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 RESPONSE TO AMICUS BRIEF FILED IN SUPPORT OF RESPONDENT COUNTY OF ORANGE

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INTRODUCTION

The arguments advanced by Amici (the League of California Cities ["LCC"] and California State Association of Counties ["CSAC"]), in support of Respondent County of Orange, suffer from two fundamental errors, one of law and one of fact. First, Amici insist that "Memoranda of Understanding" ("MOUs") between counties and their unions must be construed as statutes, rather than contracts, such that obligations and rights do not arise unless legislative bodies "explicitly" state those obligations in "legislative enactments." But Amici provide no basis in law or policy for this Court to overrule its 1975 decision in *Glendale City Employees Association v. City of Glendale* (1973) 15 Cal.3d 328, in which it held that MOUs are bilateral, binding contracts, construed and enforced like other contracts. Thus, contrary to Amici's insistence on "statutory" standards and presumptions, the answers to both portions of the certified question—whether implied-in-fact terms arise with respect to retirement health benefits and whether such benefits "vest" when an employee retires—must be found through application of contract law.

Second, Amici warn that REAOC's claim, if successful, will take the matter of retirement health benefits "off the table" for purposes of collective

bargaining, rendering those benefits and their attendant costs fixed and non-negotiable as to retirees *and* active employees alike. That is plainly false. REAOC brought its claims only on behalf of those County employees who had already retired when the County ended its 23-year policy and practice by eliminating the Retiree Premium Subsidy from its retiree medical insurance program. REAOC's position is that the County acted lawfully when it negotiated with active employee unions to obtain their agreement to remove that benefit, prospectively, but unlawfully when it revoked that benefit—unilaterally and retroactively—from those employees who had retired while it was still a component of the County's promised benefits package. That proposition—that benefits may be altered prospectively but not retroactively—is well established in case law. In fact, some 55 members of Amici (the LCC) successfully urged this position in prior litigation regarding retirement health and other fringe benefits of public employees.

The application of settled principles of contract law compels the conclusions that retiree health benefits may arise by implication from established, longstanding policies and practices, and that such benefits become contractually protected—*i.e.*, earned or "vested"—once an employee retires.

ARGUMENT

I. THIS COURT SHOULD APPLY PRINCIPLES OF CONTRACT INTERPRETATION, RATHER THAN STATUTORY CONSTRUCTION, TO ANSWER THE CERTIFIED QUESTION.

In *City of Glendale*, this Court held that MOUs are binding, bilateral contracts, rather than mere statements of the governing body's legislative intent. (*City of Glendale*, 15 Cal.3d at 334-37; *see also Sonoma County Organization of Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 304 [same]). As such, MOUs must be construed, like other private and government contracts, according to rules of interpretation set forth in the Civil Code as well as common law doctrines. (*City of Glendale*, 15 Cal.3d at 334-38; *see also City of El Cajon v. El Cajon Police Officers' Assn.* (1996) 49 Cal.App.4th 64, 71 [in construing terms of an MOU, "[w]e are guided by the well settled rules of *interpretation of a contract*, endeavoring to effectuate the mutual intent of the parties . . ."] [emphasis added]). Those rules of construction include (1) the doctrine of implied-in-fact contracts (Civil Code §§ 1619-21, 1655-56); (2) the application of the parol evidence rule; and (3) the recognition that MOUs are by their very nature "incomplete" and often require courts and arbitrators to "fill in" missing

terms to reflect industry practice, parties' course of dealing, history of negotiations, *etc.* (*See City of Glendale*, 15 Cal.3d at 337-40 & nn. 15-17.)

Amici insist that this Court effectively reverse this precedent, by holding that MOUs must be construed according to rules of statutory interpretation. Those rules include a presumption that statutes do *not* create contract rights, and the rule that such rights will be found only where the legislative body "expressly" and "unmistakably" confers them. But Amici offer no reason—in law or in policy—for this Court to revisit its holding in *City of Glendale*, a holding that has governed public labor-management relations, and guided courts (and the Public Employee Relations Board) for decades.[1]

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[1] Amici rely on a recent unpublished opinion in *Sonoma County Association of Retired Employees v. County of Sonoma* (N.D. Cal. 2010), attached as Exhibit A to Amici's RJN. But that case did not involve the interpretation of MOUs. Rather, plaintiff there premised its claim on statutory enactments, and contended that contract rights arose from that legislation. Indeed, based on this difference the parties themselves (including one of Amici's members, Sonoma County) disclaimed any relationship between the motion decided by the court there and this certification proceeding. (*Id.* at 11 n.4.)

A. The Fact That Public Employment Contracts Are Approved By Board Action Does Not Convert Them Into "Statutory Contracts."

Amici contend that rules of contract interpretation do not apply to MOUs because MOUs are not *actual* contracts, but instead are "statutory contracts." (County Amicus Brief ("AB") at 21.) Courts have used the term "statutory contract" to describe the situation where no common law contract exists, but a court determines that a legislative body intended to create "contract-like" rights in individuals when it passed a statute. (*See California Teachers Association v. Cory* (1984) 155 Cal.App.3d 494, 505 [describing formation of "statutory contracts" and rules governing when it is appropriate to find "implied" promises in statutory framework].) It has no application where, as here, a municipality entered directly into negotiated, bilateral contractual obligations. (*City of Glendale*, 15 Cal.3d at 334-40; *see also City of El Cajon*, 49 Cal.App.4th at 71.) Indeed, in *City of Glendale,* this Court rejected the proposition that municipalities retain their legislative discretion to alter terms of employment "statutorily" once they have entered these "indubitably binding" bilateral contracts. (*City of Glendale*, 15 Cal.3d at 334-40 [rejecting City's contention that it retained "legislative" authority to determine wages notwithstanding wage provisions in MOU].)

The only support Amici offer for their position is the observation that, under the MMBA, MOUs do not become binding until the legislative body approves them "legislatively." (*See* Gov't Code § 3505.1; AB at 21-22.) But that requirement of board approval existed in the MMBA when the Court decided *City of Glendale*. The Court made repeated and explicit reference to this requirement as *support* for its conclusion that MOUs should be treated like other binding bilateral contracts. (*Id.* at 334-37.) Accordingly, it is nonsense to suggest that this provision is a basis to distinguish, let alone overrule, *City of Glendale* and its progeny.

Further, Amici's argument proves too much. It would remove from the realm of contract law every municipal contract that requires board "approval" or "adoption" before it becomes binding. (*See, e.g.*, Los Angeles City Charter, § 373 [requiring council approval for "long term contracts"]; San Francisco Charter § 9.118 [requiring board approval for long term contracts and contracts with specified anticipated costs or revenues].) Amici cite no reason for this Court to re-make the law of municipal contracts in that manner.

Finally, the Ninth Circuit has held that implied-in-fact contract terms arise from parties' longstanding course of dealing even in the context of a "statutory contract," that is, a city ordinance that the court construed to

create "contractual" right and duties. (*Southern California Gas Co. v. City of Santa Ana* (9th Cir. 2003) 336 F.3d 885, 890-92 [court treated city ordinance as a contract between gas company and city, and held that decades-long practice of permitting gas company to excavate under city streets free of charge created contract right in gas company to continue to do so; "[e]ven adjustments in implicit financial terms can constitute substantial impairment" for purposes of contracts clause claim].)

B. Public Employment Is Not Governed By Statute Where, As Here, The Government Enters Into Binding Bilateral Contracts With Its Employees.

Amici contend that "the terms and conditions of public employment are governed by statute, not contract." (AB at 6, *citing Miller v. State* (1977) 18 Cal.3d 808, 813.) However, as REAOC explained in its Opening and Reply briefs, this statement from *Miller* does not apply where, as here, the plaintiffs undisputedly worked under valid bilateral *contracts*. (*Olson v. Cory* (1980) 27 Cal.3d 532, 537 ["We recognize the often quoted language that public employment is not held by contract and therefore is not protected by the contract clause. . . . On the other hand . . . [w]hen agreements of employment between the state and public employees have been adopted by governing bodies, such agreements are binding and constitutionally protected."] [quoting *City of Glendale*, 15 Cal.3d at 337-338]; *Shaw v.*

Regents of University of California (1997) 58 Cal.App.4th 44, 55 [*Miller* rule does not apply "[w]hen a public employer chooses instead to enter into a written contract with its employee"].)

Notably, in a prior case related to public sector fringe benefits,[2] 55 of Amici's member cities filed an amicus brief in which they acknowledged that the *Miller* rule did not apply in the context of MOUs negotiated under the MMBA. In that brief, these member cities observed that, *prior to* the MMBA, "employment was purely statutory, and public employees were subject to those terms and conditions of employment established by city resolutions and ordinances." (REAOC Second RJN, Exh. B at 7.) They went on to note that public employment under the MMBA became a matter of collective bargaining, binding negotiated agreements, and interpretation and enforcement of MOUs in accordance with rules of contract law *and* doctrines applied in federal cases under the National Labor Relations Act. (*Id.* at 7-9.) While Amici would now like to go back to the pre-MMBA days for purposes of *this* litigation, it is telling that 55 of their members were eager to recognize the contractual nature of MOUs when it suited their interests.

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[2] *San Bernardino Public Employees Association v. City of Fontana* (1998) 67 Cal.App.4th 1215, 1223 (discussed further, *infra.*)

Amici rely on *Association of Los Angeles Deputy Sheriffs v. County of Los Angeles* (2007) 154 Cal.App.4th 1536, for the proposition that "the public employee is entitled only to such compensation as is expressly provided by statute or ordinance." (AB at 6-7.) However, in that case, the court relied on the fact that the "ordinance" at issue was entirely consistent with the operative MOUs, and repeated this Court's holding in *City of Glendale* that MOUs are binding agreements. (*Id.* at 1549.) Accordingly, the case does not support Amici's contention that counties' "statutory" authority somehow trumps their contractual obligations with regard to terms of employment.[3]

C. Counties Do Not Enjoy "Sovereign" Or "Plenary" Authority Over Their Contractual Relationships With Employees.

Amici contend that the implied-in-fact contract doctrine does not apply here because counties act in their "sovereign," rather than "proprietary," capacity when they "set terms and conditions of public employment." (AB at 19 n.4.) This argument also fails, for several reasons.

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[3] Further, the *Miller* rule has been limited by subsequent holdings, that even where public employment *is* held by statute (such as civil service statutes), rather than contract, express and implied terms relating to *retirement* benefits do enjoy "contractual" protection. (*California Teachers Association v. Cory* (1984) 155 Cal.App.3d 494, 504-505.)

First, Amici cite no authority for the proposition that a government's entering into bilateral contracts with its own employees is a "sovereign" exercise. In fact, the law of this State is to the contrary. (*See Shoban v. Board of Trustees of Desert Center Unified School Dist.* (1969) 276 Cal.App.2d 534, 545 [employee may invoke estoppel against municipal employer because, *inter alia*, municipality acts "in its proprietary capacity," rather than as sovereign, when it acts "qua employer"]; *see also Gray v. County of Tulare* (1995) 32 Cal.App.4th 1079, 1089 [First Amendment limitations on government's ability to restrict speech in its sovereign capacity do not apply to restrictions it imposes on its employees in its "employer" capacity].)

Moreover, Amici's argument does not square with the MMBA's requirement that municipalities enter into negotiated, bilateral *contracts* with their employees. (*City of Glendale*, 15 Cal.3d at 334-40.) A government must be deemed to cede some of its "sovereignty" whenever it enters into a contractual relationship. (*U.S. Trust Co. of New York v. New Jersey* (1977) 431 U.S. 1 25 & n.23 [states bound by contract obligations despite fact that those obligations "in theory" impinge on their sovereign powers].) It cannot be a party to an enforceable, bilateral, negotiated employment contract and

at the same time a sovereign, with "plenary authority"[4] over the terms and conditions of that same employment.

Finally, while the "sovereign powers" doctrine that Amici appear to invoke holds that a government cannot contract away its "sovereign" authority, the doctrine applies only where the government seeks to enact "public and general" legislation that *incidentally* impairs a contractual obligation. It does not apply where, as here, the government seeks to avoid specific contractual obligations, be they to government employees or businesses that sell goods or services to the government. (*See Kimberly Associates v. United States* (9th Cir. 2001) 261 F.3d 864, 869; *DBSI/TRI IV Limited Partnership v. United States* (9th Cir. 2006) 465 F.3d 1031, 1040.)

Once properly understood, the "proprietary/sovereign" distinction that Amici rely on actually supports REAOC's position. Governments acting in their proprietary capacity must be bound by the same rules—including the

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[4] In their brief, Amici place the word "plenary" in quotation marks, suggesting that the authorities they cite in support of that contention characterized counties' power in that manner. (AB at 7.) However, that word does not appear in either the Constitutional or statutory provisions that Amici cite. (*See* Cal. Const., art. XI, § 1, subd. (b); Gov't Code § 25300.) Nor did this Court use that word to describe counties' constitutional or statutory authority over terms and conditions of employment in the case on which Amici rely, *County of Riverside v. Superior Court* (2003) 30 Cal.4th 278, 285.

implied-in-fact contract doctrine—as apply to private parties. (*See Corporation of America v. Durham Mutual Water Co.* (1942) 50 Cal.App.2d 337, 340 [when a government acts in proprietary, rather than sovereign, capacity, "its contracts and dealings are construed and measured *by the same rules and with like effect* as those of private citizens"] [emphasis added].)

II. THERE IS NO BASIS TO CREATE AN EXCEPTION TO THE IMPLIED-IN-FACT CONTRACT DOCTRINE FOR CONTRACT TERMS RELATING TO RETIREMENT HEALTH BENEFITS.

A. Amici Mischaracterize REAOC's Claims Regarding The "Vesting" Of Retirement Health Benefits.

Amici insist that a court may not construe an employment contract to include an implied term if that term would create "vested" rights to a benefit, because to say a benefit is "vested" is to say it is non-negotiable and beyond the scope of collective bargaining as to active and retired employees alike. (*See, e.g.*, AB at 5 and 6.) Removing "vested" benefits from the scope of collective bargaining, Amici argue, would be contrary to the purposes of the MMBA and would prevent employers from addressing fiscal problems posed by the cost of such benefits. (*Id.* at 5-6.)

But Amici premise their argument on a misleading use of the word "vested," and a corresponding distortion of the nature and scope of REAOC's claims. To say a benefit is "vested" means only that, *at some*

point in time during the employment relationship, an employee has "earned" some contractual right to receive it, as an element of compensation for his or her labor. For post-employment health benefits, that moment of "vesting" occurs when an employee retires. After that point the employer may not make retroactive changes that divest the employee of that "earned" benefit. (*See McCaskey v. California State Automobile Association* (2010) 189 Cal.App.4th 947, 968-69 & n.11 [noting frequent confusion caused by term "vested" and observing that "[t]o 'vest' a person with a right or interest is to give him an immediate, fixed right of present *or future enjoyment.*"] [*quoting* Black's Law Dict. (9th ed.2009) p. 1699, col. 1] [emphasis altered].)

REAOC does not contend that retirement health benefits are beyond the scope of collective bargaining or non-negotiable *during* employment, and before the exchange of labor for wages and benefits has been completed. Indeed, REAOC's claims seek reinstatement of the Retiree Premium Subsidy only for those retirees who were already retired when the County unilaterally revoked that benefit on January 1, 2008. REAOC contends that public employers (1) *may* resort to collective bargaining to alter prospectively the terms relating to retirement health benefits of active employees, but (2) *may not* revoke those same benefits from those who have

retired, are by law outside the scope of the collective bargaining process, and have fully earned the benefits.

It is true that, in the context of pension benefits, the term "vested" has taken on an additional meaning. Thus, once a government employee *begins* service his or her employer ordinarily may not make even *prospective* changes to the terms under which that employee will earn pension benefits in the future. (*See Betts v. Board of Administration* (1978) 21 Cal.3d 859, 864.) But that is only one meaning of the term "vested." It does not describe REAOC's contentions in this litigation.

REAOC's position confirms, rather than undermines, the "negotiability" of retirement health benefits as to those who have the right and obligation to negotiate (active employees). It leaves employers free to do what the County did here: drastically reduce their future retirement health benefit liability by negotiating with labor unions to reduce such benefits to active employees. But it also recognizes that once employees retire and can no longer bargain over their benefits, they acquire the contractual right to receive what they earned.

B. Amici's "Fiscal Crisis" Argument Misrepresents The Facts And Provides No Basis To Exempt MOUs From Application Of The Implied-In-Fact Contract Doctrine.

Amici express alarm at the supposed crushing financial burden the Retiree Premium Subsidy placed on Orange County, and predict that dire consequences are in store for municipalities state-wide if this Court recognizes implied-in-fact rights and obligations relating to retiree health benefits. But Amici's assertions have no support in the evidence.

With regard to the financial burden on Orange County in this case, the undisputed facts—as contained in the County's own projections—established that the County's cost to provide the Retiree Premium Subsidy to those who were retired as of January 2008 was approximately $800,000 per year, for a 30-year projected total of $24 million. (*See* REAOC Opening Brief at 30-31 and evidence cited therein.) The County's annual revenues for 2007 were $3.5 billion. (*Id.*) Accordingly, the evidence shows that the cost of the health benefit at issue in this case in 2007 represented just **.023%** (twenty-three one-thousandths of one percent) of the County's annual budget. In short, the County faced nothing resembling a "crisis" regarding the funding of this benefit.

Amici fare no better with regard to their warnings of the calamities that will befall cities and counties state-wide should REAOC prevail in this

litigation. Notably, Amici offer not a *single citation* to evidence to support this prediction: no mention of what sorts of implied-in-fact retirement health benefit terms may be at issue in other counties, what level of financial burdens they might impose, whether and how much those burdens are growing in relation to the overall budgets, or whether and how the funding of such benefits is shared by State and Federal government programs. If the retirement health benefits at issue in other counties are as "burdensome" as the benefit at issue in this case, there is hardly cause for alarm.

What the evidence *does* establish is that County retirees and their dependents have faced devastating increases in their health insurance costs since the County revoked this benefit in 2008. Since then, retiree premium inflation has more than tripled, to a staggering 16% per year on average, and increased 24.6% for 2011 for the County's two self-funded insurance plans. (*See* REAOC Opening Brief at 26-27.) During this time of skyrocketing premiums, retiree pension income (which averaged just $27,000 per retiree in 2007) has increased by just 3% per year. (*Id.*) In 2011, annual premiums for a retiree and one dependent in the County's new retiree-only PPO plan will be $25,000, nearly 90% of the average retiree's annual pension income. (*Id.*) Retirees are literally being priced out of medical coverage.

Finally, contracts clause jurisprudence already addresses the rare situation when a government *is* facing a real fiscal crisis. In those circumstances, a government may impair its contract commitments (subject to certain limitations) for the sake of averting a public catastrophe. (*See Sonoma County Organization of Public Employees v. County of Sonoma* (1979) 23 Cal.3d 296, 308-11.) Tellingly, in this case, the County has never attempted to bring this dispute within the narrow scope of this emergency exception.

C. It Would Be Unfair And Contrary To The Policies Underlying The MMBA To Hold That Active Employees Have Protected Rights To Future "Implied-In-Fact" Retirement Benefits, But Lose All Rights To Those Benefits The Moment They Retire.

Amici, the County and REAOC agree that the County had a duty, under the MMBA, to negotiate with its active employees before it altered or revoked their future rights to the Retiree Premium Subsidy. This is true *despite* the fact that the Retiree Premium Subsidy arose not from express contract terms, but rather from the 23-year past practice of providing that benefit. (*Sacramento County Attorneys Association v. County of Sacramento* (2008) PERB Dec. No. 2043-M at 11 [past practice of providing retiree medical benefit gives rise to employer's duty to negotiate over proposed changes to that benefit].) Amici, the County and REAOC also

agree that *retired* employees were not and could not have been part of that collective bargaining process; their rights to this same retirement benefit were not "on the table" during those negotiations.

But the parties differ on what follows from these observations. Specifically, what rights do these already-retired employees have with regard to this benefit that they can no longer protect at the bargaining table? REAOC proposes that, because retired employees have completed the exchange of labor for wages and promised benefits, and because there is no feasible way to "negotiate" collectively with retired employees, they have a contractual right to receive the benefit during their retirement.

That position is supported by the United States Supreme Court's decision in *Allied Chemical and Alkali Workers of America, Local Union No. 1 v. Pittsburg Plate Glass Co.* (1971) 404 U.S. 157. In that case, the Court stated that "the future retirement [health] benefits of active workers are part and parcel of their overall compensation." (*Id.* at 180-81 & n.20.) As such, the Court reasoned, they are mandatory subjects of bargaining with respect to active employees. Once employees retire, they lose the protection of collective bargaining but, "under established contract principles," they enjoy substantive rights to those benefits, such that they "may not be altered without the pensioner's consent." (*Id.*)

By contrast, Amici and the County argue that employees may simply lose *all rights* to retirement health benefits the moment they retire. But it is absurd to say that an employee has a contingent right to a future benefit *and* that the employer may revoke that benefit at its pleasure after the contingency occurs. (*See U.S. Trust Company*, 431 U.S. at 25 & n. 23 ["A [government's] promise to pay, with a reserved right to deny or change the effect of the promise, is an absurdity."]; *cf. Erie County Retirees' Association v. County of Erie* (3d Cir 2000) 220 F.3d 193, 210 ["It is inconceivable" that Congress would forbid employers to discriminate with respect to the future retirement benefits of employees but "in the same breath" permit such discrimination once the employee retires].)

Amici's proposed rule would make a charade of the collective bargaining process and undermine the policies the MMBA was intended to achieve, that is, the application of bilateral contract principles to the public employment relationship, and the facilitation of *meaningful* good faith negotiation between labor and management. (*City of Glendale*, 15 Cal.3d at 334-40.) Permitting an employer to use promises of retirement benefits to induce employees to make concessions at the bargaining table, while retaining the authority to revoke those benefits when the employees retires, strikes at the very heart of these policies. As this Court aptly observed,

> [t]he 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 . . . a statute which encouraged the negotiation of agreements, yet permitted the parties to retract their concessions and repudiate their promises whenever they choose, would impede effective bargaining.

(*Id.* at 336; *see also San Bernardino Public Employees Association v. City of Fontana* (1998) 67 Cal.App.4th 1215, 1223 [same].)

D. There Is No "Statutory Prohibition" Against Implied-In-Fact Terms Arising In Public Employment.

Amici echo the County's insistence that Government Code section 25300 contains an express statutory prohibition against any implied terms arising in public employment. (AB at 18.) REAOC refuted that argument in its Opening Brief (at pp. 47-49) and in its Reply (at pp. 25-27).

However, the vast implications of the County's (and Amici's) argument bear emphasis. Both the County and Amici have attempted to limit this "statutory prohibition" argument to those terms of employment related to "compensation." However, section 25300 permits no such limitation. It provides that counties "shall provide for the *number*, compensation, *tenure, appointment and conditions of employment* of county employees," and that it "may" do so by resolution or by ordinance. (Gov't Code § 25300 [emphasis added]; *see Dimon v. County of Los Angeles* (2008)

166 Cal.App.4th 1276, 1283 [no basis for distinguishing between counties' powers, under Constitution and section 25300, to provide for terms of compensation vs. other terms and conditions of employment]; [*citing Curcini v. County of Alameda* (2008) 164 Cal.App.4th 629, 644-45].)

Thus, if the County and Amici correctly read this statute, *all* implied contract terms, relating to any aspect of the employment relationship, are barred. It is not reasonable to read section 25300 as creating such a sweeping exception to the rules that public contracts *are* governed by the Civil Code's implied-in-fact contract provisions, and that MOUs are construed and enforced *as contracts*.

Indeed, in *San Joaquin County Employees' Association v. County of San Joaquin* (1974) 39 Cal.App.3d 83, 86, the court expressly warned against a "hypertechnical" application of counties' statutory authority to contract with employees. Instead, the court instructed, courts should be guided by the "larger context" of the bilateral and contractual nature of the employment relationship, and the "flexibility in employee-governmental agency relations with regard to all aspects in the employer-employee milieu" that the MMBA contemplates. (*Id.*)

Further, notwithstanding section 25300's clause "by resolution as well as by ordinance," it is well settled that a term or condition of employment

may arise purely by implication and without express ordinances or resolutions, for purposes of the MMBA's mandate to bargain over "terms and conditions of employment." (*County of Sacramento*, PERB Dec. No. 2043-M at 11 [retirement health benefits]; *San Francisco Firefighters Local 78 v. City and County of San Francisco* (1992) 3 Cal.App.4th 1482, 1490 ["Changes in existing and acknowledged practices are subject to the meet and confer requirement even if those practices are not formalized in a written agreement or rule."].) Amici do not explain why the so-called "strict requirements" of section 25300 would permit purely implied-in-fact terms to arise for purposes of the duty to bargain, but not for purposes of creating a substantive right to an employment benefit.

E. Amici's Proposed Distinction Between Contract "Interpretation" and "Formation" Is Contrary To The Law And Misunderstands The Facts.

Amici acknowledge that, under the Civil Code, private and government contracts must be construed under the same rules. (AB at 18.) They contend, however, that (1) this rule of parity applies only to *interpretation* of contracts, not to their *formation*, and (2) REAOC contends that a contract was "formed" by implication. (*Id.*) This argument is incorrect on both counts.

First, Amici's argument appears to misunderstand the basic undisputed facts in this case: every MOU in force during the period relevant to this litigation was validly "formed" pursuant to the procedures mandated by the MMBA. The County has never contended otherwise. Thus, REAOC is asking the Court to apply the implied-in-fact contract doctrine to "interpret" express contracts, not to "form" them.[5]

Amici suggest a related argument, that the implied-in-fact doctrine only permits a court to "interpret" express contract terms, rather than "create" implied ones, and that the Retiree Premium Subsidy cannot be implied in the parties' contracts because there is no express term in the MOUs "related to" how retiree premiums will be set. This argument fares no better, factually or legally.

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[5] Moreover, the implied-in-fact contract doctrine applies to the formation *and* interpretation of municipal contracts. (*See Youngman v. Nevada Irrigation District* (1970) 70 Cal.2d 240, 246-47 [applying Civil Code's "contract formation by implication" provisions (*see* Civil Code §§ 1619-21) to find that an implied-in-fact contract was formed between public agency and employee]; 10A McQuillin, Municipal Corp., § 29.114 ["it is well settled" that contract may be formed by implication between government and private party]; *Kashmiri v. Regents of U.C.* (2007) 156 Cal.App.4th 809, 828-30 [implied-in-fact contract *formed* between public university and students based on policies and practices; once formed, it is also *interpreted* according to same rules of construction].

It is undisputed that all of the relevant MOUs contained express terms "related to" the Retiree Premium Subsidy: short provisions giving employees the right to remain in County-sponsored health plans upon retirement. (*See* REAOC Opening Brief at 17-18.)

The Retiree Premium Subsidy should be implied here because it supplies a critical financial term that is missing from the writings; it defines what premiums retirees must pay to receive the coverage to which they are entitled. (*See City of Santa Ana*, 336 F.3d at 890-92 [express contract terms gave gas company right to excavate under city streets but were silent as to whether city could impose fees for that excavation; parties' decades-long practice of charging *no* fees created implied-in-fact contract right in gas company to continue to excavate free of charge].)

Moreover, in proper circumstances, courts must apply the implied-in-fact contract doctrine to explain *or supplement* the express terms of a parties' writing. This Court made that clear in *Scott v. Pacific Gas & Electric Co.* (1995) 11 Cal.4th 454, 463:

> The recognition of implied-in-fact contract provisions is part of the modern trend in contract law . . . [e]vidence derived from experience and practice can now trigger *additional, implied terms* . . . courts will not confine themselves to examining the express agreements . . . but will also look to the employer's

> policies, practices, and communications in order to *discover the contents* of an employment contract.

[emphasis added]; *see also* Civil Code § 1655 [implication of additional terms in contracts to render them "conformable to usage"]; Civil Code § 1656 ["All things that in law or usage are considered as incidental to a contract . . . are implied therefrom . . ."]; Restatement 2d Contracts, § 233(2) ["Course of dealing . . . may determine the meaning of language *or it may annex an agreed but unstated term*"] and comment b [course of dealing "gives meaning to *or supplements*" the parties' express agreement, and may be used "to guide the court in *supplying an omitted term*"] [emphasis added]; *Binder v. Aetna Life Insurance Co.* (1999) 75 Cal.App.4th 832, 853 [following Restatement section 223 and Civil Code section 1655 to conclude that "course of dealing may also *supplement* or explain an agreement"].)

Further, courts have applied the implied-in-fact contract doctrine to supplement the express terms of MOUs and other government contracts. (*See Chula Vista Police Officers' Association v. Cole* (1980) 107 Cal.App.3d 242, 246-50 [once MOU is validly formed, "it is to be interpreted by the same rules as private contracts," *including* rule allowing resort to course of dealing to fill in absent terms] [*citing* Civil Code § 1635 and *City of Glendale*, 15 Cal.3d at 339]; *Tonkin Construction Company v. County of*

Humboldt (1987) 188 Cal.App.3d 828, 831-832 (1987) [like private contracts, a government contract "includes not only the terms that have been expressly stated *but those implied provisions* indispensable to effectuate the intention of the parties"]; *University of Hawaii Professional Assembly v. Cayetano* (9th Cir. 1999) 183 F.3d 1096, 1099-1104 [public sector CBA includes implied requirement that employees be paid on 15th and last day of each month, even where "collective bargaining agreement contained no provision regarding specific pay dates"]; *City of Santa Ana*, 336 F.3d at 890-93 [for purposes of contracts clause analysis, construing municipal contract to include critical implied financial term that reflected parties' decades-long practice; written contract was silent regarding the matter].)[6]

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[6] Amici make the similarly flawed argument that parol evidence may not be used to "create" an implied term. (AB at 22-23.) The parol evidence doctrine permits express contract terms to be "explained *or supplemented*" by extrinsic evidence, such as parties' course of dealing, giving rise to "consistent, *additional terms*" beyond those set forth in the writing. (Code Civ. Proc. § 1856(b)-(c) [emphasis added]; 2 Witkin, *California Evidence* Ch. 8, § 86.) One piece of admissible "parol" evidence, that may explain existing terms or add new ones, is "the [pre-litigation] acts of the parties that show what they believed the contract to mean." (*DVD Copy Control Ass'n, Inc. v. Kaleidescape, Inc.* (2009) 176 Cal.App.4th 697, 712.)

F. The Proper Application Of The Implied-In-Fact Contract Doctrine Will Not Raise Concerns About "Unlawful Delegation" Of Board Authority.

Amici contend that allowing implied-in-fact terms to arise in public employment results in an unlawful delegation of board authority over those matters, and therefore any purported implied contract (or implied terms in an express contract) would be void as *ultra vires*. (AB at 7-11.) But REAOC's claims do *not* rely on representations or other actions of Board "delegates." Rather, REAOC claims that contract rights and obligations arise from the policies and practices that the Board *itself* publicly implemented and perpetuated, every year for 23 years: (1) with full knowledge and disclosure of the Retiree Premium Subsidy and its current and projected costs; (2) after careful consideration, public meetings, and discussion with staff; and (3) with the knowledge that contract obligations arise by implication from established policies and practices between itself and its employees.

Thus, the continued recognition of implied-in-fact contract terms in public employment does *not* undermine boards' authority with regard to terms and conditions of employment. Rather, these legislative bodies remain free to alter their policies and practices as they see fit, subject only to the procedural requirements of the MMBA and principles of contract law, including the prohibition against retroactively removing elements of

compensation that employees have already earned. (*Compare Bagley v. City of Manhattan Beach* (1976) 18 Cal.3d 22, 24-25 [requirement that city salaries be submitted to binding arbitration was unlawful delegation of board authority *because* it resulted in third party making final decision in setting of terms and conditions of employment].)

III. THE COUNTY MUST PAY THE RETIREE PREMIUM SUBSIDY TO THOSE RETIREES WHO EARNED IT BY WORKING AND RETIRING WHILE THAT BENEFIT WAS A COMPONENT OF THE COUNTY'S RETIREMENT MEDICAL BENEFITS PROGRAM.

A. The Retiree Premium Subsidy Was A Promised Benefit Of Employment And An Element Of Employees' Deferred Compensation.

For decades courts have observed that retirement health benefits are not "gratuities" that employers bestow out of a sense of good will, but are instead critical components of the package of compensation (wages and "fringe" benefits) for which employees exchange their labor. (*See Pittsburg Plate Glass Co.*, 404 U.S. at 180-81 & n.20 ["the future retirement [health] benefits of active workers are part and parcel of their overall compensation"]; *I.B.E.W v. Citizens Telecommunications Co.* (9th Cir. 2008) 549 F.3d 781, 787 [same] [*quoting Pittsburg Plate Glass*]; *County of Sacramento*, PERB Dec. No. 2043-M at 11 [*citing Pittsburg Plate Glass*];

Navlet v. Port of Seattle (Wash. 2008) 194 P.3d 221, 233-34 [retirement health benefits are earned compensation].)

In *Suastez v. Plastic Dress-Up Co.* (1982) 31 Cal.3d 774, 778-80, this Court recognized the "increasingly complex use of compensation in the form of 'fringe benefits,' some types of which inherently are not payable until a time subsequent to the work which earned the benefits." (*Id.*) It held that such benefits should be treated as *compensation* that must be paid once earned, rather than as "gratuities" that spring from the "beneficence of the employer." (*Id.*) Importantly, while *Suastez* involved private employment benefits, this Court drew from public employment precedents in reaching its holding. (*Id.* [*citing Bonn v. University of California, Chico* (1979) 88 Cal.App.3d 985, 990-91].)

The conclusion that the Retiree Premium Subsidy was an element of compensation is bolstered by REAOC's undisputed evidence that, *for decades* prior to this litigation, the parties treated it as such, without exception and without interruption. (REAOC Opening Brief at 10-24; *see McCaskey*, 189 Cal.App.4th at 966 [to determine whether employee "earns" protected right to receive benefits under existing terms of employment, courts look to extrinsic evidence such as the "structure of the benefit, coupled with its purpose," as well as the parties' past practice relating to that

term].) Further, while Amici suggest that the Retiree Premium Subsidy was nothing more than a gratuity the County bestowed on retirees when money was plentiful, that revision of history is foreclosed by both the evidence in this case,[7] and the constitutional prohibition on "gifts of public funds."[8]

B. Employers May Alter Terms Under Which Benefits And Other Compensation Will Be Earned *Prospectively*, But May Not Revoke Benefits Once They Have Been Earned.

> Amici suggest a clear and workable standard: retirement benefits and compensation that have been actually earned are subject to the vested rights doctrine, but future compensation rates . . . are not vested unless and until the employee performs the work and earns the pay at issue.

This reasonable and fair rule of law was proposed not by Amici in this case, but rather by 55 of their member cities in a prior case involving the issue of the "vesting" of employment and post-employment benefits. (*See San Bernardino Public Employees Association v. City of Fontana* (1998) 67

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[7] Even during its notorious bankruptcy in the 1990s, when the County was "broke," it continued to provide this benefit to its retirees every month without interruption.

[8] *See Sturgeon v. County of Los Angeles*, 167 Cal.App.4th 630, 637 (2008) (Article XVI, section 6 of the California Constitution prohibits gifts of public funds); *Lamb v. Board of County Peace Officers Retirement Commission* (1938) 29 Cal.App.2d 348, 350 (retirement benefit is an unlawful gratuity unless conferred as compensation in exchange for services rendered).

Cal.App.4th 1215; REAOC Second RJN, Exh. B [amicus brief filed in *City of Fontana*] at 5.)

In *City of Fontana*, the court considered whether an employer could negotiate with active employees to make changes to the terms under which employees would accrue certain "fringe" benefits, *after* the changes were implemented. (*Id.*) The City—supported by an amicus brief filed on behalf of 55 California cities—insisted that, under principles of contract law, fringe benefits do not become vested until earned, and therefore are subject to *prospective* changes agreed to by employers and their employee unions. (REAOC Second RJN, Exh. B at 12 ["The Court of Appeal should clarify that contract provisions regarding *future, unearned* compensation do not create individual vested rights."] [emphasis added]; *see also id.*, Exh. A (appellate brief filed by City of Fontana) at 7 ["the new 1995 MOUs only affected future accrual of personal leave and longevity pay . . . [they] were not retroactive . . . [i]n other words any already earned personal leave time or longevity pay was not disturbed"] & 13 ["it is undisputed that this was not a situation in which already earned benefits were being forfeited . . . [t]he parties understood that only future accrual of longevity pay and personal holiday leave were being affected"].)

The court adopted the cities' proposed rule. It held that under established contract principles, purely prospective changes to the terms under which benefits would accrue were lawful. (*City of Fontana*, 67 Cal.App.4th at 1223-24.) The court reasoned that employees earn only those benefits that accrue under existing MOUs; they have no contractual right to *continue* to earn future benefits on those same terms. (*Id.*)

This core principle has been applied in the context of other benefits of public employment and retirement. (*Kistler v. Redwood Community College District* (1993) 15 Cal.App.4th 1326, 1331-33 [accrued vacation cannot be reduced; terms under which vacation would accrue prospectively may be altered] [*citing Bonn*, 88 Cal.App.3d at 990-91]; *Association of Los Angeles County Deputy Sheriffs*, 154 Cal.App.4th at 1544 [county could make prospective changes to provisions regarding vacation accrual and cash-out; "[t]he cases on which the employees rely are inapposite because they concern vacation benefits already vested, while the benefits at issue here are prospective"]; *Creighton v. Regents of U.C.* (1997) 58 Cal.App.4th 237,243-44 [special incentives for "early retirement" did not vest for employee unless and until he or she *retired* under that program; active employee had no vested interest in the continued availability of those terms].)

These very principles that Amici's members successfully embraced in *City of Fontana* defeat their argument here, because unlike *City of Fontana*, this case involves the retirement health benefits *of retirees* whose benefit—the Retiree Premium Subsidy—was *retroactively* eliminated. Nevertheless, Amici (and the County) repeatedly cite *City of Fontana*, without mentioning the prospective/retroactive distinction at the heart of their argument, and of the court's holding, in that case. (*See, e.g.*, AB at 24-25.) Amici in *City of Fontana* correctly stated the law: because retiree health benefits are elements of compensation that employees earn in exchange for their labor, employers may make changes (through negotiation) to the terms under which active employees will accrue those benefits prospectively, but they may not retroactively reduce or eliminate those benefits once an employee retires and thereby earns them.

Amici contend that the Ninth Circuit applied *City of Fontana* to conclude that a public employer's "provision of retiree health benefits did not give rise to *any vested rights*." (Amicus Brief at 25-26 [emphasis added] [*citing San Diego Police Officers Association v. San Diego City Employees' Retirement System* (9th Cir. 2009) 568 F.3d 725, 740].) However, in *San Diego Police Officers Association* the court addressed only whether *active* employees may bargain away their future retirement health benefits in

exchange for other compensation. (*Id.* at 739.) In answering that question in the affirmative, the court expressly noted that the City's proposed changes were *prospective only* (they were "applicable only to *current* employees . . ."), and relied on evidence establishing that "retiree medical benefits here were considered a term of employment," as opposed to a term of retirement, that could be changed prospectively "through the collective bargaining process." (*Id.* at 739-40 [emphasis added].) Thus, to the extent that *San Diego Police Officers Association* is a correct statement of California law, its holding is inapposite.

Amici also cite *Robertson v. Kulongoski* (9th Cir. 2006) 466 F.3d 1114, 1118 as support for their contention that there can be no "vested" right to the Retiree Premium Subsidy. (AB at 24.) But in *Robertson*, the Ninth Circuit merely held that under Oregon law *prospective* changes to certain provisions in Oregon's pension statute did not impair contract rights *of current employees*. (*Id.* [rejecting challenge to 2003 changes in pension statute that, effective January 1, 2004, eliminated one "formula" under which active employees' contribute to their pension accounts].) Indeed, the District Court in *Robertson* went to pains to stress this distinction between prospective benefits of employees and *accrued* benefits of retirees:

> Because the court finds that the PERS contract does not guarantee *prospective benefits for future work*, the Contract Clause is only affected if the [challenged statute] operates *retrospectively* . . . whether it *alters accrued benefits for completed work.*

(*Robertson v. Kulongoski* (D. Or. 2004) 359 F.Supp.2d 1094, 1101 [emphasis added]; *see also id.* 1103 [contracts clause "does not prohibit modification of future benefits for future work"].)

In short, none of Amici's authority stands for the radical proposition it advances in this case: that unless an employer explicitly promises not to do so, it may unilaterally and at its pleasure revoke retirement health benefits *from retirees*.

C. REAOC Is Not Proposing That Retirement Health Benefits "Automatically" Vest The Way Pension Benefits Do Under ERISA.

Amici insist that retirement health benefits cannot "automatically vest" in the manner that pension benefits do under ERISA. (AB at 31-32.) Here again, however, Amici are addressing a straw man rather than REAOC's actual position. REAOC contends that (1) the "vesting" question must be answered by principles of contract law, and (2) the compensatory nature of the Retiree Premium Subsidy, along with the parties' course of dealing and other extrinsic evidence, compel the conclusion that County employees who retired prior to January 1, 2008 had the right to receive the

Retiree Premium Subsidy throughout their retirement. As the Washington State Supreme Court recently held in the context of public sector employment,

> [t]he compensatory nature of the [retirement health] benefits creates a vested right in the retirees who reached eligibility under the terms of the applicable collective bargaining agreement. Once vested, the right cannot be taken away and will survive the expiration of the agreement.

(*Navlet*, 194 P.3d at 234-35 [*citing International Union, United Automobile, Aerospace, & Agricultural Implement Workers of America v. Yard-Man, Inc.*, 716 F.2d 1476, 1482 (6th Cir. 1983)] [retiree health benefits "are in a sense 'status' benefits which, as such, carry with them an inference ... that the parties likely intended those benefits to continue as long as the beneficiary remains a retiree"].)

IV. AMICI'S REMAINING ARGUMENTS AGAINST THE VESTING OF RETIREE HEALTH BENEFITS ARE UNAVAILING.

A. Amici's Observations Regarding Pension Regulation Are Inapposite.

Amici contend that retirement health benefits should be treated differently from pensions with respect to "vesting" because pensions are governed by statutory requirements relating to formation, funding and fiduciary duties of fund directors. (AB at 30-31.) But they cite no authority

for this leap of logic. Further, California courts long ago extended "contractual" protection to public employee pension benefits not because those benefits were subject to regulatory schemes, but rather because they represented a form of compensation that, like salary, cannot be revoked once earned. (*Kern v. City of Long Beach* (1947) 29 Cal.2d 848, 851-52; *Miller*, 18 Cal.3d at 815-16.) In this way retirement health benefits *are* akin to pension benefits; both are elements of deferred compensation, and neither may be revoked once earned.

B. The Fact That Some Aspects Of Retiree Health Insurance Change Over Time Does Not Preclude The "Vesting" Of The Longstanding, Consistent, Structural Aspects That Have Matured Into Separate Benefits.

Amici vaguely suggest that no element of retiree health benefit programs create protected contract rights in retirees, because *some* aspects of those programs change "nearly every year." (AB at 32.) This argument is easily dismissed.

REAOC does not contend that *all* (or even many) of the elements of the County's retiree medical insurance program created "vested" rights in County retirees. Rather, it contends that one core, structural element—the Retiree Premium Subsidy whereby current employees pay artificially higher premiums thereby subsidizing the artificially lower premiums for retirees—

became a contractually-protected benefit because it was longstanding, consistent, bargained for, and treated by the County as an implied term in the MOUs, a separate retiree health "benefit," and an element of employee compensation. Under the implied-in-fact contract doctrine, those numerous aspects of a retiree medical insurance program that change frequently (co-payments, deductibles, preferred providers, third-party administrators, *etc.*) would never be treated as "contract" terms in the first place. (*County of Sacramento*, PERB Dec. No. 2043-M at 11 [implied-in-fact term arises from a "*consistent course* of conduct that is a *historic and accepted practice*"] [emphasis added]; *Cayetano*, 183 F.3d at 1103 [past practice becomes implied term only where it is subject to bargaining, longstanding and material to the employment relationship]; *Bonnell/Tredegar Industries, Inc. v. N.L.R.B.*, 46 F.3d 339, 344 (4th Cir. 1995) (to become an implied contract term, a course of dealing must be sufficiently "longstanding" and "recognized" that it has "ripened into an established and recognized custom between the parties").

C. There Is No Support For Amici's Assertion That Government Code Section 31692 Applies To This Dispute.

Like the County, Amici contend that Government Code section 31692 provides an "additional reason" for this Court to find that the Retiree

Premium Subsidy did not vest. However, section 31692 merely provides that legislation conferring benefits "pursuant to section 31691" does not create vested rights. As REAOC demonstrated in its Reply Brief, the County did not provide, and could not have provided, the Retiree Premium Subsidy "pursuant to section 31691." (REAOC Reply at 34-40.) Tellingly, Amici do not even attempt to address REAOC's arguments.

CONCLUSION

This Court may readily confirm a rule that protects municipalities' interests in maintaining the negotiability of active employees' future retirement health benefits, but simultaneously protects retired employees' rights to receive *all* of the benefits that they earned with their years of labor. It is a rule that many of Amici's members have previously embraced: future retirement benefits of active employees may be re-negotiated through the procedures mandated by the MMBA; earned retirement benefits *of retirees* must be paid as agreed, whether that agreement was express or implied-in-fact.

Dated: February 7, 2011 Respectfully Submitted,

MOSCONE EMBLIDGE & SATER LLP

By: _____
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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 8,340 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 February 7, 2011 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 February 7th, 2011, I served:

PETITIONER'S RESPONSE TO AMICUS BRIEF FILING IN SUPPORT OF RESPONDENT COUNTY OF ORANGE

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 February 7th, 2011, at San Francisco, California.

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