusive statement of the terms of the agreement" between the parties, and an "integration clause" is a contract provision that clearly indicates such an intent. (Code Civ. Proc. § 1856(b).) Here, the only contract language the County identifies is a brief statement at the beginning of each 100-plus page memorandum simply stating that the document "sets forth the terms of agreement" between the parties. (*See* ER IV: 0872.) This is a far cry from the standard integration/merger clause, which explicitly memorializes a mutual intent that "the writing shall constitute the entire contract, and that there are no agreements, warranties, or representations other than those expressly mentioned." (2 Witkin, California Evidence (4th ed. 2000) § 70; *see also Masterson v. Sine* (1968) 68 Cal.2d 222, 225 [example of integration clause that assists court in determining parties' intent *expressly*

states that "there are no previous understandings or agreements not contained in the writing" and that it is the parties "intention to nullify antecedent understandings or agreements"].)

2. The Record Is Replete With Uncontroverted Evidence Demonstrating That The Parties Agreed That Retirees Would Continue In The Same Health Plans As Active Employees And Pay The Same Premiums.

The County incorrectly contends that the implied-in-fact contract doctrine and parol evidence rule cannot apply here because there are no express writings that can form the "launching point" for application of those doctrines. (*See*, *e.g.*, RB at 34.) Both parties agree that the MOUs that were in effect during the 23 years relevant to this dispute included only a vague reference to retiree medical insurance. "Health Plan Booklets" that were made available to employees to explain employment and post-employment health and welfare benefits, provided a fuller explanation of the retiree medical insurance benefit: "[w]hen you retire from the County you will be eligible to continue with the health insurance plans" (1994 version) and "[w]hen you retire from the County of Orange and receive a monthly retirement check, you will be eligible to continue your enrollment in one of

the County health insurance plans" (1996 and 1999 revised versions). (ERV 920:26 – 921:15; ERV 978)[3]

Thus, while the express terms of the relevant writings establish that retirees are entitled to remain in "the health insurance plans" throughout their retirement, they do not explain how premiums under those plans are to be calculated. Because the express terms are incomplete and not inconsistent with the implied-in-fact term proffered by REAOC, the Court must consider REAOC's proffered extrinsic evidence to prove that term, that is, to "supplement" and "explain" retirees' rights and the County's obligations regarding retiree insurance benefits. (Code Civ. Proc. § 1856 (a)-(c); *see Southern Pacific Transportation Co. v. Santa Fe Pacific Pipelines* (1999) 74 Cal.App.4th 1232, 1241-42.)

The County is plainly incorrect in its suggestion that extrinsic evidence may not provide a supplemental term relating to the Retiree Premium Subsidy because the express MOU provisions are silent as to that

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[3] In construing collective bargaining agreements, courts look to related "collateral" documents, such as explanations of employee benefits, for evidence of the substance of the parties' understanding. (*See Senior v. NSTAR Elec. & Gas Corp.* (1st Cir. 2006) 449 F.3d 206, 219-21.) This practice applies to the interpretation of public sector CBAs in California. (*See City of Glendale*, 15 Cal.3d at 339-40 & n.17 [MOUs should be construed using the same principles as applied to private CBAs under the NLRA].)

subject. The parol evidence rule "is not calculated to, nor does it in practice, exert any compulsion upon the parties to put their entire understanding in writing. . . ." (*Mangini v. Wolfschmidt, Limited* (1958) 165 Cal.App.2d 192, 200; *American Industrial Sales Corp. v. Airscope, Inc.* (1955) 44 Cal.2d 393, 397 ["It has long been the rule that when the parties have not incorporated into an instrument all of the terms of their contract evidence is admissible to prove the existence of a separate oral agreement as to any matter on which the document is silent and which is not inconsistent with its terms."] [emphasis added]; *Southern California Gas Co. v. City of Santa Ana* (9th Cir. 2003) 336 F.3d 885, 890-93 [new term may be implied into public contract, based on historic past practice, where it "relates to" a subject that is included in the express writing].)

That evidence may include course of dealing, past practice, bargaining history, and party admissions. (Code Civ. Proc. § 1856(b)-(c).; *Southern Pacific Transportation Co. v. Santa Fe Pacific Pipelines* (1999) 74 Cal.App.4th 1232, 1241-42.) REAOC presented each type of evidence to prove that the parties' agreements called for retirees to continue in the same health plans as active employees and pay the same premiums, that is, premiums based on one commingled pool of active and retired enrollees.

a. The 23-Year Policy And Practice Of Subsidizing Retiree Premiums By "Pooling" Active And Retired Employees.

REAOC described the extensive evidence of a "policy and practice" of subsidizing retiree insurance by way of the pooled rate structure at pages 12-17 of its Opening Brief. That evidence included the fact that for *seventeen consecutive years* the Board received, reviewed and approved "Rate Proposals" prepared by its employee benefits staff and its outside consultant that repeated the following sentences:

> The County's *policy* has been to set the required retiree contributions at an amount equal to 100% of the average rate for active employees and retirees . . . This *practice* has resulted in the following . . . retirees not eligible for Medicare are not footing the whole bill; *they are being subsidized by the County* . . .

(RB at 14 [ER V: 931] [emphasis added].) The import of the evidence is that, before this litigation arose, the County's Board and employee benefits managers openly characterized the Retiree Premium Subsidy as the County's established policy and practice. The County argues that these repeated admissions should be disregarded because the same consultant testified—*after* this litigation arose and *after* the implications of these historic documents was apparent—that in his opinion the statements do not amount to a legal promise relating to the Retiree Premium Subsidy. (RB at 21.)

This argument is specious. The lay legal opinion of the County's paid consultant, regarding the ramifications of this piece of evidence and rendered during the course of this litigation, is of no moment.[4]

Tellingly, the County admits that it was required to—and in fact did—negotiate with its active employees in 2006 regarding its elimination of the Retiree Premium Subsidy as a benefit those employees would enjoy when *they* retired. (RB at 35 ["Here, *complying with the MMBA*, the County negotiated with its employees' representatives about the changes to the retiree medical program (*including splitting the pool*) . . ."] [emphasis added]; RB at 12.) If the 23-year practice of combining active employees and retirees in the same premium pool was *not* a legally binding "past practice," the County would have had no duty to bargain with its employee unions before eliminating it. (*Sacramento County Attorneys Association*, PERB Decision No. 2043-M [under MMBA, negotiation requirement triggered when a "past practice" relating to retiree health benefit is "historic and accepted"].)

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[4] For the same reason, the County's "evidence" that certain other County officials believe that the County did not make a "promise" to provide the Retiree Premium Subsidy is irrelevant. (RB at 20-21.)

The County insists that there is "nothing in the record" to support REAOC's contention that the Board pooled rates for the purpose of softening the blow of setting retiree rates separately, rather than set them to reflect each groups' actual claims expenses. (RB at 8.) That is incorrect. Both Russell Patton (the County's Human Resources Director in 1985) and Gaylan Harris (the County's Employee Benefits Manager at that time) testified that the Board was made aware that establishing "split pool" rates would result in much higher premiums for retirees than pooled rates, and *made its decision based on this consideration.* (ER II Tab 9 at ¶¶ 9-10 [Board decided to pool rates "after hearing concerns from retirees about the impact" of split pool rates]; ER II Tab 11 at ¶¶ 7-8 [same].)

b. The County's Admissions That The Retiree Premium Subsidy Was An Element Of The "Compensation" Package It Offered To "Attract And Retain" Its Workers.

The County contends that its published "Public Annual Financial Report" ("PAFR") did *not* characterize the Retiree Premium Subsidy as an element of the "compensation" package that the County used to "attract and retain" its workforce. (RB at 21.) But the PAFR states that the County offered "partially paid retiree medical benefits for our employees" and that "*these benefits* constitute an important component of the *total compensation*

package the County offers to *attract and retain the skilled workforce* needed to protect the lives and health, and to promote the general welfare of our citizens." (ER VI: 1223 [emphasis added].)

The County suggests that this sentence was merely a reference to only *one* of those retiree medical benefits—the "grant" benefit that is not the subject of this litigation—and was meant to exclude the Retiree Premium Subsidy. (RB at 21.) This is manifestly false. Indeed, in its own brief the County admits that what *it* referred to as the "Plan" included both the Retiree Premium Subsidy and the grant benefits. (RB at 11 ["the County's Retiree Healthcare *Plan*" had unfunded 30-year liability of $1.4 billion; approximately $1 billion for grant benefits and $400 million for "pooling subsidy" (that is, the Retiree Premium Subsidy)] [emphasis added]; *see also id.* at 1 [decision to eliminate Retiree Premium Subsidy was part of County efforts to "restructure and reform its *retiree medical plan*"] [emphasis added].) Underscoring this, the PAFR *itself* states that the "unfunded liability" for the "Retiree Medical Plan" was $1.4 billion, thus showing that the document's references to the "Plan" as an element of employee compensation was a reference to both the Retiree Premium Subsidy and the grant benefits. (ERVI: 1233)

Further, REAOC established that the County's own Office of County Counsel described the Retiree Premium Subsidy as a benefits "program" and as one of the "post-employment benefits" that the County "currently offers" its employees. (OB at 24-25.) It is well-settled that an employer who "offers" its employees "post-employment benefits" must *pay* those benefits as promised once the employee retires; post-employment benefits are elements of *compensation*. (*See* OB at 56-57.) The County contends that this admission is irrelevant, because the same document states that the County's *litigation position* would be that none of its retiree medical benefits are vested. (RB at 22.)

The County misses the point. The import of this document is the County's own general counsel's public recognition regarding the historical *facts* surrounding the Retiree Premium Subsidy, that is, that it was offered as a post-employment benefit. (*Southern Cal. Edison Co. v. Superior Court* (1995) 37 Cal.App.4th 839, 851 [in construing a contract, "the construction given it by the acts and conduct of the parties with knowledge of its terms, *and before any controversy has arisen to its meaning*, is admissible on the issue of the parties' intent"] [emphasis added].)

Finally, the County disingenuously denies that, in its Brief before the Ninth Circuit, it characterized the Retiree Premium Subsidy as a benefit it

used to attract and retain workers. (RB at 21.) In that Brief, the County responded to the suggestion that the Retiree Premium Subsidy would have been an unconstitutional "gratuity" or "gift of public funds" *unless* it was conferred as compensation for services rendered. (REAOC's Opening Brief at 57; County Ninth Circuit Responding Brief at 47-48.) The County insisted that its provision of the Retiree Premium Subsidy was *not* unlawful because, like the retiree benefits at issue in *Sturgeon v. County of Los Angeles* (2008) 167 Cal.App.4th 630, the Retire Premium Subsidy served a "public purpose." (*Id.*) That "public purpose"—the only public purpose discussed in *Sturgeon*—was this: salary and fringe benefits "*improve recruitment and retention*" of public employees. (*Sturgeon*, 167 Cal.App.4th at 637-39 [emphasis added].) Accordingly, by invoking *Sturgeon* to disprove that the Retiree Premium Subsidy was an unlawful gratuity, the County plainly *was* arguing that the subsidy was a benefit that was used as promised compensation, to "improve recruitment and retention" of County employees.

c. The Bargaining History Regarding The Retiree Premium Subsidy.

Courts look to evidence of the facts and circumstances surrounding the negotiation of agreements to determine whether there exists implied-in-

fact understandings that were not reduced to express contract terms, and to "explain" or "supplement" express terms that are either vague or incomplete. (*Southern Pacific Transportation Co.*, 74 Cal.App.4th at 1243.) In its Opening Brief, REAOC cited undisputed evidence that the County expressly treated the Retiree Premium Subsidy as a promised post-employment benefit during extensive 1990-1992 negotiations with its labor unions, even quantifying its substantial cash value for each retiree. (OB at 14-16 [citing evidence].) The County did this in an effort, which was ultimately successful, to persuade the unions to agree to allow the County to access a $150 million "surplus fund" controlled at the time by the County retirement board. (*Id.*)

The County does not attempt to undermine REAOC's evidence in this regard. Instead, it argues that the County's chief labor negotiator at that time, David Carlaw, testified that there was no express "promise" that the Retiree Premium Subsidy would continue "indefinitely." (RB at 20.) The County again misses the point. REAOC is not contending that Mr. Carlaw, or anyone else for that matter, ever made an express promise that the Retiree Premium Subsidy would go on *forever*. Rather, the County expressly acknowledged, as early as 1990, that the Board's "policy" and "practice" of subsidizing retiree health insurance had become a post-employment benefit,

a term of employment and an element of the package of compensation for which employees exchanged their labor (and made other concessions at the bargaining table). This does not mean that the County was bound to provide the Retiree Premium Subsidy (or any other benefit) "forever." Rather, the County was (1) free at any time to *bargain* with active employees to discontinue the benefit, and alter its promised deferred compensation package, on a prospective basis (which it did in 2006-2007), but (2) *not* free to unilaterally revoke the benefit from those people who had already retired and had *earned* the right to receive every element of that package.

d. The County's Admissions That The Retiree Premium Subsidy Was "In The MOUs."

The County's Person Most Knowledgeable with respect to the collective bargaining process in the County testified that the "program" of retiree medical benefits in the County included both the Retiree Premium Subsidy and the grant benefits. (OB at 18-19.) She further testified that in 2006/2007 the County negotiated with its active employees to remove the Retiree Premium Subsidy because the "program"—that is, *both* benefits—"was in the MOU" and the County wished to make "changes to the MOU." (*Id.*) The County does not rebut this critical piece of evidence in its Responding Brief.

B. The County's Proposed Broad Exception For Implied-In-Fact Contract Terms Relating To "Vested" Compensation Is Unsupported And Nonsensical.

The County argues that REAOC's authorities regarding implied-in-fact contract terms are not controlling because they do not involve terms related to "vested" compensation. But in the context of *this* lawsuit, "vested" does *not* mean, as the County suggests, that the benefit at issue is "immutable" and "not negotiable." (RB at 4.) REAOC does not contend that the County lacked the authority to negotiate with its *active employees* to remove the Retiree Premium Subsidy. It does contend that those employees who had already retired before the County revoked the benefit, and with whom the County did not "negotiate," had a right to receive the post-employment benefits for which they worked.

The County's proposed restriction on the implied-in-fact contract doctrine is senseless. To accept the County's argument is to remove from this doctrine the implied terms that form the very core of the employment relationship: those relating to the compensation for which employees agree to exchange their labor. It would deprive legal protection to those terms of employment that deserve the greatest legal protection. And it would permit employers to do what the County has, by its own admission, done here: use the promise of a post-employment benefit to "attract and retain" skilled

workers, and then revoke that benefit once those workers have been attracted and retained and have moved into retirement, expecting to receive all the benefits for which they exchanged their labor.

Not surprisingly, there is no legal support for the County's position. Not one of the authorities discussed in Section I, *supra*, or REAOC's Opening Brief (and not one authority cited by the County) distinguishes between "vested" and "non-vested" implied-in-fact contract terms.

Further, the County's attempt to disqualify retirement medical benefits from the implied-in-fact contract doctrine is directly contrary to PERB's recent holding that past practices relating to such benefits ripen into implied-in-fact obligations to continue to provide them. (*See Sacramento County Attorneys Association*, PERB Decision No. 2043 at 11 [relying on "the established principle that a binding policy may be established through a consistent course of conduct that is 'historic and accepted practice'"].)

The County acknowledges that implied MOU terms relating to retiree medical benefits arise from historic practices (RB at 34-36), but insists that these implied terms only trigger an employer's duty to bargain with *active employees* before changing those terms. Retirees, the County argues, have no legal protection for their health benefits once they retire and are outside the collective bargaining process and the scope of PERB's jurisdiction.

But it is well-settled that collective bargaining agreements confer *substantive*, not just procedural, rights. (*See Senior,* 449 F.3d at 220 [noting that federal authorities recognize implied-in-fact CBA terms for purposes of triggering substantive contract interpretation].) Indeed, in *City of Glendale,* once this Court determined that the city had violated provisions of its MOU with its employees relating to salary adjustments, it did not simply compel it to "bargain" to change the MOU terms. Rather, it enforced the substantive terms of the agreement, by ordering the city to *pay* the wages that were earned while the wage provisions were in effect. In other words, it forced the city to pay the compensation that "vested" under the MOU's terms. (*City of Glendale*, 15 Cal.3d at 343-44.) Retirement benefits are no different in this respect than unpaid wages; both are forms of compensation that, if promised in an MOU, must be paid as promised. (*See Allied Chemical and Alkali Workers of America, Local Union No. 1 v. Pittsburg Plate Glass Co.* (1971) 404 U.S. 157, 180-81 [active employees may protect rights to future retirement benefits through collective bargaining process, because they are elements of compensation; retirees may enforce their rights to promised health benefits through breach of contract claims].)

The alternative rule proposed by the County would lead to perverse results. Active employees would have contractually protected rights to

bargain over their future retirement health benefits—including benefits that are reflected only in unwritten, implied-in-fact contract terms—but would lose those rights the moment they retire and begin to receive them. Employers could promise the moon in retirement benefits to attract and retain workers, and then revoke those promised benefits at the exact moment they are required to pay them.

California law is not so disjointed, self-defeating and unfair. For the collective bargaining requirements of the Meyers-Milias-Brown Act ("MMBA") to have meaning, employers must be required to fulfill their promises *in substance* and not simply go through the charade of "good-faith" bargaining until their employees retire. (*City of Glendale*, 15 Cal.3d at 336 ["Why negotiate an agreement if either party can disregard its provisions? . . . The procedure established by the act would be meaningless if the end-product, a labor-management agreement ratified by the governing body of the agency, were a document that was itself meaningless."]; *cf. Erie County Retirees' Association v. County of Erie* (3d Cir 2000) 220 F.3d 193, 210 ["It is inconceivable that Congress would in the same breath expressly prohibit discrimination in employee benefits, yet allow employers to discriminatorily deny or limit post-employment benefits to former employees at or after their

retirement, although they had earned those employee benefits through years of service with the employer."].)

C. A County's General Statutory Power To Set Terms And Conditions Of Employment Does Not Preclude Implied-In-Fact Terms From Arising In Its Employment Agreements.

The County contends that there is an express statutory prohibition against counties binding themselves to implied-in-fact terms relating to employment. As such, the County argues, any implied obligation to employees or retirees would be *ultra vires* and void. In its Opening Brief, REAOC explained why the County's cited statutes do not impose the sort of formal requirements that could overcome the presumption that public employment contracts *do* include implied-in-fact terms and *are* construed by resort to extrinsic evidence. (OB at 44-49; *see Dimon v. County of Los Angeles* (2008) 166 Cal.App.4th 1276, 1284-86 ["actual formal resolutions are not required" for County to provide for terms of employment pursuant to Gov't Code § 25300].) In its Responding Brief the County fails to rebut REAOC's authorities on this point.

Rather than repeating its opening discussion here, REAOC will highlight a key point regarding the enormous scope of the County's *ultra vires* argument. The County refers only to purported prohibitions against implied terms relating to employee *compensation*. (*See* RB at 14-15.)

However, the statutes on which the County relies apply equally to *all* terms and conditions of county employment. (See Cal. Gov't Code § 25300 [governing "the number, compensation, tenure, appointment and conditions of employment of county employees"]; Codified Ordinances of Orange County Title 1, Div. 3, Art. 1, § 1-3-2 [governing "[t]he regulation of the method of employment, terms of employment, conditions of employment, working hours, leaves of absence, compensation of officers and employees"]. As such, the County's argument would have this Court read the phrase "by resolution" to suspend (by implication) the implied-in-fact contract doctrine and the parol evidence rule with respect to *all* terms of employment in *all* public employment agreements. Further, by extension, the County's argument would bar implied terms and extrinsic evidence in *any* public contract—employment or otherwise—that requires board approval "by resolution." There is neither authority nor a policy basis for this Court to usher in such a sea change in the field of public contracting.

In addition to the cases REAOC cited in its Opening Brief, *San Joaquin County Employees' Assn., Inc. v. County of San Joaquin* (1974) 39 Cal.App.3d 83, refutes the County's argument. There, the county sought to avoid paying retroactive salary increases to its employees, by asserting (like the County does here) that such a payment was "in excess of the board of

supervisor's power" under relevant statutes. (*Id.* at 86.) The court rejected that argument, observing that the county was improperly couching the dispute as a question of the technical interpretation of *statutes* relating to the boards' powers, rather than viewing it "in the larger context" of the flexible, bilateral, *contractual* relationship created by the MMBA. *(Id.* at 86.) Noting that the MMBA "has drawn liberally from the experiences of private management-labor relations," the court declined to read statutory provisions, relating to the powers of county boards, as imposing "hypertechnical impediments" to the formation of such flexible, bilateral relationships between county employers and employees. (*Id.*)

Similarly, this Court should not read section 25300's phrase "may . . . by resolution" as imposing a "hypertechical impediment" to the formation of employment contracts under established and venerable doctrines, that have for decades served to manage employment relationships in both the public and private sectors.

D. The MMBA's "Written Memorandum" Requirement Does Not Preclude Implied-In-Fact Contract Terms.

The County contends that the recognition of implied-in-fact contract terms is precluded because the MMBA provides that the parties "jointly prepare a written memorandum of their understanding" after negotiations are

concluded, which becomes effective after the Board or its representative approves it. (Gov't Code § 3501.1.) However, the fact that the parties are required to prepare a memorandum at the close of negotiations does not mean that the memorandum is a complete and perfect reflection of the parties' agreement. As this Court observed in *City of Glendale*, collective bargaining agreements are not, and cannot be, so complete. (15 Cal.3d at 338-39 & nn. 15-16.)

Further, as *City of Glendale* established, there is no inconsistency between (1) the existence of a written instrument (the MOU) and (2) the resort to traditional tools of interpretation—including the consideration of extrinsic evidence such as past practices and course of dealing—to interpret that instrument. (*Id.* at 336-39.) Indeed, as discussed above, "written" MOUs are consistently construed under the MMBA to include unwritten, implied-in-fact terms.

E. The County's Reliance On The *Markman* Line Of Cases Is Unavailing Because REAOC's Claims Arise Under Contracts, Not Statutes.

The County relies extensively on a line of cases holding that "[t]he terms and conditions relating to employment by a public agency are strictly controlled by statute or ordinance, rather than by ordinary contractual standards" and that therefore "the public employee is entitled only to such

compensation as is expressly provided by statute or ordinance." (*Markman v. County of Los Angeles* (1973) 35 Cal.App.3d 132, 34-135; *see also Miller v. State of California* (1977) 18 Cal.3d 808, 813.)

However, as REAOC set forth in its Opening Brief, these cases do not apply where, as here, the plaintiffs undisputedly worked under valid bilateral *contracts*. (OB at 53-55.) In its Opposition the County fails to address this clear limitation on the *Markman* line of authority.

For the same reason, the County's reliance on "public pension" cases is unavailing. (RB at 22-23.) Because the claimed contract rights in those cases arose under statutes, the courts' analysis began with the presumption that statutes are generally mere expressions of public policy that are not intended to create enforceable contract rights. (*See California Teachers Association v. Cory* (1984) 155 Cal.App.3d 494, 504 & n.7 ["[W]hat is the measure by which a *statute* manifests a promise which, when accepted, creates a contract . . . [W]e must determine whether the statute is 'intended' to create private rights of a contractual nature."] [emphasis added.) That presumption may be overcome when the statute—as well as extrinsic evidence—demonstrates a legislative intent to create private contract rights. (*Id.*)

Here, by contrast, we *begin* with bilateral contracts between an employer and employee. There is no need to search for "intent to contract," and there is no basis to employ the "presumption against contract" that applies in the specific context of statutory contract claims. (*Olson*, 27 Cal.3d at 537; *Shaw v. Regents of University of California* (1997) 58 Cal.App.4th 44, 55.) Indeed, to apply the presumption against contract and to approach MOU interpretation as *statutory construction* conflicts with this Court's command in *City of Glendale*, that contract principles displace statutory construction principles when municipal governments enter into bilateral contracts with their employees. (15 Cal.3d at 337-39.)

F. The Cases Interpreting Government Code Section 53205.2 Are Inapplicable Because REAOC Is Making No Claim Under That Statute.

Government Code section 53205.2 requires counties to "give preference to" insurance plans that provide equal benefits to active and retired employees, at equal cost. In two cases decided in 1991, the Court of Appeal rejected plaintiffs' claims that the phrase "give preference to" imposes an absolute mandate that a County "choose" a plan with equal benefits and equal cost. (*Orange County Employee Association v. County of Orange* (1991) 231 Cal.App.3d 833, 841-42; *Ventura County Retired Employee Association v. County of Ventura* (1991) 228 Cal.App.3d 1594,

1596) While the County contends that these holdings bolster its defense, the cases are inapposite because they involved purely statutory claims under section 53205.2—not contract or contracts clause claims—and the courts said *nothing* about whether retirees could have contractual rights to certain health benefits, based on established past practices and course of dealing. (*Id.*)

H. If It Applies, *Sappington* Supports REAOC's Argument Regarding Implied-In-Fact Obligations Relating To Retirement Health Benefits.

The County relies heavily on *Sappington v. Orange Unified School* District (2004) 119 Cal.App.4th 949, 954-55, for the proposition that public employers cannot be held to obligations regarding retirement health benefits except through express promises in board legislation. (RB at 18-19, 24.) But *Sappington* said no such thing. Rather, the court was asked to construe the meaning of the district's express promise to "underwrite" retiree health coverage. The court concluded that the plain meaning of the term "underwrite" was to "pay a portion of," rejecting the retirees' contention that it must be construed to mean "pay 100% of PPO insurance plans." In reaching that conclusion, the court *did* look to extrinsic evidence, including the parties' course of dealing, but found it lacking. (*Id.* at 955 ["the retirees fail to cite any evidence that they . . . had a reasonable expectation the

District would always provide *free PPO coverage* as part of the medical insurance program. Nor could we find any evidence in the record to support such a claim."] [emphasis added].) Here, by contrast, REAOC has presented volumes of evidence that the Subsidy was a bargained-for retirement health benefit, an element of compensation and an implied term in the MOUs.

Further, *Sappington* did not involve collective bargaining agreements or principles; the court did not cite any authority regarding the interpretation of MOUs, or the effect of parties' course of dealing in the context of collective bargaining. Finally, the County relies on the *Sappington* court's statement that "[g]enerous benefits that exceed what is promised in a contract are just that: generous . . . [t]hey reflect a magnanimous spirit, not a contractual mandate." (*Id.* at 955.) Not only does that statement ignore the settled principles that established and longstanding provision of benefits *may* give rise to contractual rights and duties, but it appears also to be inconsistent with the California Constitution's provision that forbids public entities to dole out unearned compensation out of a "generous" or "magnanimous spirit." Retirement benefits for public employees constitute unlawful "gratuities," unless they are granted for services previously rendered which, "at the time they were rendered," gave rise to a "legal obligation" on the part of the County to provide the benefit. (Cal. Const.

Art. XVI, section 6; *Sturgeon v. County of Los Angeles*, 167 Cal.App.4th 630, 637-38 (2008); *Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 851-52.)

II. THE COUNTY'S REMAINING ARGUMENTS, RELATING TO ALLEGED "NON-VESTING" RULES, ARE SPECIOUS.

A. The County Has Admitted That The 1993 Plan Document Has No Application To The Retiree Premium Subsidy At Issue In This Litigation.

The County half-heartedly contends that REAOC's claims are precluded by a "non-vesting" clause in a "1993 Plan Document" that purports to govern a *different* retiree health benefit, a monthly grant used to defray retiree premium costs. Article 1.3 of that Plan Document purports to limit retirees' rights "to the benefits provided hereunder," and articles 5.4 and 5.5 purport to permit the County to amend "any or all of the benefits provided hereunder." (Supplemental Excerpts of Record at 62-63; 79-80.) But the County admitted that the Subsidy was not one of those "benefits provided hereunder," because it was *not* provided under that 1993 Grant plan. Rather, the County provided the Subsidy under a separate program that predated the Grant plan, and the 1993 Plan Document, by eight years. (ER VI: 1307:1-3; Second Supplemental Excerpts of Record at I: 7:19-8:12.)

B. The County Cannot Assert Defenses Under Government Code Section 31692 Because It Never Provided Any Retirement Health Benefits—Let Alone The Retiree Premium Subsidy—Pursuant To Section 31691.

Government Code Section 31692 provides that "*[t]he adoption of an ordinance or resolution pursuant to Section 31691* shall give no vested right to any member or retired member . . .." (emphasis added). Section 31691 authorizes counties to provide certain enumerated retirement benefits (but *not* retiree health insurance). It states:

> (a) The board of supervisors of any county *by ordinance*, or the governing body of any district under the County Employees Retirement Law, by ordinance or resolution, may provide for the contribution by the county or district from its funds and not from the retirement fund, toward the payment of all or a portion of the premiums on a policy or certificate of *life insurance* or *disability insurance* issued by an admitted insurer, or toward the payment of all or part of the consideration for any *hospital service or medical service corporation*. . . . (Gov't Code § 31691(a) [emphasis added].)

By its express terms, section 31692's "non-vesting" provision applies *only* to benefits provided "pursuant to section 31691." But the County has never adduced one piece of evidence to establish that it provided the Retiree Premium Subsidy "pursuant to section 31691."

In fact, the evidence plainly establishes that the County did *not* invoke section 31691 as authority for providing the Retiree Premium Subsidy.

First, the plain language of section 31691 does not even authorize counties to provide retiree medical insurance. Rather, it permits them to pay (1) premiums for life insurance or disability insurance, and (2) "consideration" for "hospital service corporations" or "medical service corporations." (Gov't Code § 31691(a).) Hospital and medical service corporations are *not* insurance companies; indeed, engaging in the business of insurance disqualifies an entity from being considered a medical or hospital service corporation. (*See California Physicians' Service v. Garrison* (1946) 28 Cal.2d 790 [explaining difference between "service" corporations and "insurance" providers].) This Court must presume that the Legislature chose its words deliberately when it enumerated specific types of retirement health benefits (disability insurance, life insurance, consideration for medical service and hospital service corporations) and excluded others (health insurance).

This presumption is buttressed by the fact that the other statutory scheme authorizing counties to provide retiree medical benefits—section 53200 *et seq.*—is entitled "Group *Insurance*" and broadly authorizes counties to provide "health and welfare benefits," including "medical . . . insurance or benefits, *whether provided on an insurance or a service basis . . .*" (Gov't Code §§ 53200(d); 53201 [emphasis added].) Section

53200 *et seq.* was enacted years before section 31691. Clearly, the Legislature knew the difference between "insurance" and "service" benefits when it enacted section 31691; it chose to permit counties to provide both under section 53201, but authorized only the latter under section 31691.

Further, section 31691 requires that county boards of supervisors pass an ordinance in order to invoke its authority. (Gov't Code § 31691(a).) By contrast, the statute permits "the governing body of any *district* under the County Employees Retirement Law" to do so "by ordinance *or resolution*." (*Id.* [emphasis added].) The County has admitted that it never passed an ordinance to invoke section 31691, but argues that the Legislature didn't really *mean* to say that counties must resort to ordinances—rather than less formal resolutions—to provide benefits under section 31691. Rather, the County argues, the Legislature used the terms ordinance and resolution "interchangeably." (RB at 31.) This is nonsense.

It is a well-settled tenet of municipal law that when the Legislature employs the terms "ordinance" and "resolution," it is presumed to have intended to create a significant distinction. An ordinance is a formal piece of legislation that requires that certain procedural requirements be met, while a resolution encompasses other means by which a legislative body expresses its intent. (*Dimon,* 166 Cal.App.4th at1284.) In *City of Sausalito v. County*

of Marin (1970) 12 Cal.App.3d 550, the court expressly rejected the notion that the Legislature uses the two terms "interchangeably," and stated that the Legislature must be presumed to use the two words deliberately, to impose different formal requirements. (*Id.* at 565-66 ["By statute, the Legislature has made the terms "ordinance" and "resolution" synonymous in a very few instances, each of which is highly specialized and applies to a city only . . . in innumerable other statutes authorizing or directing actions by county boards of supervisors, it has been careful to state whether the specific action shall be taken by "ordinance" or by "resolution" in each case].)

Further, throughout the County Employees Retirement Law, Govt. Code §§ 31450 *et.seq.* ("CERL"), the Legislature was very specific regarding which provisions could be invoked by resolution and which required formal ordinances. (*See, e.g.*, Gov't Code § 31500 [counties must use ordinance to create retirement system]; § 31502 ["districts" may adopt retirement system "by resolution"]; § 31610 ["by resolution"]; § 31676.1 [same].) Indeed, the County itself adopted—by ordinance—*twelve* specific provisions of CERL, but *declined* to adopt section 31691. (*See* Codified Ordinances of Orange County, Title I, Div. 3, §§ 1-3-7 through 1-3-11.)

The County contends that the legislative history of section 31691 is silent regarding whether the Legislature intended to distinguish between

"ordinance" and "resolution." (RB at 30-31.) But in light of the recognized distinction between the two terms, legislative history is irrelevant. Moreover, the legislative history of section 31691 *does* indicate that the Legislature's use of each term was deliberate. The February 22, 1961 version of the statute (Assembly Bill No. 1859) did not distinguish between ordinances and resolutions, but permitted counties and districts alike to invoke the statute "by ordinance or resolution." (REAOC RJN Ex. A.) But the April 12, 1961 *amended* Assembly Bill changed that and substituted the current language, carefully inserting "by ordinance" after "county" and "ordinance or resolution" after "districts." (REAOC RJN Ex. B.) Clearly, the Legislature acted intentionally when it imposed the "by ordinance" requirement on counties in section 31691.

In a last ditch attempt to salvage its section 31692 defense, the County contends that the non-vesting clause of section 31692 should apply to *all* retiree health benefits provided by any county, regardless of whether such benefits were provided "pursuant to section 31691," as the statute requires. Specifically, the County asks this Court to discard the express limitations of section 31692 and graft its non-vesting clause onto the statute on which the County *did* rely in providing this benefit, section 53200 *et seq.* (*See OCEA*

v. County of Orange (1991) 234 Cal.App.3d 833.) But the County provides no basis for the Court to engage in such blatant rewriting of a statute.

First, this Court's task is "to discern the Legislature's intent," and "[t]he statutory language itself is the most reliable indicator" of that intent. (*Wells v. One2One Learning Foundation* (2006) 39 Cal.4th 1164, 1190.) Here the statutory language is clear: the Legislature intended that section 31692 apply only to a certain class of retirement benefits, that is, those provided under section 31691.

Second, to discard the phrase "pursuant to section 31691" is to violate the rule that "every word, phrase, sentence and part of a statute must be accorded significance if reasonably possible" and that "statutory construction that interpretations which render any part of a statute superfluous are to be avoided." (*Wells*, 39 Cal.4th at 1206-07.)

Third, "[i]f a statute on a particular subject omits a particular provision, inclusion of that provision in *another related statute* indicates an intent the provision is not applicable to the statute from which it was omitted." (*In re Calhoun* (2004) 121 Cal.App.4th 1315, 1346 [emphasis added] *quoting In re Marquis D.* (1985) 38 Cal.App.4th 1813, 1827.) Section 31692 and section 53200 *et seq.* both relate to retiree health and

welfare benefits. Accordingly, this Court should not insert a phrase from the former into the latter, where the Legislature chose not to.

The County further suggests that section 31692 should be expanded to include all retirement health benefits, because in enacting it the Legislature was concerned that retirees not have "vested" claims to funds from pension systems, as opposed to county general funds. (RB at 28.) However, section 53200 *et seq.* makes clear that the Board's payment of retiree health benefits must come "[f]rom funds under its jurisdiction" and that "[t]hese expenditures are charges against the funds," that is, the "funds under its jurisdiction." (Gov't Code § 53205.) Thus, there is no danger that benefits provided under section 53201 would ever threaten to impinge on pension funds, which are not under the jurisdiction of county or district boards.

In short, if the Legislature intended to make *all* public employee retirement health benefits non-vested, it certainly could have said so. It did not. This Court should not rewrite section 31692 to expand its reach beyond the scope that the Legislature clearly intended.

CONCLUSION

Consistent with well established principles under California law for the interpretation of contracts in general, and public employment contracts in particular, this Court should inform the Ninth Circuit that, yes, a California

county and its employees *can* form an implied contract that confers vested rights to health benefits on retired county employees.

Dated: November 29, 2010

Respectfully Submitted,

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CERTIFICATE OF WORD COUNT

In accordance with California Rule of Court 8.520(c)(1), I hereby certify that this brief has been prepared using double-spaced 14 point Times New Roman Typeface. According to the "Word Count" feature in the Microsoft Word for Windows software, this brief contains 8,317 words not including the tables.

I declare under penalty of perjury that this Certificate of Word Count is true and correct and that this declaration was executed on November 29, 2010, in San Francisco, California.

By: _____
G. Scott Emblidge

Attorneys for Retired Employees Association of Orange County

I, JUSTINE CHMIELEWSKI, declare as follows:

I am a citizen of the United States, over the age of eighteen years and not a party to the within entitled action. I am employed with Moscone Emblidge & Sater LLP, 220 Montgomery Street, Suite 2100, San Francisco, CA 94104.

On November 29, 2010, I served:

PETITIONER'S REPLY BRIEF ON THE MERITS

on the interested parties in said action, by placing a true copy thereof in sealed envelope(s) addressed as follows and served the named document in the manner(s) indicated below:

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☒ **MAIL:** I caused true and correct cop(ies) of the above documents to be placed and sealed in envelope(s) addressed to the addressee(s) named above and, following ordinary business practices, placed said envelope(s) at the Law Offices of Moscone Emblidge & Sater LLP, 220 Montgomery, Ste. 2100, San Francisco, California, 94104, for collection and mailing with the United States Postal Service and there is delivery by United States Post Office at said address(es). In the ordinary course of business, correspondence placed for collection on a particular day is deposited with the United States Postal Service that same day.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed November 29, 2010, at San Francisco, California.

JUSTINE CHMIELEWSKI